



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
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Consultation paper

Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022 and updated Responsible Lending Code

22 September 2022

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The Ministry of Business, Innovation and Employment (**MBIE**) seeks written submissions on the exposure draft regulations by 5pm on **20 October 2022**.

Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please use the submission template provided at: mbie.govt.nz/have-your-say/exposure-draft-of-credit-contracts-and-consumer-finance-amendment-regulations-no-2-2022. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission by:

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- mailing your submission to:

Consumer Policy Team
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473

Wellington 6140
New Zealand

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List of Acronyms and Abbreviations

CCCFA	Credit Contracts and Consumer Finance Act 2003
Draft Regulations	Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022
MBIE	Ministry of Business, Innovation and Employment
The Regulations	Credit Contract and Consumer Finance Regulations 2004
The Code	Responsible Lending Code

Introduction

Purpose of this consultation and context

1. In January 2022, the Minister of Commerce and Consumer Affairs initiated an investigation into the impacts of recent legislative and regulatory changes under the CCCFA that came into effect on 1 December 2021. The investigation report was published on 2 August.
2. On 7 July 2022 a number of changes and clarifications to the Credit Contracts and Consumer Finance Regulations 2004 (**the Regulations**) and Responsible Lending Code (**the Code**) came into force. These covered matters such as:
 - a. clarifying requirements for estimates of borrowers' expenses, particularly in relation to use of bank statements
 - b. removing 'savings' and 'investments' as examples of outgoings that lenders need to inquire into
 - c. clarifying that a 'reasonable surplus' is not required if the lender has applied adequate buffers and adjustments to income and expenses
 - d. new guidance and examples for when it is 'obvious' that a loan is affordable.
3. Following consideration of the investigation report, Cabinet agreed to further changes to the Regulations, to address unintended impacts of the December 2021 changes under the CCCFA. These comprise changes to the treatment of discretionary expenses, the estimation of expenses associated with revolving credit contracts, and the exception for variations and replacements of existing credit contracts.
4. We are consulting on an exposure draft of the Credit Contracts and Consumer Finance Amendment Regulations (No 2) 2022 (**the Draft Regulations**), which implement these decisions, along with changes to Chapter 5 and 7 in the draft Responsible Lending Code (**Draft Code**). MBIE is specifically seeking public feedback on the design and workability of the Draft Regulations and Draft Code, as policy decisions have already been made.

Issues to be addressed by further set of changes

5. The Draft Regulations respond to the following issues identified by the investigation:
 - a. The investigation found that in practice the way in which lenders are required to assess discretionary expenses when estimating a borrowers likely relevant expenses (as prescribed in regulation 4AF(2)(a) and frequently or regularly recurring outgoings as defined in paragraph (d) of 'listed outgoings' under regulation 4AE) is driving inquiries that are perceived by some as disproportionate or unreasonable, and is causing lenders to include discretionary expenses in their estimate of a borrowers expenses, contributing to overly conservative estimations.
 - b. Regulation 4AL(2) sets out a prescriptive approach for lenders to estimate the expenses that may arise from credit cards and revolving Buy Now Pay Later (BNPL) facilities, as part of their estimation of the borrower's likely relevant expenses. This does not take into account borrowers who use these facilities for day-to-day transactions and pay them off quickly, rather than making a large purchase to be paid back over months or years. This

can result in 'double counting' of both the assumed debt payment on the revolving credit contract and the regular expense being paid under the revolving credit contract.

- c. There is an exception from a full affordability assessment where lenders refinance or consolidate debts owed to themselves under regulation 4AH. However, there are situations where borrowers seek to refinance or consolidate debts from other lenders with lower repayments. This includes where those borrowers are encountering financial difficulty with existing payments, or otherwise seek lower cost arrangements. Requiring lenders to conduct a full affordability assessment can result in unnecessary delays and cost for lenders and borrowers. The current scope of regulation 4AH may therefore be limiting access to more affordable credit.
6. In response to these issues, Cabinet has agreed on three changes to the Regulations, set out below.

CABINET AGREED CHANGES TO THE REGULATIONS AND/OR CODE

- Adjust the scope of expenses that need to be estimated by lenders to more explicitly exclude discretionary expenses
- Amend the Regulations to reduce 'double counting' of expenses associated with revolving credit contracts such as credit cards and buy-now pay later schemes
- Expand the exception in regulation 4AH to include refinancing of credit contracts the borrowers have with other lenders where this would be in the best interests of the borrower

7. These changes are reflected in the Draft Regulations and Draft Code that we would like your feedback on. Further information about the Draft Regulations and Draft Code is set out below.

Changes relating to the treatment of discretionary expenses

8. The Draft Regulations amend the definitions of 'relevant expenses' and 'listed outgoings' in regulation 4AE.
9. The Draft Regulations make the following changes to the Regulations:
 - a. In regulation 4AE, definition of 'listed outgoings, replacing paragraph (d):
 - i. "any regular or frequently recurring outgoings other than savings and investments (for example, gym memberships, entertainment costs, or tithing) that are material to the estimate of relevant expenses that the borrower is unable or unwilling to cease after the agreement is entered into or materially changed."
 - with:
 - ii. "any regular or frequently recurring outgoings (for example, tithings or remittances) that are material to the estimate of relevant expenses; excluding savings and investments."
 - b. In regulation 4AE, after definition of 'relevant expenses' in paragraph (a), inserting a new subparagraph (ab); and"
 - i. "may exclude discretionary expenditure that responsible lender would reasonably expect the borrower to cease if they were at risk of substantial hardship:"
10. The purpose of amending the definition of 'relevant expenses' is to create a test for the exclusion of discretionary expenses to the extent the borrower would cease these expenses if at risk of hardship. This is drafted as an objective test based on what a 'responsible lender' (a concept currently referenced in section 9C(2)(a) of the CCCFA) would expect the borrower to cease.
11. We propose to amend paragraph (d) of the definition of 'listed outgoings' to remove the examples "gym memberships" and "entertainment costs" as well as removing the reference to "expenses the borrower is unwilling or unable to cease after the agreement is entered into or materially changed". Gym memberships and entertainment costs will largely be discretionary expenses and are therefore not appropriate to include as examples of listed outgoings. Any expense that the borrower is willing and able to cease after the agreement is entered into will also be a discretionary expense excluded by the amended definition of 'relevant expenses'; therefore, we consider this aspect of paragraph (d) to be redundant and potentially confusing.
12. In addition to these changes, we have suggested two options for new guidance in the Draft Code that sets out how lenders may exclude discretionary expenses in respect to the amended definition of 'relevant expenses'.

13. **Option 1:**

The Draft Code (at paragraph 5.9) provides that:

- a. Lenders who inquire into the borrower's current expenses (as part of estimating likely relevant expenses), should in the first instance capture expenses that have a significant risk of not being discretionary. A lender may make inquiries to identify further discretionary expenditure that a borrower would cease.

The Code sets out a range of assumptions that lenders should have regard to when considering whether an outgoing is likely to be discretionary. For example, that many borrowers have social or moral obligations and expectations that prevent them from ceasing certain expenditures, such as tithing or remittances.

14. **Option 2:**

The Draft Code (at paragraph 5.10) provides that:

- a. In considering whether expenditure is discretionary, lenders may presume that all expenses other than those defined are discretionary, unless the lender has reason to believe that this is not correct for a particular borrower.

The Code sets out a number of categories of non-discretionary expenditure. For example, fixed financial commitments – including any expenses with underlying contractual requirements or significant break fees associated with ceasing them (e.g. some television subscriptions, gym memberships and bundled phone plans).

15. Option 1 requires lenders to do a broader initial capture of expenses, to include expenses where there is a risk that a particular kind of expense is not discretionary. Some of these expenses may subsequently be excluded from likely relevant expenses, following the lenders' further consideration. This option aims to mitigate the risk that lenders take an unduly narrow approach to capturing non-discretionary expenses, causing the individual circumstances of borrowers to be overlooked, and relevant expenses to be missed. However, it is likely to require lenders to conduct more inquiries than Option 2 in circumstances where there is doubt about the affordability of a loan under the initial capture of expenses.
16. Option 2 permits lenders to take a narrower initial capture of expenses, further reducing the extent of inquiries. Lenders would still need to consider an individual borrowers' circumstances where they have reason to believe that some expenditure that might usually be discretionary was in fact non-discretionary. This option has a higher risk that lenders take a blanket approach to treating expenses as discretionary, when further inquiries would reveal these to be non-discretionary, in reality.
17. The diagram on page 25 of the Draft Code has also been changed to reflect changes to paragraph (d) in regulation 4AE in the definition of 'listed outgoings' discussed above.
18. The aims of these changes to the Regulations and Code are to provide sufficient discretion to lenders in the estimation and treatment of discretionary expenses, reduce the information sought from most borrowers, and ensure that the outcome of the affordability test is only affected by only expenses that are essential to borrowers or which they would be unlikely to give up if faced with hardship.
19. We would welcome views on how such guidance could be best expressed.

- 1 Do you agree with amending the definition of 'listed outgoings' along the lines proposed? Do you have any comments on the wording of these changes?
- 2 Do you agree with amending the definition of 'relevant expenses' along the lines proposed? Do you have any comments on the wording of these changes?
- 3 Which of the two options for guidance in the Draft Code relating to treatment of discretionary expenses is most appropriate and why? Do you have any comments on the wording of either of the options?

Changes relating to the treatment of revolving credit contracts

20. The Draft Regulations amend regulation 4AL to permit lenders to disregard potential expenses from BNPL contracts and some credit cards.
21. The Draft Regulations make the following changes to the regulations:
 - a. After regulation 4AL(2):
 - i. inserting a new subclause 4AL(2A):
 - A. “Despite subclause (2), relevant expenses in respect of a payment under any revolving credit contract excludes repayments on a credit card if the lender –
 - a. is satisfied that, in the previous 90 days, the borrower has not had any interest charged on the credit facility; and
 - b. has no reason to believe that the borrower will incur interest after entering the revolving credit contract; and
 - c. is satisfied that the interest free period on the revolving credit card facility is no longer than 60 days; or”
 - ii. inserting new subclause 4AL(2B):
 - A. “Subclause (2) does not apply in respect of a buy now pay later contract.”
22. This change aims to account for borrowers who use these facilities for day-to-day transactions and pay them off quickly without incurring interest, rather than making large purchases to be paid back over months or years. This reduces the extent of ‘double counting’ of both the assumed debt payment on the revolving credit contract and the regular expense being paid under the revolving credit contract.
23. The reference to the lender having ‘no reason to believe the borrower will incur interest after entering the contract’ is to address situations where the borrower might not have yet incurred interest on the credit card but has recently changed (or intends to change) their use of the credit card. For example, the borrower might have recently made a large purchase on the credit card that will need to be repaid, but the interest-free period has not yet elapsed.
24. The condition that the interest-free period of the card is less than 60 days is intended to limit the exception to credit cards commonly used for day-to-day payments and paid off regularly, rather than cards that are designed with long interest-free periods (and sometimes payment holidays) that encourage the accumulation of larger unpaid balances that are paid off over a longer period. In many cases, a borrower may not have incurred interest on the latter type of card, but will need to make payments over several months or more to pay off any balance before the interest-free period expires. These payments will need to be made on top of the borrowers’ other day-to-day expenses.
25. We note that some lenders, in particular banks who comply with Australian Prudential Regulation Authority guidance, may continue to apply the current treatment to credit cards for those purposes.¹

¹ Australian Prudential Regulation Authority, *Prudential Practice Guide APG 223 – Residential Mortgage Lending*, paragraph 35. June 2019,

- 26. The proposed change also explicitly excludes BNPL expenses from being calculated in the manner prescribed in regulation 4AL(2). This means that the fact that a borrower has a BNPL revolving credit facility per se will not count towards their relevant expenses.
- 27. Any payments actually due on a BNPL contract will be treated as debt payments for the purposes of the definitions of 'listed ongoing' and 'relevant expenses'. This is the same treatment that applies to any other debt obligation. We have suggested potential guidance to this effect in the Draft Code. The Draft Code (at paragraph 5.34) clarifies that lenders should treat any payments due under BNPL facilities as debt payments under the definition of listed ongoing. We would welcome feedback on whether this guidance is necessary.
- 28. We note that there is risk to treating BNPL in this manner. If lenders were to treat BNPL as debt payments, there is risk of an underestimation of expenses as it would only account for debt due under the BNPL facility at that point in time. However, the borrower has the potential to utilise the facility to its full limit, and where a borrower has numerous BNPL facilities, this risk may be greater. We would welcome any feedback on how this risk could be addressed in a proportionate way.
- 29. We also note that BNPL has not yet been defined in the Draft Regulations, but we intend to include a definition in the final version.

4	Do you agree with the approach to excluding some credit cards as proposed in 4AL(2A)? If not, what changes would you make?
5	Is any additional guidance needed for the exception in 4AL(2A) for certain credit cards? If so, what should this guidance state?
6	Do you agree with explicitly excluding BNPL in its entirety from 4AL(2)? If not, are there alternative ways, that would be workable for lenders, to impute future BNPL expenses based on a borrower's existing BNPL facilities?
7	In light of excluding BNPL from 4AL(2), is any further guidance in the Code necessary to address the treatment of BNPL expenses? If so, what should this guidance state?

Changes relating to variations and replacements of existing credit contracts

30. The Draft Regulations propose two mutually exclusive options for an exception from Regulations 4AF and 4AI where the borrower is replacing or proposing to replace an existing credit contract (held with Lender A) with another lender (Lender B) where certain conditions are met:

31. **Option 1:**

Regulations 4AF and 4AI do not apply if:

the total monthly repayments under the new credit contracts will be equal to or lower than the monthly repayments under the existing credit contracts.

Monthly repayments are to be calculated in accordance with the assumptions described in the Draft Regulations.

Under this option, the condition that the borrowers monthly repayments with Lender B must be lower than the monthly repayments with Lender A allows borrowers to consolidate their debt to make it more manageable, without increasing their monthly repayments.

However, whilst the monthly repayments must be equal or lower in the new arrangement, there is no expressed limitation on credit limit increases, meaning that there is potential for an increase credit limit which would prolong the repayment term. This poses a risk to affordability, particularly in cases where other options such as insolvency or a hardship process may be more appropriate.

32. **Option 2:**

Regulations 4AF and 4AI do not apply if:

*Lender B is satisfied that the borrowers **total credit limit** will not increase (or increase only to the extent reasonably necessary to allow for the postponement or reduction of existing payments to reduce financial difficulties that the borrower is experiencing or reasonably expects to experience); and the **total daily interest** on the refinanced contracts will not increase.*

The total credit limit and total daily interest are to be calculated in accordance with the formulas provided in the draft Regulations under option 2, draft regulation 4AH(1B). There is also a worked example demonstrating the use of the prescribed formula.

Allowing the credit limit to increase provides for those scenarios where borrowers are seeking to refinance existing contracts due to financial difficulty. We note that allowing the credit limit to increase poses a risk, as it could result in the provision of credit which a borrower could not otherwise afford. This risk could be mitigated by suggested Draft Code guidance detailed below.

The condition that the total daily interest rate will not increase, in addition to prescribing a formula for how this must be calculated, intends to eliminate the risk of hardship which may result from an increase in the total daily interest rate under the refinanced credit contract, and to ensure that all credit contracts which are part of the new arrangement are calculated appropriately.

- 33. Both options for this change aim to remove the requirement that limits the use of the exception for variations and replacements of existing credit contracts to credit contracts provided by the lender themselves. This would improve ease of access to safe credit and has the potential to benefit consumers, as there are instances where refinance or debt consolidation from one lender to another can reduce harm, for example by reducing the interest rate and extending the repayment term so debt is less costly and more manageable.
- 34. For each option, there is a risk that refinancing is provided to borrowers in hardship in circumstances that are not in their best interests. Refinancing has the potential to extend financial hardship without addressing an unsustainable debt burden. Consumer advocates have identified particular risks with unscrupulous debt consolidation services. In some cases, a borrower would be better off seeking relief from their existing lender, obtaining advice from a financial mentor, or entering into a personal insolvency process.
- 35. This risk could be mitigated by suggested Draft Code guidance for lenders to assist borrowers to make an informed decision where the lender is aware the borrower is having financial difficulties and seeking to refinance another lenders' agreements.
- 36. We are suggesting new guidance in the Draft Code (at paragraph 7.4) that sets out how lenders should assist borrowers to make an informed decision in situations where the lender is aware the borrower is having financial difficulties and seeking to refinance another lenders' agreements, and that where the borrowers agreements are unsecured and they are shifting to a secured agreement, that this fact and its implications are pointed out so the borrower is aware.
- 37. The diagram on page 25 of the Draft Code has been amended to reflect proposed changes to regulation 4AH as discussed above.
- 38. We are also suggesting new guidance in the Draft Code (at paragraph 5.43) that sets out the records lenders should keep when using the proposed exceptions on 4AH. The purpose of this is to help ensure that records are kept that demonstrate that the exception applies.

8	Do you agree with the way that the Draft Regulations relating to the expanded exception for variations and replacements of existing credit contracts is phrased? If not, what changes would you make?
9	Which of the two drafting options for expanding the exception for variations and replacements of existing credit contracts would be most workable and why?
10	Do you agree with the suggested guidance in the Draft Code relating to the expanded exception? If not, what changes should be made to the Draft Code guidance?

Process from here

39. The changes above could be made in February 2023. This would allow them to come into force in March 2023.
40. We consider the proposed changes to be 'permissive' in nature, rather than requiring lenders to change processes to comply with changes. However, we expect lenders may choose to change their processes in response to the greater discretion/flexibility granted by the changes.
41. We would welcome views from lenders as to whether any of these changes would require changes to your systems before they could come into force, and your estimated timeframes for implementation of any such changes.

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Would any of these changes require changes to lender systems before they could come into force? If so, what are the likely timeframes for making these changes?

Recap of questions

1	Do you agree with amending the definition of 'listed outgoings' along the lines proposed? Do you have any comments on the wording of these changes?
2	Do you agree with amending the definition of 'relevant expenses' along the lines proposed? Do you have any comments on the wording of these changes?
3	Which of the two options for guidance in the Draft Code relating to treatment of discretionary expenses is most appropriate and why? Do you have any comments on the wording of either of these options?
4	Do you agree with the approach to excluding some credit cards as proposed in regulation 4AL(2A)? If not, what changes would you make?
5	Is any additional guidance needed for the exception in 4AL(2A) for certain credit cards? If so, what should this guidance state?
6	Do you agree with explicitly excluding BNPL in its entirety from 4AL(2)? If not, are there alternative ways, that would be workable for lenders, to impute future BNPL expenses based on a borrower's existing BNPL facilities?
7	In light of excluding BNPL from 4AL(2), is any further guidance in the Code necessary to address the treatment of BNPL expenses? If so, what should this guidance state?
8	Do you agree with the way that the Draft Regulations relating to the expanded exception for variations and replacements of existing credit contracts is phrased? If not, what changes would you make?
9	Which of the two drafting options for expanding the exception for variations and replacements of existing credit contracts would be most workable and why?
10	Do you agree with the suggested guidance in the Draft Code relating to the expanded exception? If not, what changes should be made to the Draft Code guidance?
11	Would any of these changes require changes to lender systems before they could come into force? If so, what are the likely timeframes for making these changes?