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

Thank you for the opportunity to provide submissions on the draft Amendment Regulations and draft Code. We are happy to discuss our submissions in more detail if required.

1. Treatment of discretionary expenses

1.1. Our primary submission on the treatment of discretionary expenses is that there is too much focus on whether an expense is discretionary or not. This is because, to a certain extent, all lenders and borrowers objectively know which expenses are discretionary; it is clear that paying the rent is not discretionary, whereas paying for Netflix is discretionary. From FSCL's point of view, the focus should be on the expected consumer behaviour once the loan is granted, and the timing of when discretionary expenses would need to cease.

1.2. To unpack this, in our experience of investigating consumer credit complaints, there is often a very fine line between the loan being affordable and not. We can see from borrowers' bank statements dated immediately prior to loans being granted, that many borrowers have what would objectively be considered discretionary expenses. For example, pay TV subscriptions and money regularly (most nights a week) being spent on takeaways.

1.3. However, the difference between affordability and unaffordability is so tight, that the borrower actually needed to cease those 'discretionary expenses' **immediately** to afford the loan; those expenses being 'material' to the question of affordability.

1.4. However, the amendments to the Code and to the Regulations seem to be written in a way that assumes there would be enough room in all borrowers' budgets to absorb those discretionary expenses for a time. And that further down the track, if their budget was tightened, they would cease those discretionary expenses. This may be workable, generally speaking, for certain types of lending, and where borrowers have stable and regular incomes, and savings. However, this is not the reality for many consumers accessing consumer credit, especially in the vehicle lending space, where we see a lot of complaints.

1.5. In fact, in the complaints we see, the borrower would need to immediately change the way they are currently spending, to be able to afford the loan and not immediately default or have to cut back on spending on essentials.

1.6. However, where that change of behaviour needs to be different from the day the loan is drawn down, we consider there's a higher risk that the borrower won't, as the lender might assume they would, immediately change their spending behaviour. We consider the lender should be required to tell the borrower what discretionary expenses make the difference between affordability and non-affordability, and that the borrower needs to cease them immediately.

Buffers and surpluses

1.7. The risk we have identified above in paragraph 1.6 should not be mitigated by the buffer and surplus requirements in regulation 4AF.

1.8. To unpack this a little further, our understanding of the buffer/surplus requirements in regulation 4AF(2)(b) is that there should be buffers and surpluses to mitigate the risk of overestimation of income and underestimation of 'relevant expenses'. However there appears to be a third purpose of the buffer/surplus being "that the borrower may need to incur **other expenses** that cause them to suffer substantial hardship". This appears to be indicating the buffer/surplus also needs to account, at least in part, for a 'rainy day fund' – to cover **other life expenses** that occur regularly. For example, having to buy a new washing machine if your existing one stops working. Including the word "**or**" in "**or** that the borrower may need to incur other expenses", could also be problematic, because it could suggest an 'either/or' situation.

Option 1 preferred

1.9. We prefer option 1 at paragraph 5.9 of the Code. This is primarily because we think that some of the 'assumptions' set out in paragraphs 5.9(a) to (f) are helpful prompts for lenders to think more broadly before assuming that an expense is discretionary.

1.10. However, there should be a further assumption included as a paragraph g) which says that: "If a borrower must immediately cease a discretionary expense to make the loan affordable, the lender should assume that the borrower may not immediately cease that expense. The lender should outline to the borrower which expenses need to immediately cease to make the loan affordable."

1.11. We also propose a further paragraph h) to make it clear that the buffer and surplus requirements should not be used to mitigate the risk that a borrower won't immediately cease a particular discretionary expense to make the loan affordable.

2. BNPL

2.1. We submit that proposed paragraph 5.34 remains in the Code. It could be technically unnecessary, but it would serve as a good reminder to lenders that any BNPL commitments should be treated as listed outgoings.

2.2. In response to paragraph 28 and questions 6 and 7 of the consultation document, we agree that BNPL is riskier than other revolving credit facilities. This is because of the ease at which a consumer can obtain BNPL (without affordability checks), the ease at which BNPL credit limits are increased, and the fact that consumers often have several BNPL accounts with different providers. We would have preferred that BNPL had not been excluded from 4AL(2). However, because it appears a policy decision has been made on this, the best place to address the issue is in the Code.

2.3. We find that the greatest risk of harm with BNPL is where the consumer has several BNPL accounts. Even though the new draft regulations require lenders to include any actual commitments the borrower has under all their BNPLs at any one point in time (for example's sake – say another 6 weeks of payments on one, 3 on another, and 8 on another), in our view, there remains the real and increased risk that a borrower with several BNPL accounts will again maximise all the credit available to them.

2.4. We therefore think that a further 'assumption' could be included at paragraph 5.9 of the Code which says a lender should assume that where the borrower has several BNPL accounts, there is an increased risk that the borrower is going to continue to use those facilities to their maximum in the future as ongoing lines of revolving credit. And, that lenders should factor this into their affordability assessments.

3. Refinancing third party debt

3.1. We prefer option 1. From our experience of investigating complaints arising out of the variation of third-party debts due to financial difficulty – the key consideration is that the immediate financial difficulty is alleviated. This alleviation is primarily achieved by a reduction in the regular payment amount, rather than considerations around the credit limit.

3.2. We agree with paragraph 36 of the consultation document that the guidance here is better suited to 'informed decision making', rather than 'affordability'. We also strongly agree with the record keeping amendments suggested at paragraph 38 of the consultation document.

3.3. However, we want to point out that the carve out from 4AH being extended to third party debt consolidation carries with it the greater risk that, even though the consolidation may improve the person's financial position, the repayments may still be unaffordable. It should be noted in the Code that a carve out from 4AH does not equate to a carve out from the requirement that the variation must still meet the overarching affordability test in section 9C(3)(a)(ii) of the Act.

Yours sincerely

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