NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Discussion paper: Review of consumer credit regulation

1 August 2018

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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following seventeen registered banks in New Zealand are members of NZBA:

   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - MUFG Bank, Ltd
   - China Construction Bank
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Background

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment (**MBIE**) on the discussion paper: *Review of consumer credit regulation* (**Discussion Paper**). NZBA commends the work that has gone into developing the Discussion Paper.

4. If you would like to discuss any aspect of the submission further, please contact:

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Introduction

5. NZBA supports MBIE's review of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). Our members are committed to ensuring that they comply with their obligations under the CCCFA and doing what they can to ensure that their customers are able to make informed decisions about credit. They also support measures to tackle predatory and irresponsible lending.

6. However, at the outset, we note that tightening legislation regulating the provision of credit may have the unintended consequence of driving vulnerable consumers towards predatory lenders. That may happen where vulnerable consumers are turned away from responsible lenders if they do not meet restrictive affordability criteria.

7. Rather, we consider that the most effective way to address predatory and irresponsible lending is to ensure that sufficient resources are directed to enforcement of the existing rules.

Issue one: Excessive cost of some consumer credit agreements

8. Some consumers may be lent money by high cost lenders in circumstances where it is clear (based on a reasonable affordability assessment) that the consumer cannot afford to repay the loan.

9. Consumers also take on high cost loans because:

   (a) They need to meet (sometimes unexpected) expenses that have to be paid before the next income cycle. These consumers could include potentially vulnerable customers such as those with dependencies (eg gambling or alcohol addictions) or customers with low financial capability or in financial hardship. Unexpected expenses could include such events as vehicle breakdowns, medical costs, children's school fees, etc.

   (b) High cost lenders often actively target groups of vulnerable customers because of their lack of financial capability.

   (c) Where high cost lenders have become embedded in a community, it becomes usual for people in that community to approach those lenders for finance (rather than looking to other types of lenders and/or comparing lenders).

Options for addressing high interest and fees

10. High cost lenders are defined in the *Additional information to support the Discussion Paper* as lenders who charge a very high annualised interest rate (being an interest rate exceeding 50% pa as per the Responsible Lending Code). In parts of the Discussion Paper, it appears that high cost lending also presumes that high cost loans are of short duration. Clarification is required.

11. We strongly support Cap Option C (subject to our comments below). That option is the simplest and delivers the largest benefit to consumers. By contrast, Cap Options A and B are complex and would be difficult to understand, manage and enforce.

12. **Cap Option A:**

13. Subject to our request that the definition of 'high cost lender' is clarified (and does not capture mainstream lending), NZBA supports Cap Option A's intent, but questions its practical application in some circumstances, for example:

    (a) Where the amount of borrowing fluctuates (through repeated increases in borrowing or part repayments). It would be difficult for lenders (and, more importantly, consumers) to determine whether they are being required to repay more than twice the original loan principal.

    (b) Where the amount of the loan balance is small, reasonable fees could conceivably take the total amount payable above the proposed threshold making the granting of small loans unfeasible for lenders and, therefore, limiting this type of credit.

14. Two key components requiring definition are the hurdle interest rate and the maximum term of the loan. For example, a home loan lasting over 25 years at an interest rate of 6.5% pa would result in a total amount of interest payable that is more than the loan principal, as would a 30 year home loan at 5.5% pa.

15. Cap Option A might also have the unintended effect of reducing the number of small loans available to consumers as lenders require consumers to agree to minimum levels of lending that enable lenders to meet the proposed requirements (but which surpass the consumer's lending requirements). That is because:

    (a) If a consumer defaults on a small loan, the reasonable costs of recovering that loan (eg calls to that consumer) could easily push accumulated costs above the proposed threshold and would, therefore, make lending small amounts less attractive to lenders (even those seeking to recover reasonable costs).

    (b) Some legitimate small consumer lenders that have higher cost business models might also be eliminated.

16. NZBA also queries whether the potential extension at paragraph 32 relates to one high-cost credit agreement per lender or across all lenders. Limiting high cost loans to one per consumer (and applying a cooling off period) would be very difficult to manage if it is intended to apply across all lenders. It would be difficult to use credit reporting to identify whether the consumer's existing loan was a high cost credit agreement.

17. **Cap Option B:**

18. We support the intent behind Cap Option B, however, there are significant issues with its application; it is extremely complex. Consumer legislation should be easy for consumers to understand and apply to their circumstances. This is even more important for high cost loans where borrowers typically have financial capability issues.

19. Cap Option B has three different reference points: (i) the Equivalent Interest Rate (**EIR**) or separate interest and fee caps, (ii) the total accumulation cap, and (iii) the limits on default interest and fees.

20. We note the following specific concerns:

(a) *EIR* – the EIR model raises the following issues (many of which existed pre-CCCFA):

(i) The EIR is a notional interest rate (ie it shows the amount of interest that would be payable if fees were incorporated as part of the interest component). It was not easily understood by consumers (pre-CCCFA) and seems even less likely to be understood by vulnerable customers.

(ii) It relies on lenders taking a consistent approach as to which fees should be incorporated as part of the EIR calculation. It is not clear what 'mandatory' means.

(iii) Some lenders might try to manipulate the categorisation of fees to artificially lower their EIR (while still charging those amounts outside the EIR calculation).

(iv) In some circumstances, it is genuinely difficult for lenders to calculate an EIR and this difficulty would lead to inconsistencies between lenders. This was certainly the experience pre-CCCFA.

(b) *Separate interest / fees caps* – we support capping interest rates. However, capping fees is highly problematic and we do not support that measure for the following reasons:

(i) Increasingly, there is a wide range of lender business and delivery models (some being highly digitised and others relying heavily on manual processing). Devising a fee cap that is not meaninglessly high for some lenders or cripplingly low for others would be difficult.

(ii) We query whether the Commerce Commission will have the resources to reset the caps on a sufficiently regular basis given (understandably) divergent industry positions on what the cap should be.

(iii) Technology is moving at a rapid rate. Now more than ever lender costs are changing as processes change. A fee (though reasonable when set at the time) might enable some lenders to charge fees for services that no longer reflect the actual costs of that service.

(iv) If fee caps result in actual costs for lenders exceeding the capped fee, this might dissuade lenders from providing loans to consumers where the lender anticipates actual costs will be higher than capped costs.

(v) Some lenders charge higher fees because they provide a better but more costly service. Capping fees might have the unintended impact of limiting the consumer services a bank will offer (which some consumers will want, and are happy to pay for).

21. The Discussion Paper states that there would be a markedly different outcome (between Cap Options A and B) regarding levels of payments made by consumers. However, it seems likely that, without a cap on all fees, a reduction in some fees will be offset by an increase in uncapped fees. Therefore, the impact on the consumer might not be as dramatically different as suggested in the costs/benefits table.

22. **Cap Option C:**

23. Cap Option C is our preferred option. We support elimination of lenders charging unjustifiably high interest and fees.

24. However, rather than limiting the total cost of interest and fees, we propose limiting only interest rates. Bundling interest and fees under one limit adds another layer of complexity that is unnecessary, particularly given the proposals in Issue 4 (Fees Option A), which should ensure that fees are reasonable.

25. Limiting interest only should:

    (a) eliminate high cost lending;

    (b) be simple for consumers to understand and apply;

    (c) avoid the issues we have identified above with the EIR model;

    (d) be consistent with the Commerce Commission's existing policy regarding fees and would not require a significant change in approach for most lenders (who already evidence how they have determined the reasonableness of their fees); and

    (e) maintain the onus on lenders to ensure that fees are reasonable no matter what their business or distribution model.

26. More importantly, this approach has already been proven to work. There have been substantial declines in fees since the 'reasonableness test' was introduced. The impact of technical changes in some lenders' business models have resulted in reduced costs and reduced fees.

27. That said, while many lenders are maintaining fees at a reasonable level, others are not. Again, the primary issue appears to be one of enforcement as opposed to there being an issue with the existing fee policy.

28. NZBA would support further consultation with the industry to identify an appropriate interest rate cap that would eliminate predatory high cost lenders.

Issue two: Continued irresponsible lending and other non-compliance

Options for increasing lender registration requirements

29. **Registration Option A:**

30. This would effectively give the Commerce Commission a regulatory power, where it is traditionally an enforcement body.

31. **Registration Option B:**

32. NZBA supports Registration Option B. However, if this is to go ahead, NZBA considers that banks should be deemed to comply given they are already subject to fit and proper person requirements. Additionally, there is a risk of misalignment with other legislative requirements.

33. **Registration Option C:**

34. As stated at paragraph 7, we consider that stronger enforcement of the existing rules would curb predatory lending behaviour. Nevertheless, we also consider that introducing a licensing regime may be an effective method of regulating the behaviour of irresponsible lenders as identified in the Discussion Paper. However, Qualifying Financial Entities (**QFE**) (known as Financial Advice Providers (**FAP**) under the Financial Services Legislation Amendment Bill (**FSLAB**)) should be deemed to comply or be excluded because:

    (a) Requiring both a QFE/FAP and a CCCFA licence might result in conflicts due to overlapping, and possibly inconsistent, licensing and supervision requirements.

    The different approach taken by the Commerce Commission and the FMA regarding the operation of Harmoney's peer-to-peer lending service is a good example of the kinds of issues that might arise.

    (b) Banks already hold and comply with multiple licences, are registered, and are effectively regulated. Additionally, QFEs/ FAPs are already subject to conduct obligations under the FMA's supervision which mitigates any concerns around engaging in high risk predatory lending activities.

    (c) Evidencing and reviewing criteria required for a creditor license is very resource intensive for the lender and the regulator.

35. We note also that FSLAB introduces a carve-out in relation to advice given for the purpose of complying with lender responsibilities (Schedule 5, s 10). As such, MBIE would need to consider how a comprehensive creditors licensing system would interact with that carve-out.

36. If licensed QFEs/FAPs are also required to be licensed under the CCCFA, we consider that there should only be one licensing regulatory body and hence one licence supervisor. We query whether MBIE has identified which lenders will not be providing financial advice (and already require a licence) under FSLAB.

Options for strengthening enforcement and penalties for irresponsible lending

37. In principle NZBA supports the options for strengthening enforcement and penalties for irresponsible lending. However, any new powers or penalties need to be clear, fairly reflect the level of culpability and harm caused (eg materiality thresholds), and take into account the current subjectivity of the Responsible Lending Code.

38. **Enforcement Option A:**

39. NZBA considers that some caution is warranted in respect of Enforcement Option A as it would effectively create a penalty regime for breaches of a principles-based

system. This is problematic as it can be difficult for lenders to determine whether they are compliant or not, and there are issues with punishing lenders with civil enforcement penalties in situations where the standards are not black and white.

40. **Enforcement Option B:**

41. NZBA does not support the expansion of liability to include directors and senior managers of banks.

42. This option is not sensible for banks taking into account their management structures. As the paper points out, bank directors tend to have a broad governance role, and are not well placed to ensure compliance (vs a hands-on director in a small organisation). It would be unfair to make directors liable in this situation, additionally, it would not be useful in achieving the desired aims.

43. NZBA would, however, support a penalty regime for high-cost lenders where directors are directly responsible for CCCFA breaches.

44. **Enforcement Option C:**

45. Enforcement Option C requires careful consideration. There is a risk that supplying consumers with affordability assessment criteria (or the assessments themselves) may allow consumers to manipulate application information to obtain lending approval.

46. Additionally, this option would be likely to create significant compliance costs and would be difficult to comply with given the principles-based approach of the Responsible Lending Code.

47. **Enforcement Option D:**

48. NZBA supports Enforcement Option D.

49. **Enforcement Option E:**

50. NZBA is generally supportive of Enforcement Option E, provided it does not create data security and privacy risks for the consumer:

    (a) the consumer would need to provide appropriate authorisation (and to remember to withdraw such authorisation when appropriate); and

    (b) the consumer would need to understand the risks of providing a third party with personal information about their finances, and the right to engage on his or her behalf.

Options for introducing more prescriptive requirements for affordability assessments and advertising

51. NZBA considers that the current CCCFA protections, when followed appropriately, provide sufficient levels of protection in relation to affordability assessments and advertising. However, any prescriptive requirements that are introduced should clarify the regime rather than cause unnecessary compliance burdens.

52. NZBA supports the maintenance of a principles-based approach to affordability assessments and advertising.

53. **Responsibility Option A:**

54. We support all lenders having minimum standards for conducting affordability assessments. However, banks already have prescriptive requirements for conducting these assessments.

55. Minimum affordability standards should be considered in light of the Financial Adviser legislative reform, to avoid regulatory uncertainty.

56. If this option were to be adopted clarification of the following matters would be necessary:

    (a) The definition of 'high cost loans', as discussed above.

    (b) How this option would operate in the context of digital lending applications.

    (c) How much verification would be required.

    (d) The definition of 'vehicle loans', as this may capture banks (we would likely advocate for this to be narrowed and targeted at vehicle sellers who also provide finance).

57. Additionally, NZBA does not support the removal or narrowing of s 9C(7) of the CCCFA – this section is already sufficiently limited by the overlay of the Responsible Lending Code (particularly the principles relating to verification).

58. **Responsibility Option B:**

59. If Responsibility Option B is adopted, it will be important to ensure the requirement to include risk warnings is not extended beyond high cost lenders (assuming banks fall outside that definition).

60. Additionally, we consider that requirements around advertising be removed from the Responsible Lending Code and shifted to the CCCFA to avoid inconsistency; we query whether it is appropriate to include prescriptive requirements in an otherwise principles-based code.

61. Further clarification will be also be required around enforcement of the mandatory requirements. Additionally, NZBA would advocate for a materiality threshold and a tailored remedy regime (eg publish a correction vs fine or other penalty).

62. **Responsibility Option C:**

63. NZBA does not support Responsibility Option C.

64. Complete alignment of meaning for disclosure documents between languages would be very difficult, and would be likely to create interpretation issues.

65. It would also be necessary to consider the impact on cl 7.17 of the Responsible Lending Code – this states that lenders do not need to routinely inquire as to whether a borrower has a good understanding of English.

Issue three: Continued predatory behaviour by mobile traders

Options to address credit sales falling outside the CCCFA

66. NZBA agrees with the assessment of the issues around mobile traders, and the assessment of the costs and benefits of extending coverage of the CCCFA to more mobile traders.

67. NZBA remains concerned that mobile traders may be able to find loopholes in the proposals. Accordingly, we believe that MBIE should better define the activity of mobile traders and expand the scope of CCCFA to ensure they are directly captured.

Options to address predatory and irresponsible behaviour by mobile traders

68. **Scope Option A:**

69. Paragraph 91 of the Discussion Paper states that under Scope Option A any credit contract charging default fees would be a 'consumer credit contract' and thus regulated by the CCCFA. On its face, this could be interpreted to mean that any credit contract charging default fees would be deemed to be a consumer credit contract, regardless of the other requirements of the definition at s 11 of the CCCFA. This would result in a vast range of credit contracts being regulated by the CCCFA where there is no requirement for consumer protection – for example, business loans may charge default fees but should not be treated as consumer credit contracts.

70. However, if the intent of Scope Option A is to amend s 11 to include that 'default fees are or may be payable under the contract' (under s 11(c)), NZBA would support this option. This would capture 'buy now pay later' arrangements such as AfterPay and LayBuy, which is appropriate as these have the potential to allow people to overcommit themselves, and charge relatively high amounts for defaults (on low purchase amounts generally).

71. **Scope Option B:**

72. NZBA has no specific comments on this option.

Issue four: Unreasonable fees

Options for addressing unreasonable fees

73. NZBA supports Fees Option A. However, caution is required before imposing new substantiation requirements. Depending on how frequently lenders would be required to substantiate their fees, and what evidence would be required to substantiate them, the cost on lenders to comply with new substantiation requirements may be significant. A substantiation requirement may also unnecessarily complicate the existing legal framework. We therefore consider that there should be further consultation on this issue. In addition, we note that lenders would be unlikely to agree to provide commercially sensitive information to persons other than regulators.

74. We do not support Fees Option B (see our above comments on Cap Option B).

75. We do not support Fees Option C on the basis that it would likely be confusing for customers who are accustomed to seeing separate interest and fees figures (as is currently required). Also, we consider this option would be likely to raise compliance costs with little benefit (or even a detriment) to customers. This option may also undermine efforts by other regulators to make fees easier to understand (eg FMA's efforts in the Kiwisaver space; fees are now displayed as the actual fee amount, rather than as a percentage).

Options for tightening regulation of third-party fees

76. The purpose of a broker is to undertake the legwork for a consumer. Some consumers will be harder to arrange finance for, so broker costs naturally vary.

77. It is possible that some brokers are charging consumers excessive fees for their services. If there is evidence that this is taking place, broker practices should be separately investigated.

Issue five: Irresponsible debt collection practices

78. The definition of 'debt collection' in the Discussion Paper is extremely wide. It would be preferable for debt collection to be defined as meaning the point at which the lender believes that the consumer is either incapable or unwilling to adhere to the repayment schedule proposed following default for reasons explained below.

79. Additionally, we consider that some of the problems identified lack the necessary context.

80. **Debt Collection Option A:**

81. To the extent that our concerns around the definition of 'debt collection' are noted, and the definition is revised accordingly, NZBA generally supports Debt Collection Option A.

82. We consider that the debt collector should be required to provide the consumer with a properly formulated notice that verifies the debt collector's right to collect the debt (ie amount of the loan, status of any repayment plan, etc).

83. However, we do not think the debt collector should be required to provide copies of the original loan documentation, and details of the debt, interest and fees. Rather, this information could be provided to the borrower on request. Noting that in some instances it will not be possible to provide a consumer with the information outlined in paragraph 119 of the Discussion Paper (for example, where it is a copy of a contract for a credit card that was applied for prior to 1980). Additional required disclosures to consumers will also likely cause further costs to be incurred by lenders, which may translate into increased debt collection costs for consumers.

84. Additionally, we note that it may be difficult to provide the customer with details of fees charged before the debt has 'crystallised' as there will be some fees which are incurred on a one-off basis and won't necessarily be engaged.

85. **Debt Collection Option B:**

86. In relation to Debt Collection Option B, we reiterate our concerns regarding the breadth of the definition of 'debt collection'. If this option were to be adopted we consider that that definition would have to be revised. That is because, in some

cases, affordability (or hardship) is not the issue. Rather, the consumer has either forgotten to pay or has decided to not pay.

87. We also note that this requirement would need to be flexible, particularly in respect to how affordability is determined and substantiated. If the requirements in this respect are too prescriptive the cost of debt collection could become prohibitive.

88. Additionally, the requirement should allow for variation to the repayment plan by mutual agreement to reflect a change in circumstances. For example, a consumer may be unable to repay a loan due to losing his or her job. A repayment schedule would be agreed on that basis. However, if the consumer then obtains a new job, and his or her affordability materially improves, it is in both the borrower's and the lender's interests to update that repayment schedule. For that reason, we consider that the debt collection agency should be permitted to periodically contact the borrower to review their financial position. It is in the borrower's best interest to get the debt paid off as quickly as possible.

89. **Debt Collection Option C:**

90. We do not support Debt Collection Option C. That is because the Responsible Lending Code already provides that contact must be restricted to appropriate hours and days. Additionally, it is not clear what it is meant by "appropriate limits", that phrase is inherently subjective.

91. NZBA also considers that the right to nominate a representative should not be absolute – debt collection agencies should be permitted to make contact with the borrower, for example, if the agent is not responding or acting in the borrower's best interests.

92. **Debt Collection Option D:**

93. NZBA supports Debt Collection Option D; debt collectors should be subject to the CCCFA requirements.

94. **Debt Collection Option E:**

95. NZBA supports Debt Collection Option E.

96. Debt collection fees should be cost-based or capped, for example, as a percentage of the debt outstanding. Unlike in the case of capped lenders' fees, we do not believe that capped debt collection fees would marginalise certain groups of consumers. On the contrary, a cap on debt collection fees might ensure that a proportionate response to the recovery of smaller debts occurs. Third party debt collection agencies are able to profit based on the discounted amount they pay for the debts. It is conceivable that third party debt collection agencies could be required to factor in the cost of recovery into this discount and not separately charge for collection fees at all.

Other issues

97. **Question 26:**

98. In our experience, we have not seen harm from loans to small businesses, retail investors or family trusts as a result of them not being regulated under the CCCFA.

99. **Question 27:**

100. We do not believe that applying the protections of the CCCFA to small businesses, retail investors or family trusts is the right answer for these borrowers.

101. Non-personal borrowing entities are, by nature, controlled by more sophisticated borrowers with access to professional advice.

102. Factors relevant to business lending significantly differ in nature. For example:

(a) Small business owners borrow to fund working capital or purchase business assets. This kind of finance is typically medium to long term (as compared with the short term finance provided by payday lenders).

(b) The suitability of the loan structure is important. For example, typically asset finance is not provided beyond the depreciated life of a business asset.

(c) Credit policies appropriate for business lending are different to those applied to retail lending. Credit analysis for business lending focuses on sustainable cash flow (having to often factor in variable cash flows). Business lending is inherently higher risk due to the uncertainty around business cash flows. This is harder to assess and not something that easily fits into the current provisions of CCCFA. Security and adequate rights of enforcement are also key requirements.

(d) Debt collection for business lending is typically a multi-staged process that may ultimately necessitate the appointing of a receiver or liquidator if other options to recapitalise the venture are unsuccessful.

103. Additional restrictions or overheads are likely to reduce the supply of credit to small business owners.

104. **Question 28:**

105. We also wish to note our submission in response to MBIE's consultation on Regulatory Systems Bill 3. In particular, we note our views around s 99(1A) and reiterate that, in our view, s 99(1A) drives some creditors to take a more conservative approach to lending because of concerns around the disproportionate impact of that section. We note the June 2018 Cabinet paper which recommends a prospective amendment to that section. However, that cabinet paper does not entirely address our concerns around the impacts that section may have on lenders as it does not apply retrospectively.