FINANCIAL SERVICES FEDERATION

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Introduction:
The Financial Services Federation (FSF) is grateful to officials for the opportunity to provide feedback to them on the Updated Credit Contracts and Consumer Finance Regulations 2004 (the Regulations) and Responsible Lending Code (RLC). The FSF is also appreciative of the opportunity that has been afforded to us to participate in the investigation initiated by the Minister of Commerce and Consumer Affairs.

By way of background, the FSF is the industry body representing the responsible and ethical finance, leasing, and credit-related insurance providers of New Zealand. We have over 85 members and affiliates providing these products to more than 1.7 million New Zealand consumers and businesses. Our affiliate members include internationally recognised legal and consulting partners. A list of our members is attached as Appendix A. Data relating to the extent to which FSF members (excluding Affiliate members) contribute to New Zealand consumers, society, and business is attached as Appendix B.

FSF members take their responsible lending obligations very seriously and therefore they always treat their customers fairly and ethically. It is not in the interest of achieving this to provide credit that is unaffordable or that would cause the borrower to experience substantial hardship. It is also not in the interest of operating a sustainable business model – without their customers meeting their loan repayments as per the credit contract, they would be unable to continue to operate.

As responsible lenders, FSF developed the Responsible Lending Guidelines several years ago which formed the basis of the Lender Responsibility Principles (LRPs) introduced to the CCCFA with the reform of that Act which came into force in 2015. At that time, the FSF was pleased to see the responsible behaviour to which FSF members adhered being applied to all lenders.

It has therefore always been of concern to the FSF that, following the introduction of these principles, it was felt that there was a need for this latest review of the CCCFA because apparently there was evidence that harm was still being caused to vulnerable borrowers as a result of irresponsible lending. The FSF has always believed that, if such practices were still occurring, these lenders should have been subject to investigation by the regulator and the full force of the law should have been applied to them if they were found to be in breach. The FSF therefore believes that much of the change to the Act and the introduction of much of the accompanying regulations from 1 December was unnecessary if the law was being adequately enforced against those players who were breaking the existing law.

The FSF did however support some changes to the Act including the introduction of a definition in the law of a “high-cost loan” or “high-cost lender”, the parameters that were put in place to limit the amount these lenders could be paid and the interest and fees they could charge, and also the extension of the types of penalties that could be applied by the regulator to allow them to act more swiftly and decisively when they identified irresponsible lending practices.

The FSF has always strongly disagreed with the prescriptive nature of the affordability regulations of 2020 and voiced the concerns of members that they would result in access to credit being restricted to all prospective borrowers – not only those in more vulnerable circumstances – in every submission made throughout the process of developing the regulations and the accompanying guidance of the RLC.

The FSF takes no satisfaction from being proven correct in these assertions and that this has resulted in the need for this investigation being initiated literally only weeks into the new regime. This is particularly so because of the pressure that was placed on all lenders to be fully compliant with the new requirements by 1 December last year which required significant changes to lenders’ systems and processes with the resultant impacts on staff wellbeing due to the stress this pressure placed on them, not to mention the significant expense that was incurred to achieve this.

The FSF is yet to quantify the actual cost of the systems changes, the extra people required to implement them, changes to documentation, professional advice to ensure compliance etc., but the cost imposition has been heavy with individual members reporting the cost to them being in the region of $2 million each. This does not reflect the cost of staff attrition from lenders’ businesses as people have left due to the pressure of the 1 December deadline who have had subsequently to be replaced.

Having applied all this pressure and cost on lenders to be fully compliant by 1 December with a regime which they did not believe was necessary in the first place, it is therefore a bitter pill to have to swallow to have the deficiencies in the regime become so glaringly obvious so early in the piece. Regulation requiring a review less than 2 months into its coming into force is clearly poor regulation.

***The 1 December CCCFA changes apply to all lenders, not just banks*:**
The FSF notes that there has been much reactive comment in the public domain since the CCCFA changes came into force from 1 December about the adverse impact the changes have had on consumers seeking credit.

Most of this commentary has related to the effects on banks and on their customers seeking home loan finance. The FSF notes that even the discussion document released with the

Exposure Draft of the amended regulations and draft changes to the RLC, refers to the policy intention that, where a borrower declared living expenses, they could either be verified against bank transaction records or compared against a benchmark which aligned more closely with the pre-1 December processes of many banks.

The FSF wishes to make absolutely clear that these changes have adversely affected **all** consumers of credit and **every** consumer credit provider. At some point in their lives, almost every person requires access to credit – whether it be to purchase a property, a motor vehicle, a home appliance or to provide the ability to finance purchases of any other goods or service.

As demonstrated in Appendix B to this submission, 1.7 million New Zealand consumers choose to access credit from the non-bank lenders that are FSF members. These customers are equally important as those of registered banks in the view of the FSF. Appendix B also shows that 47% of all personal consumer lending in Aotearoa is financed by FSF's non-bank consumer lenders.

KPMG's recently released Financial Institutions Performance Survey which analysed the performance of New Zealand's banks over the quarter to 31 December last, bears this out. Bank lending is significantly weighted towards home lending or business lending, the remainder of their loan book is a very small amount of personal lending. This gap is filled by the non-bank lending sector and these lenders and their customers should not be put at a disadvantage by cutting access to quality credit options because their customers are not considered equally important as those of banks.

Non-bank lenders meet the need for credit of New Zealanders who the banks do not service or they provide alternative ways to access credit to that of the banks. This is a healthy competitive environment, which the Minister having responsibility for both Commerce and Consumer Affairs portfolios should support.

What should be remembered is that there are many different credit profiles amongst New Zealand consumers – not every one of whom is seeking first home lending or any other type of home lending. People need to be able to borrow to purchase their first car or a new home appliance and for many other reasons than just a house purchase. Some of this need for credit is driven by necessity. The FSF does not believe that sufficient consideration has been given to the needs of different segments of consumers either in the development of the 1 December changes or in the drafting of the proposed changes.

It has often seemed to the FSF throughout the process to develop the 1 December changes and since, that the importance of non-bank lenders to New Zealand's society and the economy has either been overlooked or not understood.

***The impact on borrowers and lenders of the 1 December changes*:**
The adverse impact on FSF members and their customers of the new regulations became obvious immediately upon their implementation – as has been widely reported. The FSF chose to seek data from members to depict this impact at the end of the first three months of the new regime. Attached as Appendix C is the result of that data-gathering.

FSF members were asked to provide data as to the number of loan applications received for the three months December 2021 – February 2022 compared to the same period 12 months previously, the number of applications approved, and the average time taken to make a decision for the same periods.

As expected, the number of loan applications received dropped by 21%, the number of applications approved dropped by 6% and the average time to decision increased by 1.1 days on average.

What is even more compelling than the above figures, however, are the verbatim comments from members with respect to the experience and reactions of their customers to the changes and the experience of their staff to manage the changes and how this has affected them. These comments are attached as Appendix D.

It is clear from these comments that consumers did not want these changes. They do not welcome the intrusive nature of the questioning now required to determine affordability and there is a common theme that they feel that they are being treated as if they are untrustworthy or unable to manage their own financial commitments.

The FSF is very concerned about the social impact on New Zealanders of the restricted access to credit the 1 December changes have clearly caused. This is excluding a portion of society from having their needs met and the major concern with respect to this is what happens to people who are declined credit by responsible lenders such as FSF members. If such lenders are unable to assist these people, then 1 of 2 things will happen – either their need for credit will disappear, or they will seek less responsible, possibly even illegal, options to meet their need. The latter is the most likely scenario in the FSF's view.

The irony is that rather than protect vulnerable consumers as they were designed to do, the regulations have achieved quite the opposite pushing customers who may not have been in vulnerable circumstances to start with towards lenders who have no intention of complying with the law, and thereby putting them into very vulnerable situations.

A further point to note with respect to this is that if the use of "underground" or non-compliant lenders does proliferate as FSF expects it will, such "lenders" will also no doubt be non-compliant with New Zealand's Anti-Money Laundering and Countering Financing of Terrorism legislation seriously undermining the country's efforts to prevent money laundering and terrorism financing.

The regulator will have to be extra vigilant to ensure that they are able on top of such illegal behaviour as it occurs so that it can be stamped out immediately and decisively.

What is also very disturbing is the reported effects on staff morale of their no longer being able to use their judgement to help their customers and having to deal with the consequent dejection of customers to whom they are unable to provide credit with the common refrain of "if you won't help me, who will?". This has also resulted in the need for increased security for those FSF members that run branch networks because of aggrieved and aggressive customers.

The latter types of comment are particularly poignant coming as they do from people seeking unsecured personal finance from a responsible lender at a reasonable interest rate for common needs at the time of year at which the data was gathered such as for the purchase of school uniforms and supplies, etc. The question indeed is who will help them if a responsible lender is now unable to? The FSF notes that even microfinance providers have expressed difficulty in being able to help those most vulnerable under the new affordability rules.

The FSF has strongly repeated the fact that the vast majority of consumer lending in New Zealand is provided responsibly and appropriately with the principle of ensuring that the loan is affordable to the borrower without them experiencing substantial hardship being applied at the time of application. The FSF also fully supports the requirement that special care should be taken by lenders to ensure that this is achieved where they become aware that the circumstances of a particular borrower might result in them being in a vulnerable situation.

The 1 in 5 harmful loan "myth":
The FSF absolutely refutes the frequently-made assertion in commentary with respect to the 1 December changes, that "one in five consumer loans have resulted in harm being caused to borrowers" – or words to that effect. This appears to have come from a 2019 review that found that around 18% of New Zealanders found themselves in either moderate or severe hardship as a result of lending that was unaffordable to them, and which has been extrapolated out to give credence to the one in five assertion. This statistic was even quoted in Parliament by Minister Clark in February this year.

The FSF believes that this "statistic" came from a consumer survey conducted by MBIE that asked a handful of people whether their existing lending was causing them hardship. Given the unscientific nature of this survey, it is likely that respondents to the survey when asked this question, thought something along the lines of "well, if I didn't have that loan repayment commitment, I could be spending my money on something else – therefore the loan repayment is causing me hardship".

Certainly, if it were a fact that 20% or thereabouts of all consumer lending was resulting in hardship, lenders would be finding that a considerable proportion of their lending book was in arrears or default – it could be expected that this would be close to this 20% figure or at the very least in double figures. Quite the opposite is the case. In the 2021 survey of FSF members, the average percentage of members' loan books that were in arrears was 4.4% (a drop from the average in 2016 of 5.8%).

The Loan Conversion Report by Centrix dated February 2021 which was included as an Appendix to the Cabinet Paper put up by Minister Clark in support of the need for the proposed changes to the regulations and RLC, bears out the fact that loan arrears are at their lowest levels ever across all credit products - home loans, personal loans, credit cards and motor vehicle loans – and that financial hardships had fallen to a 2 year low which further gives the lie to the "1 in 5 myth".

The FSF believes that this narrative which has been allowed to continue unchallenged deflects from the reality that the vast majority of lending in New Zealand is being provided responsibly to consumers who understand the terms and conditions of their loan contract and who are prepared to make the necessary changes to their expenditure that taking on such a commitment will require of them. The FSF further believes that this important fact was lost sight of in the review process and the development of the new regulations.

***Consumer resource*:**
The FSF was very disappointed that, leading up to 1 December, there was no consumer awareness campaign mounted by Government to explain the changes and why it was felt they were necessary.

Given then that it was left up to lenders themselves to try to provide such explanation, the FSF took the initiative and developed the consumer resource: 'Changes to Consumer Lending and How it Affects You'. This was done in collaboration with the New Zealand Bankers' Association, whose members also felt that there was a major gap in consumer awareness of the impacts of the changes and also with FinCap.

This is available here at our website in brochure form or in soft copy – also attached as Appendix E – and is distributed via FSF and NZBA member websites and branch networks and through the FinCap national financial mentor network. Any public support, promotion, or even acknowledgement of this initiative from MBIE or the Minister may have lessened the initial shock to consumers, unfortunately however this request was rejected.

***Open banking/Consumer Data Right*:**
The FSF strongly advocated in many of the submissions made on behalf of members with respect to the changes to the Act, the new regulations and the RLC, that New Zealand required a Consumer Data Right to be in place before it would be possible for every lender to be able to access customers' bank transactional information, in order to be able to meet the prescriptive requirements of the affordability regulations. This has proven to be the case.

It is a fact that banks have considerable competitive advantage over non-bank lenders because of the transactional data that they hold about their customers given the regulations place such a heavy obligation on lenders to acquire recent transaction records for a period of at least 90 days.

In the absence of a Consumer Data Right the only means for non-bank lenders to obtain this information accurately is for them to invest heavily in fintech solutions that provide a highly secure means for customers to provide this information.

It is disturbing that the banks actively discourage the use of such means as does CERT NZ – another department of MBIE.

The FSF does not support any action that allows one sector of the market to have a competitive advantage over another and this includes any suggestion that the regulations should be loosened for one sector whilst remaining tighter for another – with the exception of those which apply specifically to high-cost lenders.

Inquiries into affordability regulations:

The FSF is particularly disappointed that the affordability regulations require lenders to concentrate entirely on analysis of income and expense data received by way of declaration by the borrower, bank transaction records and/or the use of benchmarks without considering the value that a consumer's credit history or repayment history provides in predicting the ability to meet repayments. In fact, this vital data was actively discounted as being of any value in the affordability assessment process during the formulation of the regulations.

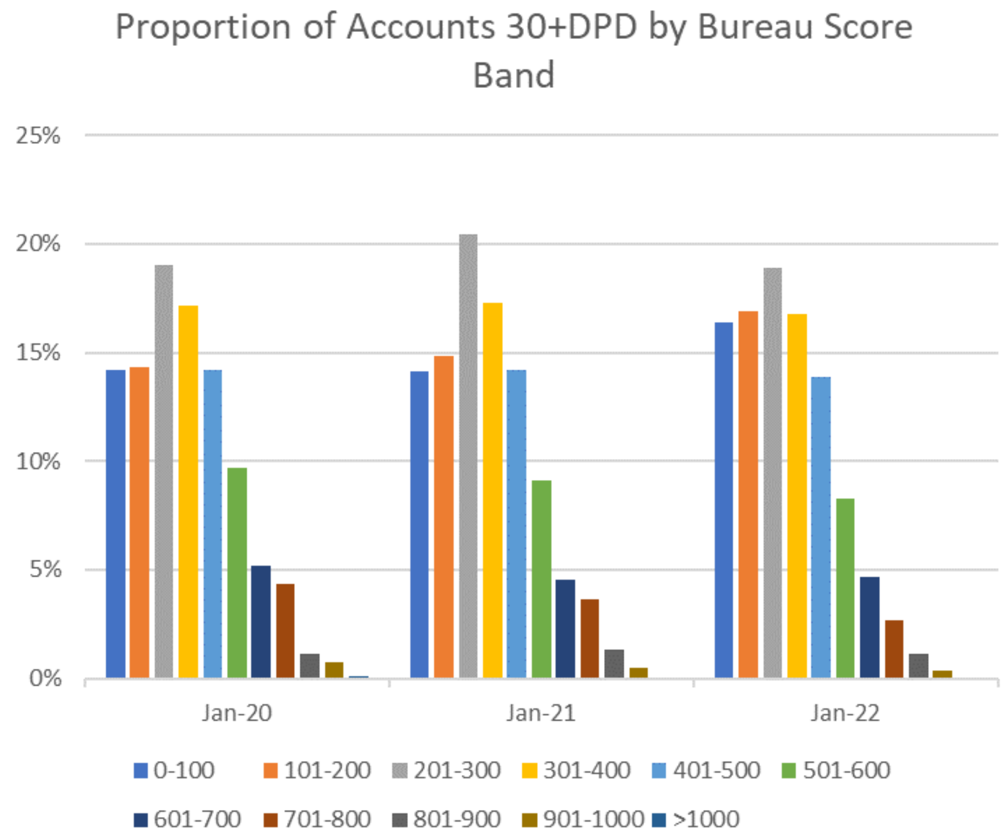
The FSF believes that now is the time to revisit that viewpoint. A person's credit rating is something that they have worked hard to develop from the very first time they accessed credit. People with financial capability and a good credit history receive no value from this under the current regime and are treated as being guilty of being unable to meet their commitments until they are proven innocent.

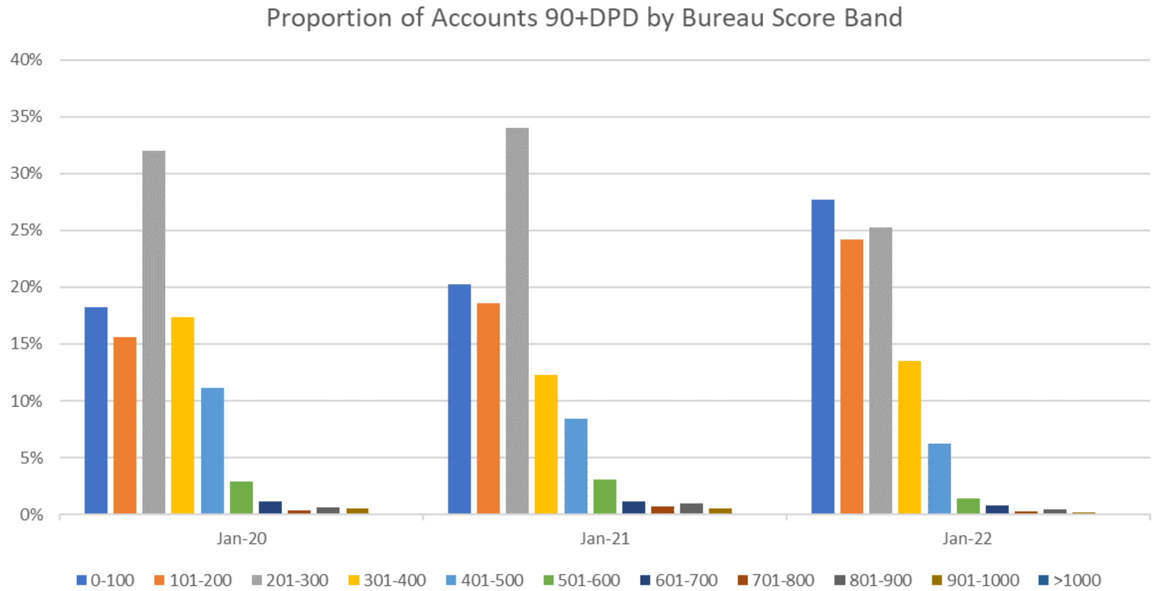
Repayment history and a good credit rating are both directly related to the probability of a customer meeting their repayments. This has been proven over and over again which is why it is part of most lenders' credit criteria.

Comprehensive credit reporting (CCR) is not simply showing whether or not a person has had a credit default or a judgment lodged against them by a credit provider. It provides data on the payment of all accounts to lenders including credit cards, mortgages etc, together with telcos and utilities providers over a long period of time so it is directly relevant to the person's ability to meet their commitments.

Payment history, whether it is internal or external (CCR), is unbiased and independent information built up over a long period of time. It demonstrates a customer's historic repayment behaviour and is a strong indicator of how they will behave in the future. A good payment history means the customer has the ability and willingness to modify their spending behaviour if required to meet debt obligations. This is a much stronger and more reliable record than 90 days of bank transaction records which can show an inaccurate, short-term spending pattern if a customer modifies their spending behaviour over the period before they apply for a loan.

The degree to which a person's credit score predicts the likelihood of payment default in the next 12 months is demonstrated by the following data provided by Equifax and via the Centrix data provided at Appendix F.





It is absolutely clear that the higher a person's credit score, the lower the risk of default and this information creates a viable pathway towards the affordability assessment that the FSF believes should be allowed for in the regulations and the RLC with an acknowledgement that the higher the person's credit rating, the less intrusive the questioning about living expenses and discretionary expenditure is required to be. Conversely, obviously, a borrower with a lower credit rating would require more detailed scrutiny of their income and expenses to determine their ability to afford the loan without suffering substantial hardship.

The FSF believes that, in not taking into account the value of repayment and credit history and allowing lenders to use this vital information as part of their assessment process demonstrates a complete lack of understanding of the way in which lenders assess credit risk.

***Some general comments with respect to the inadequacy of the current regime*:**
As the FSF has already said, we do not believe the changes to the CCCFA brought in from 1 December were necessary had the existing regime been adequately enforced. The FSF was opposed to the majority of the changes brought in from 1 December as they removed the flexibility the existing principles-based approach provided to lenders to be able to do the right thing by their particular customer segment without imposing undue or unnecessary prescription.

The reversal of the principles-based approach to what is now a highly prescriptive regime has always in the FSF's view been a backward step. The FSF disputes statements made by Minister Clark that lenders have misinterpreted the regulations by taking too prescriptive an approach to their implementation. The regulations are written in such a way that they are not open to misinterpretation. And the penalties are so severe as to be a significant disincentive to lenders for not following them to the letter.

The proposed changes to the regulations are merely "tweaks" as opposed to actually addressing the elephant in the room which is that they were wrong from the outset.

The FSF will now turn to answering the specific questions posed in the consultation document.

1. **Do you agree with the way that the draft Regulations are phrased? If not, what changes would you make?**

The FSF supports the removal of "savings" and "investments" from Regulation 4AE paragraph (d) of the definition of "listed outgoings" as the inclusion of the requirement for lenders to consider such savings and investments as part of a borrower's regular or frequently occurring outgoings was something the FSF strongly opposed during consultation on the original drafting of the regulations.

The FSF does not see any benefit to consumers or lenders of the proposed amendment to Regulation 4AK. Regulation 4AK requires lenders to do an initial estimate of the borrower's likely relevant expenses including by asking the borrower about their relevant expenses. Regulation 4AM then requires lenders to adjust their initial estimate of the borrower's likely relevant expenses by verifying the amount of the expense with reliable evidence. Regulation 4AF(2)(b)(i) and (ii) then requires lenders to be satisfied that it is likely the borrower will make the payments under the agreement without suffering substantial hardship because the borrower's likely income exceeds their likely relevant expenses and there is a reasonable surplus or the lender's estimates of likely income and likely relevant expenses included reasonable buffers or adjustments to adequately address the risk that likely income may be overestimated, or that likely relevant expenses may be underestimated.

It is precisely this 3-step process of the initial estimation of expenses, the adjustment to the initial estimate and the application of a buffer or surplus, that is causing the problem of restricting access to credit for both consumers and lenders. The net result of that analysis and application of surpluses and buffers is that the borrower's expenditure calculation is vastly overstated making it appear that they cannot afford the repayments without suffering substantial hardship when that is not the case. This is severely and unnecessarily restricting access to credit.

In the FSF's view, the proposed change to Regulation 4AK goes no way towards addressing the overly prescriptive nature of these requirements or the issues the FSF raised during the investigation into the effects of the CCCFA changes, so the proposed change to the Regulation is very disappointing.

As the FSF has already said in this submission, a consumer's overall credit history and their repayment history with a particular lender is a far better indicator of the loan affordability than any of the analysis required in the current Regulations.

2. **Do you agree with the way that the guidance relating to expenses is communicated in the Draft Code? If not, how do you suggest it is improved?**

Given that the FSF believes that the proposed change to Regulation 4AK is merely a "tweak" that slightly changes the way in which the Regulation is worded but essentially makes no material change to the requirements of Regulation 4AK, the guidance in the Draft Code is hampered by the lack of any real change to the regulatory requirements. This seems to be borne out by the fact that the amendments to the diagram on page 25 of the Code (page 2 of the exposure draft on the Code) to reflect the change to Regulation 4AK(2)(b) merely moves the box relating to that particular Regulation from where it currently sits to further down in the flow chart and removes the word "material" from that box.

The clarity that is provided in para 5.3 of the Draft Code that lenders may choose to use only one or a combination of information sources to create the initial estimate of likely relevant expenses under Regulation 4AK(2)(a) is helpful.

However, para 5.4 of the Draft Code is less helpful when it says that lenders may choose not to use the bank transaction records they have gathered to estimate the amount of those expenses where they have already formed an initial estimate of the borrower's relevant expenses by asking the borrower about these but then goes on to say that lenders should not "close their eyes" to information contained in the bank transaction records. Given the extremely punitive penalty regime introduced via the CCCFA review that attaches to the senior managers and directors of lending organisations, without the ability for this liability to be insured or indemnified against, it is very unlikely that any lender would choose not to use the bank transaction information to make their initial expense estimate if they already held it. This renders this piece of guidance to be of no use at all.

Whilst the FSF is supportive of the guidance provided in para 5.5 of the Draft Code where it says that lenders may also ask the borrower about how expenses are likely to change once the contract is entered into and that they can take this into account in making their initial estimate under Regulation 4AK meaning that any expense the borrower declares to the lender that they will cease once the contract is entered into does not have to be included in the initial expense estimate.

As the FSF frequently submitted during the process of the CCCFA review, a contract requires obligations on both parties and a loan contract is no different. However, the 1 December changes to the CCCFA regime have had the effect of placing all the onus for ensuring that a borrower acts responsibly once the contract is entered into on the lender. The FSF would like assurance that, if a borrower's declaration that an expense would cease once the contract is entered into, and that declaration is recorded, the lender is not going to be subject to the regulator's interpretation that the lender has breached their responsible lending obligations if the borrower fails to cease this expense and later finds themselves in a situation of hardship as a result.

The FSF notes that para 5.6 of the Draft Code deals with the concept of discretionary expenses. The FSF believes that the CCCFA changes have taken away any discretion on behalf of either the borrower or the lender. In the case of the borrower, this discretion allows them to make their own decisions as to how they manage their finances in order to meet their commitment under the loan contract.

Officials will no doubt be aware of the "Wagyu and shiraz" judgment that came from Justice Nye Perram in the 2020 Westpac versus ASIC case in Australia. Justice Perram found that a customer's current living expenses were not an important indicator of whether they could afford the loan, contending expenses could be cut if necessary. "I may eat Wagyu beef everyday washed down with the finest shiraz but, if I really want my new home, I can make do on much more modest fare," he wrote. Judges upheld this ruling following ASIC's appeal, agreeing that the law requires a lender to make reasonable inquiries about a potential borrower's circumstances, but it does not need to take all that information into account when assessing if a loan is affordable.

As the verbatim comments attached to this submission as Appendix D show, consumers do not wish to be treated as though they have no ability to manage their own finances. They do not wish to have to discuss in detail how they currently spend their money and what they will stop spending or change in order to provide sufficient surplus income for the lender to feel comfortable that they can lend to them without being in breach of the law.

Whilst para 5.6 of the Draft Code acknowledges the fact that the expenses shown on bank transaction records are often "discretionary", the FSF does not believe that lenders should have to ask intrusive questions of borrowers at a very granular level to determine what discretionary expenses they intend to cease or reduce.

The FSF does, however, understand that in cases where lenders have identified that they might be dealing with a customer whose circumstances make them more vulnerable, further enquiry might be required to be satisfied that that customer does understand the commitment they are making under the loan contract and the possible need for a change in spending habits to accommodate this.

3. Should the guidance be limited to certain types of expenses e.g. food?

On the basis of the answer to the question provided above, in particular with respect to what has been said about the guidance provided in para 5.6 of the Draft Code, the FSF believes that the guidance should absolutely be limited to certain types of expenses such as food (not including dining out or takeaways).

The FSF believes that the definition of "relevant expenses" in Regulation 4AE is excessive including as it does any regular or frequently recurring outgoings (with the exception of savings and investments now removed). Entertainment costs as an example are entirely discretionary and can easily be ceased or reduced in order to make a loan repayment affordable.

The FSF suggests that the definition of "listed outgoings" could be further amended to not just delete the reference to savings and investments but to also delete regulation 4AE(d) relating to any regular or frequently recurring outgoings.

Guidance in the Code could then be provided as to what lenders are expected to take account of when determining what exactly constitutes reasonable living expenses.

4. Are there other practices for estimating expenses that the Code should endorse?

With respect to the requirement for lenders to adjust the initial estimate of borrower's likely relevant expenses, the commentary in the Draft Code notes that lenders have the choice of either verifying expenses against evidence or using a benchmark and then notes that if neither of these options is reasonably practicable, they may use a "reasonable cost estimate". Para 5.8.c reiterates the fact that the lender could use a benchmark or a "reasonable cost estimate". The FSF believes that this is helpful clarification.

The FSF is however deeply concerned at the focus being put on estimating a borrower's expenses as being the only means to determining whether the loan will be affordable without substantial hardship.

As the FSF has previously said in this submission, the best predictor of a borrower's ability to meet their commitments under a loan contract is not about "estimating expenses" but through analysing their repayment history. People with a strong history of meeting their commitments, as evidenced through comprehensive credit reporting, and a strong credit score are far more likely to meet their repayment obligations than those with lower credit scores or a poor repayment history. This is a truism for all types of lending and is a key means to determine whether a loan will be repaid and therefore that the loan is affordable.

Comprehensive credit reporting gives a full account of an individual's ability to meet existing commitments including all other debt such as mortgages, credit cards, etc., utilities such as telephone and power etc. It is not a simplistic report, and the data has been built up over a long period of time so that it provides an accurate picture of the way in which the individual meets their payment obligations. The FSF therefore strongly submits that the use of comprehensive credit reporting and assessment of a borrower's credit score must be a practice that is allowed for in determining whether or not the loan is affordable.

5. Is the new wording in the Draft Code on how lenders may apply a reasonable surplus to comply with regulation 4AF(2)(b)(i) relating to changes to expenses clear? If not, how do you suggest it is improved?

The FSF has always had significant issues with the application of surpluses and/or buffers or adjustments.

If the requirements of Regulation 4AK for lenders to do an initial estimate of borrower's likely relevant expenses, and then the requirements of Regulation 4AM for lenders to adjust this initial estimate of borrower's likely expenses have been carried out, the FSF sees no good reason as to why this third step of applying a further surplus or buffer is even necessary.

The FSF understands the concept that the surplus or buffer is required to adequately address the risk that likely income may be overestimated, likely relevant expenses may be underestimated, or the borrower may need to incur other expenses that cause them substantial hardship. However, if income and expenditure have been verified by transactional information, use of a benchmark, completion of a credit check, the use of a "reasonable cost estimate", etc., and the guidance provided in paras 5.16, 5.17 and 5.18 of the Draft Code has been applied, the FSF sees no need for any further surplus or buffer to be applied to determine the loan affordability.

However, the FSF believes that some of this guidance once again demonstrates the lack of understanding of the way in which non-bank consumer lending works and is targeted more at bank lending.

The FSF says this because, with the exception of housing lending undertaken by non-bank lenders, almost all non-bank consumer loans are short-term (less than 5 years) and are provided at a fixed interest rate for the duration of the term of the loan. In other words, the interest rate will not change throughout the term of the loan. Therefore, there is no need to use a single, sensitised interest rate including a buffer or the loan's actual interest rate plus a margin because the interest rate will not change throughout the term of the loan.

On this basis, it should be made clear in the Code that the guidance in paras 5.16 and 5.17 to include a buffer to take into account possible variations in the interest rate, does not apply where the interest rate is fixed for the term of the loan.

The FSF notes that new para 5.19 of the Draft Code states that a lender may not require a reasonable surplus at all if they have already applied an appropriate sensitized interest rate in accordance with para 5.16 and have made appropriate discounts to volatile, irregular, or variable income (if any) in accordance with para 5.18 and has compared most living expenses against statistical benchmarks in accordance with Regulation 4AM(2)(b).

As stated above, the FSF believes that para 5.19 must also make clear that a surplus or buffer is not required to take into account possible interest rate adjustments where such adjustments will not occur – i.e., in cases where the interest rate is fixed for the duration of the loan.

The FSF also suggests that para 5.19(c) should allow for lenders having used transactional banking records to provide an accurate picture of the borrower's income and expenses to not be required to add a further reasonable surplus over and above the borrower's proven income and expenses.

6. Do you have any other proposals for additional guidance on surpluses?

Please see the answer provided to question 5 above.

7. Is the updated guidance and examples on "obvious" affordability helpful? Do the examples represent situations where affordability is obvious? If not, how could they be improved?

The FSF is pleased to see that some change is proposed to the guidance as to when a lender might rely on the exception in Regulation 4AG, particularly the removal of the statement that the use of the exception is intended to be a high test. The fact that lenders are required to report to the Commerce Commission on the number of instances in the past 12 months in which they have relied on this exception in their annual report, and the very tame circumstances outlined in the example provided in the current RLC as to when it might be used, together with the extreme penalties that could be imposed on directors and senior managers if they are found to be in breach of their compliance obligations, provides a very strong disincentive for this exception to be used under any circumstances. This has rendered the exception to be of absolutely no use to lenders whatsoever.

However, the new examples provided in the Draft Code, whilst certainly better examples than the one previous example, do not appear to the FSF to be common circumstances under which lenders might be able to determine that the use of the exception is appropriate and therefore will apply in very few cases, rendering the exception not much more helpful than it was previously.

The FSF goes back to what the 1 December changes were designed to achieve which we understood to be to provide further protection to consumers in vulnerable circumstances from the harm that can be caused by irresponsible lending practices.

The exception allowed under Regulation 4AG is not intended for use when lending to a person who could be deemed to be in more vulnerable circumstances, and nor should it be in the FSF's view. However, there are far more likely circumstances where the exception could be applied to the benefit of both borrower and lender than are described in the 3 new examples in the Draft Code.

As the FSF has previously stated, from members' combined years of experience of assessing credit risk (i.e., the ability of the borrower to meet their repayment commitment), the best possible predictor of this is a person's credit score and previous payment history. The FSF believes that an example that allows for the exception to be used in situations where the borrower has a spotless credit record using comprehensive credit reporting data should also be provided. This is particularly so where the borrower has a strong relationship with the lender built up over time with a good repayment history which currently counts for nothing.

The FSF takes strong issue with the statement in para 5.27 that "For the avoidance of doubt, credit scores and repayment history will not, in themselves, be decisive as to whether affordability is obvious." The FSF believes this demonstrates a complete lack of understanding of the way in which credit risk is assessed to determine the likelihood that a loan is affordable and strongly submits that this statement should be reworded to say: "For the avoidance of doubt, credit scores and repayment history are strong predictors that affordability is obvious."

If a borrower is able to declare to a lender that they will cease or reduce certain discretionary expenses under Regulation 4AK, the FSF does not see any reason why the borrower cannot declare that the previous lending they had with the lender was affordable without substantial hardship and that their circumstances have not changed since that previous lending meaning that any future loan will be affordable without substantial hardship.

This is particularly relevant to FSF members who finance high end vehicles to a loyal customer network of high-net-worth individuals. These people have particularly found the granular dissection of their living expenses to be especially intrusive and the FSF believes that, where a long-established relationship exists, there should be the ability for the lender and the borrower to trust each other sufficiently that use of the exception in 4AG is appropriate.

8. Do you have any other proposals for additional guidance and examples for "obvious" affordability?

The FSF has nothing further to add to what has been said in response to question 7 above.

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

FSF members report that the proposed changes are so minor as to require very little in the way of change to lender systems, with the exception of the removal of the need to take into account savings and investments in their expense calculations. On that basis, the changes could be implemented almost immediately.

The FSF notes, however, that a full report of the investigation carried out on behalf of the Council of Financial Regulators is due to be made to Minister Clark some time this month. Given that the FSF has no overview of what might be recommended in this report, no comment can be made at this point as to whether any further proposed changes might require changes to lender systems that require a longer timeframe to implement.

Final comments:

The need for further review:
As the FSF has strongly expressed throughout the entire process of the CCCFA review resulting in the 1 December changes, the changes were largely unnecessary to protect vulnerable consumers if the existing regime had been adequately enforced.

The FSF has always believed that the principles-based approach of the pre-1 December CCCFA regime allowed lenders to make appropriate lending decisions based on their experience of assessing consumer credit risk that resulted in borrowers being able to access credit when required without putting them into substantial hardship whilst ensuring that lenders took more care when dealing with consumers in vulnerable circumstances as is entirely appropriate.

In the open letter to Minister Clark dated 19 January 2022, the FSF called for the repeal of the affordability regulations 4AF – 4AN in their entirety and a return to the principles-based approach that applied prior to the 1 December changes (including the reinstatement of Principle 9C7 which allowed lenders to rely on information provided by the borrower unless they had grounds to believe the information was unreliable. The FSF still believes very strongly that this is the right way to go to ensure borrowers have access to responsibly provided credit and that vulnerable consumers are adequately protected if this was to be adequately enforced.

The FSF believes that this is what the majority of New Zealand consumers want. The FSF also notes that the Commerce Commission now has more resources to ensure this enforcement and more tools to swiftly and decisively deal with infractions or breaches as they are identified which means that the public can more effectively be protected from harmful lending practices.

The FSF therefore submits that a further comprehensive review of the CCCFA should be carried out once the regime has been in force for 12 months. This should seek the views of all consumers, not just those who may seek the services of a financial mentor and should also consider the impact restricting access to credit has had on the New Zealand economy.

The proposed enforcement approach:
Having completed the answers to the questions posed in the consultation document, the FSF has a question with respect to how it is envisaged that the regulator will enforce the existing (post 1 December) requirements versus the new (post 3 June) requirements given the short space of time between the implementation of the changes in December to the recognition that the regime was not working appropriately. Will they apply the post 3 June requirements to loans written in the period 1 December – 3 June? If not, this seems to be unreasonable given the fact that clearly the regulations from 1 December were problematic.

Application of penalties:
As noted, several times in the above submission the CCCFA changes have brought severe personal penalties into play for senior managers and directors of lenders against which these individuals are unable to insure or indemnify themselves. It is the severity of these

penalties that has, in part, driven the conservative approach taken to the CCCFA changes and the application in particular of the affordability regulations since 1 December – although, having said that, the FSF believes that the regulations are so prescriptive as to leave lenders with no choice but to follow them to the letter.

The FSF has often obtained the impression that any breach of the regime, no matter how small, could attract the most severe penalty against these individuals – for example use of the exception in 4AG in the circumstances described in the answer to question 7 above where a known high net worth individual has been a repeat customer of a high end motor vehicle financier for a number of years, has maintained an impeccable repayment history, has an impeccable credit record and is prepared to declare that there has been no change in their circumstances since their previous loan that may lead to a new loan placing them in substantial hardship. The use of the exception in such circumstances seems to be entirely reasonable to the FSF but it will not be for fear of the application of the penalty regime.

Whilst FSF members would never intentionally breach any of their legal obligations in even the smallest of ways, some clarity from the regulator as to whether they intend to apply some form of proportionate “sliding scale” with respect to the penalties they would apply to breaches (and what that might look like) would provide a measure of reassurance to lenders who, frankly, have been made to be so wary of exercising any level of judgement or discretion at all given the overly prescriptive nature of the CCCFA changes that they are unwilling to assist any prospective borrower who does not “tick all the boxes” – causing the problems for consumers alluded to in the above submission.

Thank you again for the opportunity for the FSF to respond to this consultation on behalf of members. Please do not hesitate to contact me if I can be of any further assistance.

Kind regards,

Lyn McMorran
EXECUTIVE DIRECTOR

APPENDIX A

FSF Membership List as at 1 April 2022

Non-Bank Deposit Takers, Insurance Premium Funders	Vehicle Lenders	Finance Companies/ Diversified Lenders	Finance Companies/ Diversified Lenders cont. Leasing Providers	Credit Reporting, Debt Collection Agencies, Insurance Providers	Affiliate Members
XCEDA (B) Finance Direct Limited ➢ Lending Crowd Gold Band Finance ➢ Loan Co Mutual Credit Finance Credit Unions/Building Societies First Credit Union Nelson Building Society Police and Families Credit Union Steelsands Credit Union Inc Westforce Credit Union Insurance Premium Funders Elantis Premium Funding NZ Ltd Financial Synergy Limited Hunter Premium Funding IQumulate Premium Funding Rothbury Instalment Services	AA Finance Limited Auto Finance Direct Limited BMW Financial Services ➢ Mini ➢ Alphera Financial Services Community Financial Services European Financial Services Go Car Finance Ltd Honda Financial Services Kubota New Zealand Ltd Mercedes-Benz Financial Motor Trade Finance Nissan Financial Services NZ Ltd ➢ Mitsubishi Motors Financial Services ➢ Skyline Car Finance Onyx Finance Limited Toyota Finance NZ Yamaha Motor Finance	Avanti Finance ➢ Branded Financial Basalt Group Basecorp Finance Ltd Blackbird Finance Caterpillar Financial Services NZ Ltd Centracorp Finance 2000 Finance Now ➢ The Warehouse Financial Services ➢ SBS Insurance Future Finance Geneva Finance Harmoney Humm Group Instant Finance ➢ Fair City ➢ My Finance John Deere Financial Latitude Financial Lifestyle Money NZ Ltd Metro Finance Nectar NZ Ltd	NZ Finance Ltd Pepper NZ Limited Personal Loan Corporation Pioneer Finance Prospa NZ Ltd Smith's City Finance Ltd Speirs Finance Group ➢ Speirs Finance ➢ Speirs Corporate & Leasing ➢ Yoogo Fleet Thorn Group Financial Services Ltd Turners Automotive Group ➢ Autosure ➢ East Coast Credit ➢ Oxford Finance UDC Finance Limited Leasing Providers Custom Fleet Fleet Partners NZ Ltd ORIX New Zealand SG Fleet	Baycorp (NZ) ➢ Credit Corp Centrix Collection House Debtworks (NZ) Limited Equifax (prev Veda) Illion (prev Dun & Bradstreet (NZ) Limited Intercoll Quadrant Group (NZ) Limited Credit-related Insurance Providers Protecta Insurance Provident Insurance Corporation Ltd	Buddle Findlay Chapman Tripp Credisense Ltd Credit Sense Pty ltd Experian EY FinTech NZ Finzsoft Happy Prime Consultancy Limited HPD Software Ltd KPMG LexisNexis Motor Trade Association PWC Simpson Western Verifier Australia Total 85 members

APPENDIX B: Key FSF data on lending and contribution to New Zealand society

FINANCIAL SERVICES FEDERATION

The Financial Services Federation (FSF) is the non-profit industry association for responsible and ethical finance, leasing and credit-related insurance providers operating in Aotearoa New Zealand.

47%

Of personal consumer lending in Aotearoa is financed by the non-bank sector represented by FSF members

55% Of loans by FSF members are approved, demonstrating careful consideration of responsible lending

Loan book in arrears

2016 → 5.8%

2021 → 4.4%

8.2B Member's total assets consumer lending

1.7M # of consumer loans of FSF members

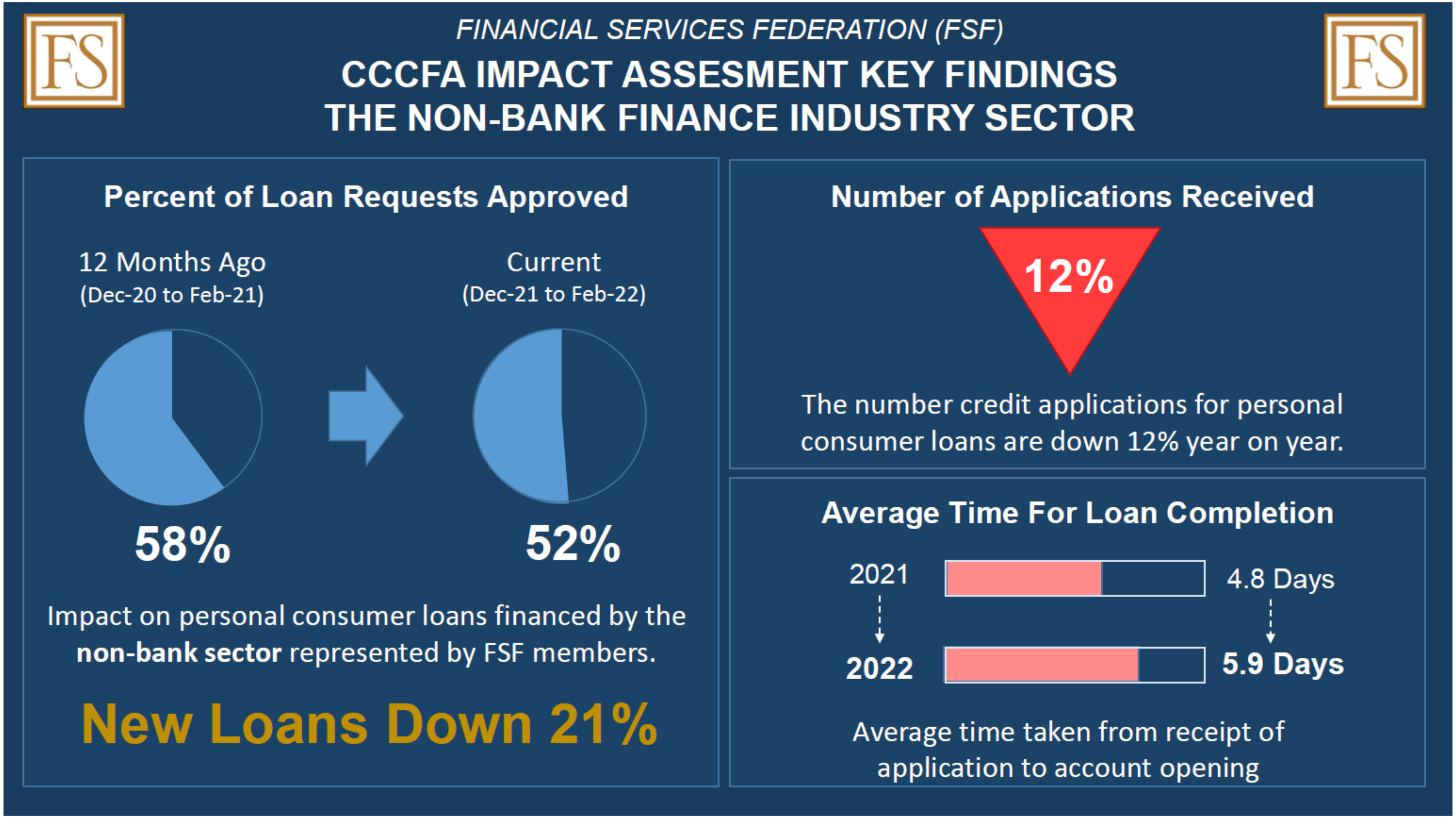
7.2B Member's total assets business lending

219k Business loans helping Kiwi businesses to achieve their goals

4,114 Jobs provided by FSF lending members

Data collected and aggregated by KPMG in FSF's annual member data survey as at February 2021. Values in NZ$.

APPENDIX C: CCCFA Impact Assessment: Key Findings for the non-bank finance sector



Verbatim comments from FSF members with respect to their customers' experience with the CCCFA changes

- "The average time taken from receipt of application to opening an account has increased from an average of 30 minutes to 90 minutes. Some customers need to return with supporting documentation from banks, some of which are closed on some days of the week, or they need to travel to another town or city, as they don't have internet banking options. There is a much longer turnaround on approval and this is time consuming for staff and customers, resulting in some frustration indicating that it was not a good experience after a very lengthy lending relationship. e.g., some decades."

- "We kept a record of the loans we would have written prior to 1 December that due to changes in the affordability we did not write. A fair portion of these were existing clients with a good payment history. Thus, the volume of loans written over this period was down 24%."

- "Employee morale is down due to reaction from clients being declined that have received loans for decades."

- "Added Security to the branches, increase in aggression from clients due to wait time and declines."

- "Declining existing customers with a perfect payment history, who can afford the loan and are a good credit risk has been one of the real demoralising aspects of the CCCFA changes. The added time it takes has added cost to our business and made the experience worse for the consumer. This will lead to the cost needing to be passed on. The extra scrutiny delving into some very personal behaviours is a step too far as well."

- "Implying that a customer will continue to spend like they have once they have taken out a loan does not make sense and judging them on their recent statements is actually short-sighted, rather than informing."

- "We regularly receive feedback around an intrusive questioning regime. The deep dive into clients' expenditure, that have long established history, has caused further relationship harm. These clients, in general, demonstrate as a good credit risk and ability to service when considering such aspects as Income, asset base, credit score/report, and past performance. The deep dive is an inference that the loan is considered unaffordable when key areas of assessment demonstrate otherwise. The clients consider the process as confronting."

- “Total applications continue to tail off with clients moving to other forms of credit such as BNPL that are not subject to the same assessment requirements. These have proven harmful as some clients have repayment obligations that can be a significant portion of their net income.”

- “Recent customer feedback includes comments such as: it takes too long, why do you need all this information when I’ve been a good customer for years, I can clearly afford the loan so why do I have to supply so much information, there is too much back and forth to clarify information, invasive nature of request.”

- “The new regulations (and extra requirements) have had a significant impact on the customer on-boarding experience. The extra income and expense verification requirements are stretching our resource levels and the longer it is taking to approve a loan is having a negative impact on customers.”

- “The regulations are also impacting our higher credit quality customers more than our lower credit quality customers. Our withdrawal rates for lower credit quality customers have remained in line with historical trends, where our withdrawal rates for higher credit quality customers have increased. This seems to be in contrast to what the regulations were aiming to achieve.”

- “There has been an increased number of customers in declines by affordability that want to know exactly why they are being declined, noting that they have had no problem being approved in the past.”

- “Customers claim they paid off many loan facilities over time without issue and truly believe they can afford the repayments on their loans.”

  “The stress and pressure put on the lending team and managers has taken a toll due to a combination of increased applications, increased time to assess/revisits, increased declines/withdrawals, fear of personal fines when we have lost customers to what we see as non-compliant lenders over this period, missing budgets as a result all have individuals within the team questioning their future in the industry. All things we as an industry communicated prior to December 1st.”

APPENDIX E: Consumer resource "Changes to consumer lending and how it affects you", published by the FSF and NZBA prior to 1 December 2021

Changes to consumer lending and how it affects you

Laws around lending money to consumers in New Zealand have changed and it may take you longer when you borrow. It's important to know how these changes affect you and what to expect as a borrower. This information has been put together for you by the Financial Services Federation and the New Zealand Bankers' Association.

Who is this information for?

This information is to help you, as a consumer, understand how and why your experience when borrowing money (including getting a loan or credit card) from a finance company or bank might look and feel a little different from now on.

Why have things changed?

The government has made some changes to how money is lent to consumers in New Zealand to help protect you against unaffordable debt.

The changes mean it may take you longer when you borrow because lenders will need to take extra steps to make sure it's not difficult for you to pay back a loan.

Whether you're borrowing from a new lender to buy a dishwasher, a return customer upgrading your car on finance, getting a home loan, or extending your credit card limit, these new requirements could affect you. The changes apply to both new consumer lending and changes to existing lending.

If a lender isn't asking you detailed questions about your financial situation, they may not be following the law.

What are the changes?

From 1 December 2021, your lender can no longer entirely rely on information you provide at face value. They now need to collect extra information from you and check the information is correct. This means:

- You will need to provide your lender detailed information about your financial situation, including your income, debts, and expenses. Lenders may ask for documents showing your recent transaction history, or other information that allows them to verify your debts and expenses.
- The credit application process may seem longer and more involved, even if you are only applying for a small loan or a top up to existing credit.
- You may find that some lending, which was previously considered responsible, will no longer be approved. This may be because of the more detailed expense information you need to provide, which shows a clearer picture of whether you can easily repay the loan. It might also be because of new requirements on lenders to ensure reasonable surpluses or buffers when checking that you can afford the loan.
- See the Commerce Commission or Ministry of Business, Innovation and Employment websites for other changes you may expect from the new process.

Responsibilities as a consumer

There are two players in getting a loan — a lender and a borrower. It is important that you as a borrower:

- Act honestly and provide full and accurate information when entering a credit contract.
- Check the lending is right for you, and affordable, and suitable for your circumstances before you go ahead.
- Read and understand the contract terms and conditions, ask if you do not understand the contract, and keep a copy of it.
- Contact your lender if your circumstances change or something needs updating.
- Contact your lender or a financial mentor as soon as possible if something goes wrong, so they can provide help and discuss options.

Legal stuff: What legislation has changed?

The Credit Contracts and Consumer Finance Act 2003 or 'CCCFA' requires all lenders who enter into 'consumer credit contracts' in New Zealand to take necessary steps to lend responsibly, including checking that lending is suitable and affordable.

Anyone found to be breaking this law could be taken to court by the Commerce Commission, which enforces those lending laws.

The CCCFA was reviewed in 2019 to include stricter rules around how lenders must make their decisions to lend, to help further protect consumers from unaffordable debt.

The changes to the CCCFA were included in the Credit Contracts Legislation Amendment Act, new Regulations under the CCCFA, and the updated Responsible Lending Code. Most of these changes came into effect on 1 December 2021.

What if you're declined?

If a lender has declined your loan application, it's because they don't believe it would be responsible to provide you with debt that may not be suitable for you, or that you may not be able to repay it.

Sometimes it's hard to step back from your own finances and see the big picture. When you feel like this, it's important to talk to someone independent — not another lender. MoneyTalks is a free and confidential financial helpline that can connect you with financial mentors and other community services.

MoneyTalks.co.nz

Email: help@moneytalks.co.nz
www.MoneyTalks.co.nz

Making a complaint

If you believe things have gone wrong with your credit contract, and talking to your lender doesn't help, you can make a complaint to an independent and free dispute resolution scheme:

Banking Ombudsman Scheme
0800 805 950
help@bankomb.org.nz
www.bankomb.org.nz

Insurance & Financial Services Ombudsman Scheme (IFSO)
0800 888 202
info@ifso.nz
www.ifso.nz

Financial Services Complaints Ltd (FSCL)
0800 347 257
complaints@fscl.org.nz
www.fscl.org.nz

Financial Dispute Resolution Service (FDRS)
0508 337 337
enquiries@fdrs.org.nz
www.fdrs.org.nz

Produced by the Financial Services Federation Inc (FSF) with support from the New Zealand Bankers' Association (NZBA)

FINANCIAL SERVICES FEDERATION

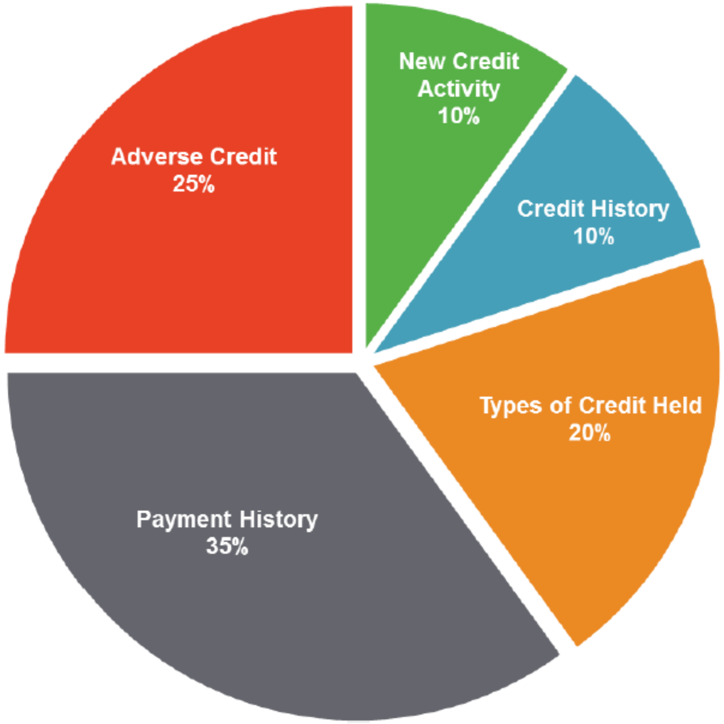
www.fsf.org.nz FinancialServicesFederation

NEW ZEALAND BANKERS ASSOCIATION

www.nzba.org.nz

APPENDIX F: Data by Centrix outlining the degree to which a person's credit score predicts the likelihood of payment default in the next 12 months.

What is in the Centrix credit score?



- Key contributing factors of the Centrix credit score (Gen2).
- New credit activity: the number of previous enquiries and new accounts opened.
- Credit history: how long has the borrower's credit accounts been established.
- Types of credit held: what products the borrower uses e.g. mortgages, cards, BNPL, loans, telco & utilities.
- Payment history: has the borrower made payments on time during the last 2 years.
- Adverse credit: any credit defaults, court judgments and insolvencies on file.

Commercial in Confidence

CENTRIX

Default risk relationship by score

Centrix Score	Good/Bad Odds	Default Risk
80	0.1	94%
160	0.1	89%
240	0.3	80%
320	0.5	67%
400	1	50%
480	2	33%
560	4	20%
640	8	11%
720	16	6%
800	32	3%
880	64	2%
960	128	1%

- The Centrix score is a highly predictive forward looking risk score.
- Predicts the likelihood of payment default in next 12 months. I.e. 'good' or 'bad' payer.
- Payment default being defined as:

  Any credit account that is at least 60 days past due or if an adverse credit event occurred (e.g. defaults or judgment) during the outcome period.
- Score in 0 to 1000 range.
- Score of 400 represents Good/Bad odds of 1:1. Risk odds doubles every 80 points.

13.33 x 7.50 in

CENTRIX

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