23 December 2014

Responsible Lending Code
Competition and Consumer Policy Team
Ministry of Business, Innovation and Employment
PO Box 3705
Wellington 6140

By email: consumer@mbie.govt.nz

SUBMISSION on the
Draft Responsible Lending Code

Introduction

1. Thank you for the opportunity to make a submission on the draft Responsible Lending Code (Code). This submission is from Consumer NZ, New Zealand's leading consumer organisation. It has an acknowledged and respected reputation for independence and fairness as a provider of impartial and comprehensive consumer information and advice.

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General comments

2. We are pleased to see the Code contains clear direction for lenders who advertise "interest free" credit, "no credit checks" and "bad credit history –ok". In particular, we support the prohibitions contained in paragraph 3.5 and 3.6.

3. We are also pleased to see the more detailed requirements for high-cost short-term credit agreements that are set out throughout the Code.

4. However, we are disappointed the Code does not provide greater direction to lenders. In many areas, it allows lenders wide discretion on how to give effect to the responsible lending principles. We're concerned this will result in lenders developing their own approach, weakening consumer protection and creating uncertainty for both lenders and borrowers.

5. We are also disappointed with the small number of examples in the Code. Examples provide a useful illustration to lenders on how to apply the responsible lending principles in specific situations. By providing further examples, lenders and borrowers would have a better understanding of the Code's practical application.

6. Given the short time frame for making submissions, we have not answered every question but have outlined below our main areas of concern.

Lender discretion

7. The introductory commentary to the Code (pp2-4) states lenders can make their own "judgment" about the number of inquiries they make, the extent of information sought, and the assistance provided for any given transaction. We consider this level of discretion is problematic.

8. In our view, there should be a set of base requirements that apply to every credit agreement and every lender. If additional protections are required for particular types of lending, these should be specified. This approach would provide greater certainty as lenders would have a clear understanding of what is expected of them.

Record keeping

9. The Code requires lenders to make and keep records of how they apply the guidance (paragraph 2.9). However, this requirement is substantially diluted by the Code stating, in a number of places, that records may be in the form of "compliance policies" (for example, paragraphs 2.9(b), 4.10(c)(ii), 5.16(c)(ii)).

10. We agree lenders should have compliance policies but we do not consider this is sufficient. The existence of a policy cannot be assumed to be evidence of compliance with that policy. In our view, a responsible lender should be able to refer to its records to justify or re-assess any lending decision. Lenders who merely keep compliance policies will not be able to do this.

11. The recent Australian case of *ASIC v The Cash Store Pty Ltd*[1] emphasises the importance of accurate and complete record keeping by lenders. In that case, the court found the lender was using a checklist to assess loan applications. Evidence indicated the form was being treated as "a mere box ticking exercise".

Advertising

12. The guidance in paragraph 3.2(b) states a lender should only use fine print to elaborate on the main selling message, not to contradict it. We believe the Code should make it clear that lenders should not use fine print to qualify the main selling message. This is particularly important following the decision in the *Cavalier Bremworth*[2] case.

13. The guidance in paragraph 3.4(b) states lenders should display with "equal prominence" an annual percentage interest rate and whether that rate is variable. We believe the guidance should also state that upfront fees should be displayed as prominently as the interest rate.

14. We agree that lenders should be required to include a prominent risk warning for high-cost short-term credit agreements. However, the risk warning in paragraph 3.7(a) is too narrow as it only requires a warning this type of credit "should not be used for long-term borrowing and is suitable only to improve short-term cash flows". It is equally important that borrowers are warned about the high cost of this type of credit, including the high costs associated with failing to meet repayments under such an agreement.

[1] [2014] FCA 926

[2] *Godfrey Hirst NZ Limited v Cavalier Bremworth Limited* [2014] NZCA 418

Inquiries into and assessment of borrower's requirements and objectives

15. We consider the inquiries listed in paragraph 4.1 should be mandatory for all credit agreements, not just high-cost short-term credit agreements. We do not think there are any circumstances in which a lender should not be required to make these inquiries, particularly given they are not particularly onerous.

Substantial hardship

16. Of the options presented in paragraph 5.1, we prefer option 2 as it acknowledges borrowers should not be put in a position where they will have to borrow further or realise security or assets to repay a debt. However, we think the wording of this paragraph could be improved. We suggest the following alternative:

> *In assessing "substantial hardship", a lender should consider whether it is likely the borrower will make the repayments under the agreement:*
> *(a) on time;*
> *(b) out of income;*
> *(c) while continuing to meet other financial commitments; and*
> *(d) without undue difficulties, including without having to borrow to meet the repayments and without having to realise security or assets.*

17. This suggested alternative uses some of the concepts from paragraph 5.3.1 of the UK Financial Conduct Authority Consumer Credit Sourcebook.

Assisting borrowers to make an informed decision

18. We are concerned that paragraph 7 of the draft Code appears to treat disclosure of information as sufficient to meet lenders' obligations to assist borrowers to make informed decisions. In our view, responsible lending requires more than informing the borrower of key features of credit products or agreements; it requires lenders to actively help borrowers understand the agreements they are signing.

19. We remain concerned about the absence of a requirement for verbal disclosure. Paragraph 7.11 envisages online and mail applications for credit "without any oral interaction between the lender and the borrower." We think there should be oral disclosure by the lender to help ensure the borrower understands the agreement. This obligation should apply whether the application is made remotely or in person.

20. If oral disclosure is not provided for in the Code, we consider there should be a requirement for email or written communication between the parties prior to an agreement being signed. The purpose of this exchange should be to assist the borrower make an informed decision about the agreement.

21. We are also concerned about the limited guidance in paragraph 7.15. The paragraph states a lender should take "further steps" to assist the borrower where it's evident the borrower has not understood key features of the agreement. However, the Code does not provide direction on what this may involve, suggesting only that the lender recommends to the borrower they seek legal or consumer advice. It's possible lenders may use this as a substitute for taking any further steps themselves.

22. If a lender enters into an agreement where it is aware the borrower has not understood the key terms, the agreement would be open to challenge under Part 5 of the Credit Contracts and Consumer Finance Act. At a minimum, the Code should draw lenders attention to the fact a decision to lend in this situation would breach their legal obligations.

Subsequent dealings

23. As mentioned above, we support the use of examples in the Code. However, we do not think that the example set out after paragraph 11.11 demonstrates a satisfactory process for extending a home loan by $100,000. In our view, the example should also mention the lender undertaking a sensitivity analysis (as is required under paragraph 5.15) and the lender checking the borrower's understanding of the loan top-up.

Fees

24. We are disappointed that the Code does not contain more guidance on fees. We are aware the appeal in the *Sportzone/MTF*[3] case may have made this difficult. However, we believe the Code should set out the specific types of fees that may reasonably be expected to be included in a credit agreement.

25. In addition, we believe the Code should set out the types of administrative costs that may be taken into account when calculating a fee, and the costs which should not be included in the calculation. For an administrative cost to be recoverable, it should be directly related to the credit agreement. For example, advertising costs are not directly related to a credit agreement so should not be recoverable under the agreement.

26. Priority needs to be given to amending this part of the Code when the *Sportzone* case is concluded.

Default and other problems

27. We would like the Code to include more detail on lenders' complaints processes. We are aware some complaints take months to resolve or to reach "deadlock" before they can be referred to an external disputes scheme. The Code should set out best practice for the operation of lenders' internal complaints processes, including timeframes for responding to complaints.

Thank you for the opportunity to make a submission on the Code. If you require any further information, please do not hesitate to contact me.

Yours sincerely

Sue Chetwin
Chief Executive

[3] *Commerce Commission v Sportzone/MTF* [2013] NZHC 2531