

15 August 2014

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

Emailed to: consumer@mbie.govt.nz

To Whom It May Concern,

Submission on Responsible Lending Code Discussion Document

1. Thank you for the opportunity to comment on MBIE's development of the Responsible Lending Code ("the Code"). We apologise for the lateness of our submission and thank MBIE for allowing us an extension of time. We provide this submission on behalf of the Members of the Insurance Council of New Zealand ("ICNZ").
2. Our submission is limited to the application of the Code to insurance products. We have summarised our submission below. Please feel free to contact us directly if you have any questions or require further information.
3. As a preliminary point, we note that the Act (and the Code) apply to two broad classes of insurance products: (i) insurance over secured property (or leased goods) and shortfall insurance ("**Asset Insurance**") and (ii) consumer credit insurance ("**CCI**")¹. We note that the Act contemplates different provisions in the Code for particular classes of agreements². Accordingly, aspects of this submission address CCI and Asset Insurance separately.

¹ CCCFA, section 5.

² CCCFA, section 9F(2).

Summary of our submission

4. A core aim of the *Credit Contracts and Consumer Finance Act 2003* (“the Act”) amendments is to provide improved protection for vulnerable consumers.³ Credit-related insurance exists to protect consumers who might be cast into a vulnerable position because of an unexpected event, such as an accident, illness, redundancy (in the case of CCI) or loss or damage to goods which are purchased on credit (in the case of Asset Insurance). To this end, our overarching submission is that:
 - any proposed regulation of credit-related insurance should encourage an efficient and effective market for credit-related insurance, and
 - if the application of the Code in respect of credit-related insurance is too onerous, it will impair lenders’ ability to approve loans and thereby unduly restrict consumer choice for both credit contracts and insurance.
5. Our submission is structured as follows. First, we provide a brief description of ICNZ and who ICNZ represents.
6. Second, we distinguish two broad classes of credit-related insurance, and submit that the Code should treat those two classes of credit-related insurance differently.
7. Third, we raise an issue of concern for our Members that was not raised in the Discussion Document. The issue is how repayment waivers will be treated under the Code. We submit that repayment waivers and consumer credit insurance must be treated equally under the Code.
8. Fourth, we discuss the advertising of credit-related insurance. We support MBIE’s comment that referring to existing advertising standards in the Code will help to maintain a consistent framework for a lender’s advertising obligations.
9. Fifth, we discuss the assistance lenders should give consumers to help consumers make informed decisions about credit-related insurance. We submit that lenders should not have to give financial advice to comply with the lender responsibility principles.
10. Sixth, we discuss what a lender must do to satisfy itself that credit-related insurance meets the consumers’ requirement and objectives and can be repaid without causing substantial hardship to the consumer.
11. Seventh, we discuss the lenders’ commission for arranging credit-related insurance. We submit that it would be arbitrary to delineate an amount of commission that is “reasonable” from an amount of commission that is “unreasonable”.

³ From the explanatory note to the Credit Contracts and Financial Services Law Reform Bill, noted at paragraph 4 of the Responsible Lending Code Discussion Document.

12. Finally, we note that a lender can manage the conflict between receiving commission and fulfilling its obligations to the borrower by observing the requirements of the Act and by having clear guidance on what the lender must be satisfied of to ensure that insurance is likely to meet the borrower's needs and objectives and can be repaid without causing substantial hardship to the borrower.

About ICNZ

13. ICNZ is the industry representative for fire and general insurers in New Zealand. We aim to assist our members in the key areas that affect their business through effective advocacy and communication.
14. ICNZ currently has 29 members who collectively write more than 95 percent of all fire and general insurance in New Zealand. ICNZ members, both insurers and reinsurers, make up a significant part of the New Zealand financial services system. ICNZ members currently protect more than half a trillion dollars' worth of New Zealanders' assets.
15. ICNZ plays an active role in representing the insurance industry. Our members are licensed under the *Insurance (Prudential Supervision) Act 2010* ("IPSA") and are signatories to the Fair Insurance Code, which requires our members to act ethically. We also perform an important role in informing and educating consumers about key insurance issues and risks.

Distinction between CCI and Asset Insurance

16. As noted above, the definition of "credit-related insurance" (which is embedded into the definition of "relevant insurance contract" for the purposes of the Code⁴) under the Act encompasses both Asset Insurance and CCI. The nature of Asset Insurance and CCI are very distinct. For example:
 - the suitability of Asset Insurance (which insures assets against uncertain events) is linked to the applicable asset, whereas the suitability of CCI (which insures the borrower's ability to make payments under the relevant contract) is linked to the circumstances of the borrower; and
 - the concerns that have arisen in other jurisdictions relating to CCI (such as consumers in the UK being required or advised to take out CCI which is not suitable for their circumstances) have not arisen in respect of Asset Insurance. Indeed, in respect of Asset Insurance, it is imperative to the lender to ensure that the Asset Insurance is appropriate for the secured asset, in order to ensure that the secured asset is appropriately insured.

⁴ CCCFA, section 9B.

17. Therefore, as detailed below, we submit that CCI and Asset Insurance should be treated differently for the purposes of the Code. We note that different provisions of the Code for different classes of agreements is contemplated and permitted under the Act.⁵

Repayment waivers and consumer credit insurance must be treated equally under the Code

18. We submit that repayment waivers and consumer credit insurance (one of the types of “credit-related insurance” as defined under section 5 of the Act) must be treated equally under the Code.
19. A repayment waiver is an agreement between the lender and borrower where the lender agrees to waive its right to pursue the borrower for amounts payable under a credit contract when the borrower defaults on payments because of sickness, disability, injury, unemployment or death. In doing so, the lender accepts the financial risk of the borrower’s default. The borrower pays “additional consideration” (a premium) to the lender for this waiver agreement.
20. We understand that lenders charge a similar amount of premium for a repayment waiver agreement as is charged for a retail consumer credit insurance premium.
21. Repayment waiver agreements and consumer credit insurance are, in substance, homogenous financial products.
22. Further, we note that the legislation treats these products as homogenous. We note that:
- The definitions of “repayment waiver” and “consumer credit insurance” under section 5 of the Act are almost identical.
 - Repayment waivers and consumer credit insurance are subject to the same restrictions on sale and disclosure requirements as consumer credit insurance under sections 69 and 70 of the Act.
 - If a credit agreement involves a repayment waiver, the repayment waiver is to be treated as part of the credit agreement for the purposes of the lender’s responsibilities in part 1A of the Act.⁶ The lender must therefore take care to ensure that a repayment waiver meets the borrower’s requirements and objectives and would not create substantial hardship, and to assist the borrower to make an informed decision about how to manage the risk of defaulting on the agreement, including by ensuring that any advertising and information is not misleading, deceptive or confusing.
23. Because repayment waivers and consumer credit insurance are homogenous in substance and in their treatment under the Act, we submit that there should be no disparity

⁵ CCCFA, section 9F(2).

⁶ Under section 9B(4) of the *Credit Contracts and Consumer Finance Amendment Act 2014*.

between the Code's treatment of repayment waivers and the Code's treatment of consumer credit insurance.

Advertising of credit-related insurance

24. We note paragraphs 40 to 57 of the Discussion Document and, in particular question 24: "how do/should responsible lenders ensure that any advertising of credit-related insurance products distributed by the lender is not misleading, deceptive or confusing?"
25. We note the existing framework of advertising standards in the lenders responsibility principles, the Fair Trading Act, the Advertising Standards Authority's Code for Financial Advertising and the Financial Markets Conduct Act 2013 ("FMCA"). In addition, recent amendments to the FTA and new obligations in respect of financial products and services (including insurance) under the FMCA have increased the controls on unsubstantiated representations, with a requirement that all claims in advertising must be substantiated at the time that they are made.
26. We submit that the Code should refer to the existing framework of advertising standards for credit-related insurance, rather than develop a new set of standards, because:
 - credit-related insurance is minimally advertised
 - there is no evidence of a problem with advertising of credit-related insurance, and
 - creating a new standard runs the risk of creating a double standard with the existing framework of advertising standards.
27. Credit-related insurance products that are underwritten by our Members are not actively advertised to consumers. A lender might incorporate the details of a credit-related insurance product within broader advertising to the consumer about the finance available, but any reference to credit-related insurance in this advertising is minimal.
28. Credit-related insurance is not so much "advertised" as available at point of sale. The lender will draw the consumer's attention to the insurance product, its key benefits and its limits. Some Members currently use standardised sales aides or brochures to assist their point of sale description to the consumer about the credit-related insurance product. These aides are prepared by or in consultation with the insurer, and summarise the insurance cover available by listing (and sometimes briefly explaining) the key events that trigger cover under the policy wording and the key exclusions to cover under the policy wording.
29. We are not aware of any other advertising of credit-related insurance that could potentially be misleading or that is targeted at consumers with particular characteristics, as per the issues raised in the Discussion Document.

30. We support MBIE's comment at paragraph 55 of the Discussion Document that referring to existing advertising standards in the Code will help to maintain a consistent framework for a lender's advertising obligations.
31. As credit-related insurance is largely not advertised to consumers to the extent that finance is advertised to consumers, and as we are not aware of any issues that consumers have with the material surrounding the sale of credit-related insurance, we do not see a need for more specific Code standards about advertising for credit-related insurance.

Assisting informed decisions

32. We note paragraphs 58 to 82 of the Discussion Document and, in particular, question 23: what information do/should responsible lenders give a borrower to assist them to make an informed decision on credit-related insurance?
33. We submit:
 - Lenders should not have to give financial advice to comply with the lender responsibility principles.
 - Lenders should provide written information to assist borrowers to make informed decisions.
 - Lenders could provide a scripted oral explanation of the contents of the written information if the consumer needs more assistance.
 - If a consumer does not fully understand the written or oral information provided by the lender, the lender should advise the consumer to contact the insurer directly and/or seek independent financial or legal advice.

Lenders should not have to give financial advice

34. We agree with the comment in paragraph 102 of the Discussion Document that the Code should guide lenders on how to assess whether credit-related insurance meets the borrower's needs. However, we disagree with the statement in paragraph 103 that "an assessment as to whether...any credit-related insurance likely meets the borrower's requirements and objectives may involve giving personalised advice that is regulated under the FAA [*Financial Advisers Act 2008*]."⁷
35. We strongly submit that the drafter of the Code must take care to ensure that guidance provided to lenders in the Code should not require lenders to give financial advice. The FAA sets out a detailed framework that governs how financial advice is provided. The related registration regime is set out in the Financial Service Providers (Registration and

⁷ Paragraph 103 of the Discussion Document at page 25.

Dispute Resolution) Act 2008 (“FSPA”). It is very important that the obligations under the Code do not require lenders to provide financial advice to borrowers, so that the Code does not overlap or present inconsistencies with the FAA and FSPA. In our view, a financial adviser’s obligations and a lender’s responsibilities are distinct, and should remain distinct.

Financial adviser obligations and lender responsibilities are distinct

36. A person gives financial advice under the FAA when that person makes a recommendation or gives an opinion about acquiring or disposing of a financial product. This includes a recommendation or an opinion to refrain from acquiring or disposing of a financial product. A contract of insurance is a financial product. A person does not give financial advice if that person merely provides information about a financial product or recommends that a person consult a financial adviser.⁸
37. The lender responsibility principles require a lender to “make reasonable inquiries, before the contract is entered into, **so as to be satisfied** that it is likely that [the insurance meets the borrower’s needs]” (our emphasis). The wording of this principle clearly requires the lender to make reasonable inquiries to satisfy itself, not the borrower, that the insurance meets the borrower’s needs.
38. This distinction is important. If a lender must satisfy the borrower that the insurance meets the borrower’s needs, then the lender would have to give the borrower financial advice regulated under the FAA as outlined at paragraph 36 above. There is a serious risk that lenders and their staff would not become financial advisers because of the additional cost and compliance requirements. This would have a serious negative impact on the credit market and the credit-related insurance market.
39. Alternatively, if a lender must only satisfy itself that the insurance meets the borrower’s needs, then the lender’s responsibility would be met, and the outcome for the consumer would be the same: consumers would not be sold credit-related insurance products that do not meet their needs. This outcome would be achieved without the additional cost and compliance requirements involved in having to register and be regulated as a financial adviser.
40. In our view, it is not the intention of the Act to force lenders to comply with the FAA just to meet their responsibilities as a lender. We submit that lenders can assist borrowers to make informed decisions without giving financial advice.

⁸ Sections 5 and 10 of the *Financial Advisers Act 2008*.

How can a lender assist a consumer to make an informed decision about credit-related insurance?

41. The best way a lender can assist a consumer to make an informed decision about credit-related insurance is to ensure a copy of the insurance policy wording and any other relevant documents, such as summaries of cover and policy schedules, are provided at point of sale. We note that lenders must provide a copy of the terms of credit-related insurance on the day the insurance is arranged under the amended section 70 of the Act.
42. We agree with MBIE's statement at paragraph 55 of the Discussion Document that written disclosure may not always be an effective way for all consumers to understand the full implications of a credit-related insurance agreement. However, we also draw on our comments about financial advice above and submit that it is not the lender's duty to go so far as to provide advice to the consumer about the product.
43. Our Members support the use of sales scripts along the lines recommended by ASIC if an oral explanation of the credit-related insurance product is required. We submit that the Code could provide for lenders to develop a script that explains certain key information about the credit-related insurance product, including:
 - that the insurance is optional (if the insurance is optional)
 - the key benefits and limits of the policy, and
 - the total cost of the insurance premium.The script may need to be tailored to CCI and Asset Insurance.
44. We note that some of our Members are already developing this scripting to assist lenders and consumers at point of sale.
45. We note that it is an industry standard practice for insurance contracts to include a cooling-off period. The cooling-off period is generally 30 days. In the context of credit-related insurance, if a consumer has not understood the written and oral information provided by the lender, they are able to seek advice during the cooling-off period, and cancel the policy without penalty if the advice is that the policy is unsuitable for their needs.
46. We submit that if the consumer has not understood the written and oral information provided at point of sale, then the lender's Code obligation should be to point out any cooling-off period in the insurance contract, and refer the consumer to the insurer, or to independent financial or legal advice for further clarification.

What must a lender do to satisfy itself that credit-related insurance meets the consumers' requirements and objectives and can be repaid without causing substantial hardship to the consumer?

47. We note paragraph 86 of the Discussion Document and submit that the Code should include clear guidance about the practices and procedures that a lender should follow to be satisfied that credit-related insurance meets the consumers' requirements and objectives and can be repaid without causing substantial hardship to the consumer. We submit that this guidance could be in the form of a checklist. We would welcome the opportunity to work with MBIE to develop a suitable checklist. Our initial comments are that:
- the checklist would need to be appropriate to the particular type of insurance (i.e. Asset Insurance or CCI). For example, as a borrower's objective in respect of Asset Insurance is simply to insure the secured asset, a lender's responsibility to make reasonable inquiries so as to be satisfied that it is likely Asset Insurance meets the borrower's requirements, is satisfied by the lender ensuring that the Asset Insurance covers the secured asset; and
 - in practice the criterion that a lender must make reasonable inquiries so as to be satisfied that it is likely the borrower will make payments under the contract without suffering substantial hardship could be dealt with under the lender's general obligation to ensure the underlying credit contract will not put the borrower into substantial hardship under the lender responsibility in section 9C(3)(a)(ii), by ensuring that the insurance premium is included in the total amount to be repaid under the loan (if that is the case).

Response to question 54: what is a reasonable amount of commission for a lender in relation to credit-related insurance?

48. We are agnostic about whether it is possible to identify a particular amount of commission that is "reasonable". Further, we submit that it would be arbitrary to delineate an amount of commission that is "reasonable" from an amount of commission that is "unreasonable". Levels of commission are matter of commercial prudence for a lender, and are best determined by market forces and informed agreement between lenders and consumers.
49. We note the main consumer "harm" regarding commissions for credit-related insurance is that if the lender receives commission, the lender is under a conflict of interest. The conflict is between receiving commission and fulfilling the lender's responsibilities to the consumer. In our view, that conflict exists regardless of the amount of commission in question.

50. Regardless, we submit that the conflict is already managed effectively under sections 45(6) and 9C(5) of the Act.
51. Further, we submit that issues of reasonableness could be addressed by requiring transparency of disclosure of commissions to the insured. It is, after all, the insured who ought to be protected from potentially unreasonable commissions, and disclosure would be a sensible way of informing the insured so that the insured can assess how reasonable commissions are.

Managing conflicts of interest

52. We note question 35 of the Discussion Document. The lender's responsibilities under section 9C(5) of the Act are unqualified. The lender must take steps to help ensure that the insurance meets the borrowers' needs and that repayments will not cause substantial hardship to the consumer. These requirements are independent of considerations about commission. If a lender trades off fulfilling their responsibilities to the borrower in favour of earning a commission, the lender runs the risk of breaching the Act. In our view a lender would not run the risk of breaching the provisions of the Act in favour of earning commission.
53. We submit that the development of a checklist of what a lender needs to be satisfied that credit-related insurance meets the consumers' needs and that repayments will not cause substantial hardship to the consumer (as discussed in paragraph 47 above) would also help lenders to manage the conflict of interest.
54. Sections 45(6) and 9C(5) of the Act underscore the need for freedom of choice for consumers and informed decision-making by consumers. If the consumer has the option of arranging insurance elsewhere, the consumer can shop for comparable insurance products and, if they find a more suitable product, can exercise their cancellation rights under the insurance contract arranged by the lender during the relevant cooling-off period.
55. If the customer does not have the option of insuring elsewhere because the lender requires the customer to use a particular insurer, then the lender cannot charge commission under sections 45(6)(a) and (b) of the Act.

Concluding remarks

56. If you have any questions or require any further information from us, please contact us by emailing nick@icnz.org.nz or by phoning (04) 495 8008.

57. Thank you again for the opportunity to submit. We look forward to the first draft of the Code in October/November 2014.

Yours sincerely,

Handwritten signature of Tim Grafton in black ink, featuring a stylized 'T' and 'G'.

Tim Grafton
Chief Executive

Handwritten signature of Nick Mereu in blue ink, featuring a stylized 'N' and 'M'.

Nick Mereu
Legal Counsel