

Submission

to the

Commerce Commission

on the

Due diligence duties for directors and senior managers – Draft for consultation

19 March 2021

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following seventeen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Commerce Commission on its draft guidance: Due diligence duties for directors and senior managers (**Guidance**). NZBA commends the work that has gone into developing the Guidance.

Contact details

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

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General

5. NZBA is supportive of the Guidance, and considers that, overall, the Commerce Commission has struck an appropriate balance of providing helpful guidance, while remaining broad enough to apply to a wide audience of lenders.
6. We provide high-level substantive comments below. Specific drafting comments are provided in the appendix.
7. We would welcome the opportunity to further discuss our comments and suggestions with the Commerce Commission, and look forward to further engagement on the Guidance.

Substantive comments

8. NZBA considers:
 - (a) the Guidance should differentiate between the respective roles and due diligence duties of directors, senior managers and lenders;
 - (b) greater emphasis is needed regarding the requisite level of organisational influence to be deemed a senior manager, particularly in the context of a large organisation;
 - (c) the Guidance should recognise that it will not always be possible for a lender to promptly stop using a deficient system, and provide guidance for lenders finding themselves in this situation; and
 - (d) the Guidance should further reflect and endorse lenders' pre-existing risk assessment processes as a way to fulfil the duty to employ reasonable methods to identify any deficiencies in a lender's systems and procedures.

The Guidance should differentiate between the respective roles and due diligence duties of directors, senior managers and lenders

9. The Guidance should recognise that directors and senior managers perform different roles, meaning they will exercise due diligence in different ways. The Guidance appears to imply that directors and senior managers will exercise due diligence in the same way, providing general guidance on what due diligence will involve without differentiating between the roles of directors and senior managers.
10. The Guidance best supports the due diligence needed by senior managers, who are involved in the day-to-day management of the lender, but less so for directors, who typically perform an oversight role. New section 59B(2) of the Credit Contracts and Consumer Finance Act (**CCCFA**) refers to the standard of a reasonable director, and

the Guidance should recognise that a reasonable director would not be involved in the day-to-day operations and management of the lender.

11. NZBA suggests including further detail to reflect how a director may exercise their due diligence duties, noting that directors perform an oversight role and would not be involved in the day-to-day operations and management of the lender.
12. Directors are more likely to satisfy their due diligence duties by driving a culture of compliance; directing and requiring management to undertake key tasks to ensure the lender is meeting its legislative and regulatory obligations and setting the approach to resourcing and priority. We think it would be helpful for the guidance to more clearly discuss the roles of directors.
13. In particular, the Guidance should better reflect that it is reasonable for a board or director to direct management to undertake certain tasks. Paragraph 23, which states that directors and senior managers cannot delegate their responsibility to another party, may create some confusion in this regard. We assume paragraph 23 is intended to reflect that the due diligence duty is personal to directors and senior managers. However, this should not prevent directors and senior managers from requiring others to complete certain tasks, which go towards that director or senior manager meeting their due diligence duty. We believe the guidance could better clarify this aspect.
14. Similarly, issues are created by the statement in paragraph 23 where another person steps into a role in an acting capacity to fill a temporary absence. The Guidance's restriction on delegation may conflict with this normal business behaviour, and we suggest it would be helpful to take this scenario into account. Whether someone acting temporarily in the role of a person who is a senior manager assumes that senior manager's responsibility under the due diligence duty may be a matter of fact, depending on the scope and duration of the delegation, etc. For example, someone who acts in the role held by a senior manager while that senior manager is on leave for two weeks may not necessarily assume that senior manager's due diligence duty. But, someone who acts in the role held by a senior manager for a year, while that senior manager is on maternity leave, may.
15. It would also be helpful if the Guidance provides further clarity on what reporting and record keeping is necessary to demonstrate that directors are exercising the required levels of care, diligence and skill to fulfil their obligations.
16. Additionally, the Guidance should focus only on the exercise of due diligence by directors and senior managers, rather than lenders. This is currently not clear in paragraphs 32 and 33 of the guidance. Section 59B of the CCCFA applies only to directors and senior managers; it does not impose any obligations on lenders themselves. Lenders' obligations are accordingly contained in legislation, the Regulations and Responsible Lending Code, and should not be included in the Guidance.

Greater clarity required on 'who is a director'

17. We are concerned that the description of who a director is in paragraph 10 (i.e. *"includes anyone who directs or instructs a named director"* and *"otherwise exercises the powers of the director"*), goes beyond the definition of 'director' as that term is defined in the CCCFA by reference to the definition in the Financial Markets Conduct Act 2013 (**FMCA**). It is imperative that lenders, such as registered banks, and lenders who are subsidiary companies have absolute clarity as to who a director is. We strongly recommend the removal of these phrases.

Greater clarity required on the level of influence necessary to be a senior manager

18. We think it would be useful for the Guidance to include further detail around the required level of influence to be deemed a senior manager, particularly in the context of a larger lender with multiple levels of management, such as a bank.
19. The Guidance should be clear that, in order to be a senior manager, a person must have significant influence over the entire lender, across the relevant functions of the business. While a particular person may exercise significant influence in relation to consumer credit matters, they are unlikely to be a senior manager unless they additionally exercise significant influence over the entire organisation.
20. We're concerned paragraph 18 in particular may result in confusion. This paragraph should reinforce that a person will only be a senior manager if they exercise significant influence over the entire organisation, in addition to any particular duties and responsibilities they have in relation to the CCCFA. While paragraph 18 seeks to recognise the 'nature of the responsibilities undertaken by the director or senior manager' may mean the level of due diligence may differ between directors and senior managers, this is still within the context of that person first being a director or senior manager, because they have organisation level influence.
21. In finalising the Guidance, we would welcome confirmation that the Commerce Commission has engaged with the Financial Markets Authority (**FMA**) to confirm that the Guidance in relation to the definitions of director and senior manager reflect the views of the FMA, given these terms are defined with reference to the FMCA.

The Guidance should consider how the duty to promptly remedy deficiencies sits with the practicalities of lending systems

22. The Guidance states that directors and senior managers should ensure lenders stop using a deficient system or procedure as soon as practicable until it is fixed (at paragraph 35.2).

23. NZBA recommends revising this paragraph to state that directors and senior managers should ensure that lenders stop using a deficient system or procedure where possible and as soon as practicable.
24. The Guidance should include details on what a lender should do where it is not practical or possible to immediately address a defect in a system or process. For example, a lender should consider what steps it can take to identify consumers who may be impacted, and minimising the risk of harm to consumers until that system or procedure is fixed. This could include running regular reporting to identify events and addressing these events promptly if they arise.
25. Given the level of automation and complex interconnections in the systems and processes used by large lenders, we do not believe it will always be possible or practical for a lender to promptly stop using a deficient system or process. The Guidance should also recognise that there may be instances where it is not possible or practical to stop using a system or process, and provide guidance for lenders on what they should do in these instances.

The Guidance should refer to lenders' pre-existing risk assessment processes when developing processes and systems for compliance

26. Large lenders often use risk assessment processes when developing processes and systems for compliance with legislation and regulations. In particular, lenders may identify a range of risks that may arise as part of using certain processes and systems and seek to identify ways to prevent or mitigate those risks.
27. We believe that this approach accords with sound risk management practice and reflects the scope of the due diligence duty. While we believe paragraphs 25 and 31.4 were intended to reflect this, we think the Guidance could more explicitly reflect this approach as a way that directors and senior managers can fulfil their duty of identifying deficiencies in systems and procedures.

Appendix: drafting suggestions

1. Throughout: there seems to be inconsistent use of the terms “assurance” and “audit” throughout the Guidance, which may cause some confusion. The focus should be on assurance alone, and we understand that the intention is an internal assurance function is sufficient for CCCFA due diligence purposes.
2. Paragraph 3.2: remove the word “any” before “deficiencies”. The inclusion of “any deficiencies” in this context does not align with the wording of section 59B CCCFA.
3. Paragraph 5: expand the third sentence to read (additions underlined):

What you will need to do to comply in your circumstances will depend in each case on the nature of the lender (e.g., its size and the nature of the credit provided) and what your role and responsibilities are.

4. Paragraph 8, footnote 14: suggest clarifying that the requirement to identify directors and senior managers on the FSPR does not apply to persons who are exempt from the certification requirements.
5. Paragraph 21: expand the first sentence to read (additions underlined):

But, in the example above, you will not be liable for any breaches of the due diligence duty for the lender’s procedures for compliance with the Lender Responsibility Principles that require, for example, affordability and suitability checks before the contract was entered into.

6. Paragraph 24.4: per our comment on paragraphs 3.2 and 3.3, remove “any” before “deficiencies”.
7. Paragraph 27.2: footnote 23 references the Responsible Lending Code. However, the content of para 27.2 refers to compliance with disclosure standards. Query whether footnote 23 should be a reference to the Disclosure Guidelines.
8. Paragraph 27.10: per our comment on paragraph 8, footnote 14, add “where applicable” after “obligations relating to certification”.
9. Paragraph 32: per our comment at paragraph 16 of our submission, suggest clarifying that the obligations described in paragraphs 32 and 33 are on the director/senior manager rather than the lender itself. Potential drafting:

32: Directors and senior managers should take reasonable steps to ensure the lender clearly and appropriately communicates those systems and procedures within the organisation. ...

33: Directors and senior managers should take reasonable steps to ensure that procedures are being used appropriately, and that the results of those checks, including any remedial steps, are reported to, and considered by, you. ...

10. Paragraph 36.2: remove the words “or unfair” at the end of this paragraph. The reference to terms that are “unfair” is a specific reference to obligations which arise under the Fair Trading Act, and directly links director and senior manager liability to breaches of other legislation. While lenders must comply with all legal obligations, it would be preferable if the Guidance did not refer to obligations arising under other legislation.

11. Responsible lending example:

- a. The header refers to affordability obligations, but the “understanding obligations” row references suitability obligations rather than affordability obligations. The different references make it unclear what obligations are being discussed in this section.
- b. The “systems and procedures” row references suitability, affordability and record-keeping, but does not incorporate other Responsible Lending Code obligations including assisting informed decisions. Suggest including these other obligations.
- c. The “identifying deficiencies in systems and procedures” row states that a director or senior manager should ensure that the lender regularly reviews complaints, defaults and hardship data to ascertain whether the procedure has been followed. Hardship data is not relevant to identifying deficiencies – this reference should be deleted.

12. Initial disclosure example: in our view,

- a. The “systems and procedures” row may be too detailed and at a lower operational level than what should reasonably be expected of a director or senior manager. We believe it should be sufficient for directors and senior managers to ensure a procedure is in place so that initial disclosure statements contain the information required by the CCCFA, and are provided to the borrower (identifying instances where a statement was not provided). The other requirements in this row are too detailed and would practically be covered by these two more general requirements. The other requirements could be kept as examples of what management would then be expected to deliver.
- b. The “checking use of systems and procedures” row is also too specific. Lenders should decide themselves what quality assurance needs to be in place to measure compliance with initial disclosure.

13. Footnote 21 page 6: We did note the case referred to in footnote 21 on page 6 may not necessarily be analogous to the CCCFA due diligence duty. That case, an Australian Health and Safety case, involved a demolition company director failing to

test his own workings against a computer model. Using that case may indicate that directors will be operationally involved in the activities of the organisation, testing systems first hand, which would set the bar impracticably high. We suggest it may be helpful to better clarify this in the footnote reference.