Submission on *Exposure draft of updated Credit Contracts and Consumer Finance Regulations 2004 and Responsible Lending Code*

Your name and organisation

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Introduction

Full Balance Financial Coaching is one of the few companies in the country that provides an Independent Financial Planning service which concentrates on the income and expenditure by clients as the base point for coaching clients to build better financial behaviour and grow their financial security.

As part of our process, we are all day every day, assessing how people spend their money and changes they can make in their income and expenditure to get affordability for their current loan payments or future aspirations. So feel we are in a good position to comment on how affordability can be calculated

We hold the major contract for Employee Assistance Program (EAP), and as such are dealing with the everyday working person that is either under stress with their finances or wanting to de better with their finances so that they can afford to buy their own home and build their wealth for retirement.

We have been involved in the evolution of the of remedies to fixing the debt issue since 2011, right back when the government started seeking feedback. Having dealt with many, many clients under loan stress we saw the damage that was done by unaffordable loans.

We in general support the current legislation as it is, but think that asking the borrower about future expenses also need to be included. The Code however needs a lot of work, as it is incredibly hard to actually work out how people spend their money and further expert advice and guidance is and will be required as these regulations play out. I think you will find the difficulty is that :

1. lenders and brokers aren't experts in how to assess how people spend money, and have in the past been making broad brush assumptions of spending amounts;
2. borrowers also don't know how they spend their money, and will just agree with whatever needs to happen in order for them to get the loan;
3. how do lenders/brokers have conversations around how people can decrease their spending in order to get affordability, if this isn't what they are experts in;
4. Lenders/brokers want to get the sale, so they aren't necessarily independent or thinking about what is best for the client (but they do want to protect themselves from bad press and large fines so are erring on the side of conservative);
5. The technology to analyse bank statements is not advanced enough to get much meaning from it

So this brings a good opportunity to provide input for improvement to the Code and in helping lenders to determine how to meet compliance, and for better protection of consumers. Hopefully the technology will continue to evolve and allow for much more accurate and quicker methods to determine affordability

Responses to questions

1	Do you agree with the way that the draft Regulations are phrased? If not, what changes would you make?
	I do not agree with the proposed amendment at all. Regardless of the method used, the lenders should always ensure the information is obtained in sufficient detail to minimise the risk of relevant expenses being missed or underestimated. Otherwise why have this legislation in the first place, if it isn't going be done properly? This was the issue with the prior affordability legislation, that it wasn't enforceable! I think there is an **assumption here that analysing someone's banks statements will give you sufficient detail to minimise risk of expenses being missed – this is just simply not true**. Anyone who works in the field will tell you, that while looking at the bank statement will give you more certainty that items haven't been missed, but it is not a magic bullet. Unless the borrower is providing all bank statements and credit cards where spending is happening, and not getting money out in cash – there is no way to know for sure that all the spending is captured! Then there is no way of knowing that those 90 days were an accurate reflection of spending (eg if it included Christmas that will push average spending up). Then you need to have the ability and patience to add up all that spending accurately (and no the technology is not able to do this accurately enough yet). Even then it tells you where the money was spent, but not what the money was spent on (eg supermarkets also sell alcohol and beauty products, petrol stations also sell food and cigarettes). What is **missing is the ability in the regulation to ask about future changes in expenses**, whether they are fixed outgoings or regular spending. It is there for income, but isn't for expenses which doesn't seem very practical given that expenses can change up and down with changes in life eg moving house, kids starting school, having a baby. Eg the number of couples that are expecting babies, and the lenders know this as they can see it, yet they don't take this into account in the affordability assessment (because then it probably wouldn't get approved). Future changes in expenses needs to be added into the 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?

Agree with 5.3, but does that mean that if they are "asking the borrower" only about some expenses, then only those expenses must be in sufficient detail? This is confusing, and why the sufficient detail should apply to all methods.

5.4 This doesn't make sense and just adds confusion – hence I don't think that the 4AK(2) amendment should be done at all. Instead just make it clear in what circumstances more checks need to be done.

5.5 As mentioned above, changes in expenses needs to be added to the regulations as a must, not a may. I think it is very important that it is clear where and why income and expenses are changing, so the borrower can clearly understand how affordability is assessed. I question whether they should be taken out of the initial assessment, wouldn't it be better to keep the initial assessment as an initial assessment and future changes be taken out at the second stage?

5.6 Discretionary expenses – where is definition of this in the regulations? There isn't one because this word is very subjective and can be used to mean different things to different people, especially when categoristion doesn't allow for enough detail to break items down to discretionary. Eg All retail spending could be called discretionary spending, yet children need new clothes and shoes are essential as they grow.

I question how bank statement records would over estimate variable expenses any more than they could under estimate them. The bank statement, is that, a statement of how they have spent their money on average as a fact (assuming you are able to catergorise everything accurately which is easier said that done even with new bank statement technology)!

The only reason for bank statement records would be over or under, is if it wasn't a representative period of how they normally spend their money for some reason eg Christmas, guests staying – but unless you have had a conversation with the borrower, and the borrower is honest, there is no way of knowing that they have been over or under estimated. Again I think any changes in the future should not be changed in the initial assessment, but the second stage to avoid confusion.

I also think it is very dangerous to rely on a borrower saying they will reduce spending, as the borrower of course is just going to say yes to get the loan. There needs to be care and it needs to be realistic as to how much they can reduce spending – Currently the legislation says it the borrower must be willing and able – where is the commentary on this??

5.8 a) It clearly states in the regs that verification is to verify the expense and that if using a benchmark that the higher is to be used – yet the commentary here is suggesting that the bank statement can be used if that is lower but verified??

b) I struggle to understand that a borrowers verified expense would over estimate likely expenses – if it has been verified, then it has been verified as being more accurate, but seems you are opening the door to then using benchmarks instead of a verified accurate figure? Remove second part of the sentence or talk about it for the future below in c.

c) But yes I do agree that cutting expenses in the second stage to a benchmarkable costs is reasonable, as long as the borrower agrees with this. I just think these need to be separated out clearly to show what is current spending and how it is being adjusted to a future assumed

spending. Which reiterates what I stated earlier, than any changes should be made at stage 2 to make it clear.

Also this would relate back to adjustments and surplus risk, if cutting costs to a lower benchmark, this adds risk – as there may be a genuine reason that their spending is higher, eg they have dietary requirements.

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

I think the Code should be endorsing that any affordability assessments where the person has a partner and they have joint bank accounts, that the affordability assessment should be done on a joint basis, even if the other person is not going to be on the loan. This should be an option for all borrowers that are in a partnership, to ensure that more accurate affordability assessments can be done. This is because it is almost impossible to apportion costs out to one income, unless you have very accurate and consistent bank statements (which is rare).

I think the code also needs to endorse how current surpluses can be verified. It is all very well gathering an estimation of income and expenses, but if you don't verify the surplus then there is no way of knowing the figures are correct. For examples research has shown that most consumers going for consumer lending such as vehicles, are not actively saving before they seek the loan (this is why perhaps they are applying for a loan) so are essentially spending all the money they earn. If the lender has done an accurate reflection of how the borrower is spending their money any surplus should show in their bank accounts(unless they have had one off costs). If not, then this means the borrower needs to make more enquires or add more buffers/surplus in.   Then the lender then needs to determine what the borrower is willing and able to reduce or what is otherwise changing in the future to get affordability. Otherwise they are incorrectly giving a loan when there isn't affordability – although again this comes down to the definition of substantial hardship though, which isn't defined!

4	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 new wording only references home loan lending and it doesn't really talk about how to apply a reasonable surplus – it just says that you don't need to apply as much of a surplus if you have applied adjustments (which is already in the regs anyway). So no, not really clear. The regulations talk about likely relevant expenses and likely income and that a surplus or buffer is needed to address risk that they have been assessed too high or too low. Therefore any discussion should be around how to know there is a risk and give examples. As I feed back previously the risk is related to the borrower and the data used to assess their income and expenditure, not the lending product! The better and detailed information that the lender has about their finances and how stable the borrowers habits and income are, the less need for surpluses. So I would propose more examples of when there is a risk, such as when joint expenses can't be proportioned easily, or there is no reliable bank records or the spending is not regular or consistent…. Home loan lending by the banks require other conservative measures governed by the reserve bank that mean that, then need for extra surpluses may not be necessary. Also in assessing the relative expense it only includes the relevant period which is 1 year. Home loan lending is that the interest rates are not likely to increase in the year after the loan has been taken out that much (especially as most mortgage rates are fixed for at least a year). So the banks don't actually need to assess at higher interest rates to meet affordability under the CCCFA regs, and the fact that they do alone means less of a need for more surpluses. Part c I'm not sure will be applicable because there just aren't that many statistical benchmarks, and to rely solely on statistical benchmarks would be a risky move – this should be removed as other lenders may think this is ok to do (they may miss the word <u>all</u> of following adjustments)
5	Do you have any other proposals for additional guidance on surpluses?
	Just to reiterate that the surplus should be relevant to the accuracy of the information provided, the processes the lender uses to assess affordability and the stability of the borrower. Not the product, unless they are targeting borrowers that are high risk as part of that product.

6	Is the updated guidance and examples on 'obvious' affordability helpful? If not, how could they be improved?
	5.27 I whole heartly agree with this, as there has been a big assumption in the past that just because borrowers aren't missing payments that the loan was affordable. And we know this isn't true, as the borrowers prioritise loan payments above food to protect their credit rating. However I think the examples used are not that relevant as explained below. Example 1. – remove the word discretionary spending. Why would someone put money into a savings account for discretionary spending – that would make it a spending account! Example 2. This is a very unusual example, how many borrowers would have such a high income. Also I question the comment about the high deposit, this is relevant to risk not affordability. Also if they are earning 300k and spending $100k, then they should have $200k/yr surplus – so why would then need a 30k loan?? They would have been easily able the save this – IF they haven't this indicates the assessment of their spending in incorrect!
7	Do you have any other proposals for additional guidance and examples for 'obvious' affordability?
	I would have thought an example of obvious affordability is that the borrower is already saving at least the amount of the future loan payments plus a surplus and isn't anticipating any negative changes in income or expenses😊. Alternatively, they may be saving less that the loan payments, but have very high discretionary spending which they are prepared to reduce, or they have changes happening in the future which means they will be able to easily accommodate the loan payments
8	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?
	No comment.

Other comments

It says in the issues to be addressed: "Some lenders appear to be estimating living expenses by asking the borrower to declare them, reconciling them from bank transactions records and comparing them against a benchmark." "The policy intention was that, where a borrower declared living expenses, they could either be verified against bank transaction records or compared against a benchmark (where both of these were options)" Yet this doesn't seem to be spelled out in the Code?