Submission template

Guidance for lenders on assessing affordability: draft changes to the Responsible Lending Code

Submission on discussion document: *Guidance for lenders on assessing affordability: draft changes to the Responsible Lending Code*

Your name and organisation

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About us

Full Balance Financial Coaching and its social enterprise, AffordIt NZ are one of the few companies in the country that provides affordable Independent Financial Coaching. As part of this service, we concentrate on the actual income and expenditure by clients as the base 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 the 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 in a robust and accurate way😊

Our company holds 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, going through change or wanting to do better with their finances.

We service a wide range of clients varying from those that are struggling due to debt and the burden of living costs, to those that are wanting to buy their first home, to those that are wanting to know how much they need for their retirement. Understanding how clients spend their money and what basic requirements are needed for living, is a big part of this.

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 and see the damage that was done by unaffordable loans.

Our Observations

We note that since the new legislation started in 1 Dec 2021 we would have expected clients coming to us because they had been declined a loan, and wanting to know what their other options were. However, we have not had any people come to us in that were declined loans when they could afford them, since the start of the legislation. This indicates the observation of consumers being declined loans that could have afforded them, has not been seen by us.

However we still see clients coming to us that were granted loans since the legislation came in force, that were not affordable and are causing harm. This shows that there are systematic issues within the lending industry, that are still coming to light even though the legislation has been in place for nearly 3 years! **We do not believe that the consumer lending industry has changed its ways enough in assessing affordability, to have confidence that they are capable of not causing harm.**

We also need to ensure that the consequences and penalties of not following the law, are still enough for lenders to take these laws seriously (as they were definitely not previously to the initial changes and why the initial legislation did not work even though it had been in place for so long). The borrowers also need to be compensated for their loss, to make it worth it for them to pursue a complaint.

Quite simply**, loans that aren't affordable, is what causes child poverty and bad social outcomes**! And the sooner the government realises this, and how important this legislation is in preventing bad social outcomes, the sooner we will be able to reduce our statistics and reduce the divide between the rich and the poor.

We also note that we have seen a strong correlation in our clients between loan hardship, and hospital admissions. So this legislation and the code that supports it, must be robust to ensure that the social outcomes of those on lower incomes with less affordability, are not a burden on governments other areas of spending on health, education and crime.

General Feedback

We believe that registered banks and home loan lending needs to not be applicable to this legislation, so that the legislation can have the targeted reduction in harm from lower tier consumer lending, it was intended to have.

We was also like the **word substantial should be taken out of the definition of hardship**. This is NZ, not a 3rd world country where hardship is ok and is common. If we want to see better outcomes for our children, parents need to have the funds available for the children to partake in activities that enable them to thrive, not survive.

When I review our submission from 2022, I noted then that the Code needed a lot of work then. And my submission in 2020 noted also that the time line for feedback was rushed over the holidays and that: "I note in general that the document is very long and wordy, making it difficult to grasp the key concepts. There is also very little use of examples, which would help to clarify situations.

The legislation states that the code shall set out the nature and extent of enquires required. 2017 edition is very light on this!!

It seems such a backwards step to revert to the 2017 edition of the Code, when so much work had been put in to it to make it better and more meaningful over the years

We are in support of a Code that clearly guides lenders on what a reasonable affordability assessment process contains, and would like to see further opportunities for the code to be updated and reviewed as the regulations and systems evolve. Particularly as the Cabinet Decision stressed that strong guidance would mitigate the relaxing on regulations.

We believe that the degree of information sort to test affordability can be related to risk, but that risk assessment is robust and includes reference to key indicators (refer 7 red flags attached) that would indicate risk of low affordability.

We also support the use of full income and expenditure not required where there is obvious affordability – and refer to our previous submissions regarding how this is determined.

Responses to discussion document questions

	Guidance (5.1-5.4)
1	*Do you have any concerns with changes proposed to paragraph 5.1, or other changes we should consider?*
	I question why the words "without undue difficulty" have been used here. This is not consistent with the definition of substantial hardship. I assume this was updated in future edition of the code for a reason? *The word reasonable needs to be added in before satisfied, otherwise there is no relevance.* *Further examples of financial commitments or description is required. Eg if they are locked into a gym membership they can't get out of; is church donations considered a financial commitment, is giving money to family members a financial commitment (eg pocket money, help to other struggling family members here or abroad), donations to causes you believe in, care of a pet, sporting activities. All of these are commitments that have a financial implication….but not all are consider essential if in hardship, but <u>essential to living their life that they have committed to prior to the loan</u>.* *5.1.c add examples of other sources to make this clear eg family, BNPL, extensions of existing borrowing etc as many people have a rudimentary definition of borrowing/debt* *Include in 5.1 e) rely on others to provide your basic living costs eg food grants/parcels* *f) apply for hardship on other loans* *g) apply for hardship on your kiwisaver* *I note that the 2023 edition has, and I see no reason it shouldn't be keep it in this edition: "Depending on the circumstances, it may be reasonable for the lender to make inquiries into matters in addition to those specified in the regulations to be satisfied that it is likely that the borrower will make payments without suffering substantial hardship (for example, where conflicting information is received in response to prescribed inquiries)."*
2	*Do you have any concerns with any of the changes proposed to guidance on responsibly estimating the payments that will be required/made under the agreement?*
	I am unsure what this is referring to, I assume 5.2.3.4? In our experience the interest rate on a consumer debt is usually locked in for the loan. In a revolving credit situation, there would be an expectation that the debt is able to be paid off in a reasonable time, which could be taken as the no more than double the loan balance is paid? *If it is of the whole of 5.1 – 5.4. Then yes I have grave concerns that now that it is not prescriptive, that lenders will continue to do affordability assessments that are not robust enough to prevent them from living in hardship due to loan payments*
3	*Do you see any other guidance on this topic as desirable? If so, please explain.*
	What topic are you referring to? The whole of section of 5.1-5.4. Yes you need to add guidance of adding buffers/contingencies relative to the risk of the borrower and the information provided. At the start you talk about risk and gathering more or less info based on that, but no guidance of how that risk is assessed?

	Purpose of inquiries (5.5-5.6)
4	*Do you have any concerns with the guidance proposed in paragraph 5.5? Is so, what changes should we consider?*
	In our experience, most consumer lending where is harm is being done will <u>not</u> be done on the premises that they are about to receive money to pay the loan in full. So only see this as applicable for bridging finance.
5	*Do you believe the Code should provide general guidance on use of surpluses, buffers and adjustments to account for uncertainty that the loan will be affordable? If so, what would you suggest it say, noting the potential for excessively conservative approaches by lenders.*
	Definitely need buffer/contingencies! If this is applied to consumer lending and not bank lending, then in our experience this is where harm is done is when lenders underestimate how much the client spends and don't ask enough questions. *We note that the potential for excessively conservative approaches by lenders, is not high in our experience, as we have not experienced this or seen it in our clients (we have only seen them be declined properly, or approved loans that weren't affordable). Therefore the risk of potential for excessively conservative approach is not high unless the lender is a low risk lender and already applied prudent figures.* *Unless there is obvious affordability then buffers/contingencies are essential. There is various red flags that highlight a client is already struggling, however lenders routinely ignore these red flags and lend anyway, causing harm. Please contact author if you would like list of red flags.* *This should say "unless there is obvious affordability due to the high difference between steady income and non discretionary expenses, or the client is already regularly saving amounts higher than the loan payments, a contingency shall be added to the budget to represent the risk of understating financial commitments and over estimating income.* *Regardless contingencies are important also as changes happen in life, and due to the effects of inflation.*
	Scope of inquiries (5.7-5.11)
6	*Do you have any concerns with the changes proposed to guidance on inquiries into income, or believe we should consider any other changes?*
	I believe the word may, needs to be replaced with should. The lender should also look into the recent past income to show variation, and should refer to payslips to show the variability between base pay and overtime via YTD gross. *I am unsure of the relevance of c, unless they are applying for bridging finance? I would hope the lender is not expecting them to sell assets to pay for a loan that they cant' afford to pay from income?* *Also the lender should directly ask whether they are expecting any change in income over the term of the loan.*
7	*What wording do you think would work best (in paragraph 5.9.c) to capture other, less essential expenses that may be important for the lender to account for?*

	I believe the word may needs to be replaced with should. It is great that asking about changes to expenditure has been added in, this should be in particular for their largest costs or new expenses due to any change in circumstance eg purchase of an additional car with related costs (we have seen this missed out in many lenders budgets because they were not occurring in the 90 days bank statements!) *There is an assumption by the lending industry that borrowers just need to reduce their discretionary spending so they can afford the loan. It needs to be remembered that it is not always easy to change habits with money, and that where there is an addiction present it is almost impossible without profession help. Therefore a responsible lender should not grant an loan where addictions are present and affordability relies on borrower giving up the addiction. A "no" to loan affordability and refer to an agency to help with the addiction would be an ideal outcome.* *In terms of the borrower making an informed decision into entering the loan, the borrower* ***must be made aware of what expenses are not in the budget****, in order for them to afford the loan. This should be part of the borrower being able to make an informed decision before entering into the loan*
8	*Do you have any concerns with other changes proposed to guidance on inquiries into expenses, or believe we should consider any other changes?*
	You need to add in a definition of what a financial commitment is, and what makes something material to the estimation. Otherwise lenders are going to be in the dark as to what to assess for. You also need to add in that it is in in sufficient detail to minimise risk of expenses missed. It is important that the legislation is enforceable, and not left to interpretation that lenders can take advantage of to give unaffordable loans. *So now is there going to be no guidance in regards to how they should gather information to assess income and expenditure. Isn't that the purpose of the code? To provide guidance?? Its seems a waste that information was developed to show lenders how to do this, and now is being removed altogether?*
9	*Do you believe guidance on joint expenses would be worthwhile. If so, would you have any issues with paragraphs 5.28 – 5.32 of the current Code being used?*
	Definitely need guidence. It is incredibly difficult to compartmentalise how much one person in a partnership contributes to expenses. The default setting should be that an affordability assessment is done on a couple that has intermingled accounts, shall be done as a joint application, or at least on a joint affordability. *The risk of doing it separately, may be that that person has affordability when looking at them, but does not take into account the bigger picture of affordability, which may be that jointly they do not have affordability as the surplus from one person is used to prop up the other. Red flags would identify this, such as no savings, spending on basics only, lots of transfers between accounts…* *So 5.28 should read that where possible affordability for loans should be assessed on a joint basis where partners have comingled accounts, to ensure the complete picture is gathered.* *Separate assessments can be done when there is a definite boundary in place with what each person pays. Eg the contribute exactly 50/50, or they contribute an exact amount to a joint flat share account. Often though if they are both struggling, then they will be a lot of movements between accounts to help the other out.*

	There would be a risk that affordability done on just one, would put them jointly into hardship. Although this could be adjusted for in the use of buffers/contingencies. *Using the example of a tenant is confusing, in current code, as isn't relevant.*
10	*Do you believe guidance on inquiring into spending through use of Buy Now Pay Later facilities is necessary? If we were to do this, would paragraph 5.33 of the current Code be a good approach?*
	Definitely need inquiry. BNPL is extremely disruptive to managing someone's finances. You do not know if the purchases are essential or discretionary. Support 5.33 staying, although a blanket approach of ignoring BNPL is dangerous and there is a risk that that spending has not been allowed for. Note that the borrower never just has one facility, it is usually multiple facilities, so plural needs to be used not singular. Thus this should effect the buffers/contingencies used for a borrower with BNPL as being higher risk borrowers!
11	*Would you have any concerns, based on the proposed guidance, about lenders making unreasonable assumptions that the borrower will reduce certain expenditure? If so, please explain why and what the Code might do to address this.*
	Yes, as previously mentioned "There is an assumption by the lending industry that borrowers just need to reduce their discretionary spending so they can afford the loan. It needs to be remembered that it is not always easy to change habits with money and some level of discretionary spending is expected for full time earners. Also where there is an addiction present it is almost impossible to reduce that expense without profession help. *In terms of the borrower making an <u>informed decision</u> into entering the loan, the borrower **must be made aware of what expenses are not in the budget that they have to give up**, in order for them to afford the loan." They must also have time to absorb that information to make a decision on entering the contract. Further buffers and contingencies should be added where the client the budget is contingent on them reducing spending or changing a habit. This is the biggest issue that leads to loan hardship, unreasonable assumptions by the lender that the borrower is happy to live in hardship and forego all discretionary spending or financial commitments to afford the loan. Eg it is unreasonable for a family with both parents working full time with children to forego takeaways completely and all family entertainment.*
	Method inquiries (5.12-5.17)
12	*Do you have any concerns with the 2017 guidance on methods of inquiry? Please explain.*
	Yes. *The section is quite clunky and tends to point out the obvious, without providing much direction!* *I am unsure of the purpose of 5.11 and why the word "likelihood of repayment" is used rather than risk of hardship or affordability. We see borrowers maintain their repayments, but live in significant hardship to protect their credit score. The lender then makes an assumption of affordability based on that the loan payments haven't been missed – which is an incorrect assumption, from what we see where foodbanks are used instead of missing loan payments.*

	Add back in 5.35 (For the avoidance of doubt, credit scores and repayment history will not, in themselves, be decisive as to whether affordability is obvious. This is because, while past borrowing behaviour is relevant to the inquiry, it does not mean that previous lending was affordable without substantial hardship, and also does not automatically mean that any future loan will be affordable without substantial hardship.) *Should added instead of may include enquiries.* a. *Needs to be split into two parts. One re asking direct questions about regular costs eg do they give donations, do they gamble etc etc. Two asking for evidence eg copies of invoices and Banks statements should be added in as an essential example of documentation from the borrower.*
13	*Do you believe further guidance on use of statistical information is necessary? If so, why?*
	How is the class of borrower determined? By the type of borrowing or the family unit of the borrower?? One would assume the family unit, but it is unclear without further definition. *Statistical data will only ever provide for certain categories, and while generally robust, is not always applicable to all clients situation – so would need to be check with the client and using the higher of the two.*
14	*Do you agree paragraph 5.13 is desirable to make lenders aware of their obligation under the Privacy Act 2020?*
	No comment
15	*What might be the implications of using the 2017 guidance on verification? What changes, if any, would you suggest?*
	The 2017 guidance is very vague and not direct in guiding what is needed to verify affordability. A lot of work has been done regarding this in more recent additions, and I think we need to start again and look at the basic information that is needed to verify affordability, and then add to that so there is clear guidance on what actions need to be done to do an affordability assessment. As was stated in the cabinet decisioin to mitigate the relaxing of these regulations. I would be happy to share the processes that we use to assess a clients True Affordability – something that takes us only an hour to gather 😊
16	*Do you have any other feedback on guidance relating to verification or use of information provided by intermediaries?*
	Yes. Need to add that if lender has any reason to doubt the information, that further checks are done. History has shown that intermediator such as car sales yards, have been immoral in their dealings. IF the intermediatory has no consequences, and is paid by commissions that this will be loop hole for them to make more money while the lender and borrower is landed with the liability on cost.

	Extent of inquiries (5.18-5.21)
17	*Do you believe the proposed guidance on extent of inquiries would encourage lenders to make their inquiries more proportionate to affordability risk, as intended? What changes might help to achieve this?*
	I wonder if all these different explanations are necessary? Why not just one stating that if there is high risk including due to the following situation is all expanded on in 5.2?? *Otherwise specific feedback is:* *5.19 needs to be more specific, than just the word circumstance, and should refer to those that effect general risk and specifically risk of affordability. IF lenders have a high liability from giving unaffordable loans both from a commercial aspect and legislation penalties, then lenders should automatically adjust their processes to reduce risk.* *5.20 include the size of the loan payment relative to the income and disposable income. This is much more relevant, as history has shown that small loans with high repayments are just as harmful.* *Do we have a definition of vulnerable borrower in NZ or even in the code? My experience is that lenders and the media keep using this word, as an excuse that the legislation only needs to protect these so called vulnerable borrowers. Yet we see, clients that are highly intelligent capable people that still make bad financial decisions. The legislation needs to protect all borrowers, not just vulnerable.* *Include – e. where there is a blanket assumption that almost all discretionary spending is given up to get affordability – this is where the greatest risk is, as the discretionary spending may be subjective.* *5.21 need should not may. Again once you develop some key indicators that the client has marginal affordability, this will be easier for lenders to determine when to do further enquires. Otherwise lenders will stay ignorant and continue with their status quo, unless there is enough liability due to not following the code. The consequences of borrower not being able to make a payment are generally always serious, re their credit rating being effect and not being able to get into house….* *15.22b Any continual missed loan payment of any borrower is always serious in the current climate where affordable housing is hard to find. Ditto if they have a mortgage. So I am unsure of the relevance of this.* *Again to make an assumption that no missed payments, means the loan is affordable is not true in our experience, as people pay the loans and bills and then what meagre amount is left is for food.*
18	*Do you have any other feedback on guidance to support lenders in assessing affordability risk and what that means for how they should approach inquiries?*
	Yes suggest you develop a resource re red flags that indicate a borrower has marginal affordability. I will include with submission, provided that is reference back to myself

	Record keeping (5.22-5.25)
19	*Do you have any views on the need for guidance on record keeping and changes we should consider?*
	A standard template that the industry uses, would make sense here. Must have enough suitable categories, then in reviewing the information it is much clearer to see what has been allowed for an what hasn't.
	High-cost consumer credit contracts (5.26)
20	*Do you have any views on the need for guidance on assessing affordability of high-cost credit and whether changes are desirable?*
	No comment, other than high cost loans represent that the risk is higher, often due to a bad history. That history may be due to the borrowers carelessness or because they were leant loans they couldn't afford in the first place (often it is assumed by the borrower it is careless ness, but we often see that it wasn't affordable in the first place). Both of these reasons point to more information needing to be gathered to check affordability. It may be in the future that the interest rate for this is reduced to capture more borrowers that need to do more in-depth investigations into affordability. This I would support, and would make it much easier than a wordy code. This would also discourage high interst risky lending.
	Pawnbroking (5.27-5.28)
21	*Do you have any views on guidance for assessing affordability in the case of pawnbroking?*
	No comment.
	Other
22	*Do you have any other feedback on how the draft content for Chapter 5 can better meet its objectives, including anything that might be missing?*
	Yes by being much clearer to lenders on what a reasonable affordability assessment process contains. A standard template and process would save a lot of hassel and create certainty of what is required – I would be happy to provide more guidance here.
23	*Do you have any suggestions for how this content could be presented more clearly or usefully to users?*
	Yes start again and take it back to basics bare minimum and then extra checks where there are indicators of higher risk of unaffordable loans 😊

Other comments