FinCap

Level 4, 276 Lambton Quay
PO Box 25335 (Featherston Street)
Wellington
Email: info@fincap.org.nz
Phone: 04 471 1420
www.fincap.org.nz

10 June 2024

Submitted via: consumer@mbie.govt.nz

Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
Wellington

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

The government should clearly guide lenders on what a reasonable affordability assessment looks like. Doing so is a vital circuit breaker to steer outcomes towards financial wellbeing and resilience rather than the consequences of irresponsible lending.

While FinCap welcomes the opportunity for public comment on the Ministry of Business, Innovation & Employment's (**MBIE**) *Guidance for lenders on assessing affordability: draft changes to the Responsible Lending Code Discussion Document* (**Discussion Document**) we are again concerned that this process has been rushed. We are working to encourage other community voices to submit in the short time limit for submissions.

We continue to strongly oppose the revoking of the regulations that set minimum standards for the reasonable affordability assessments required in the Consumer Credit and Consumer Finance Act (**CCCFA**)[1] along with the weakening of protections through the Responsible Lending Code (**the Code**) guidance. The Discussion Document is currently proposing not to provide clear guidance on how to avoid lending irresponsibly and is at odds with the Cabinet Decision having stressed that strong guidance would mitigate any relaxing of regulations.[2]

FinCap opposes the overall approach to revert drafting back to guidance from 2017 with some adjustments. Instead, the revised Code should reflect guidance contained in more recent versions of the Code and requirements from the regulated minimum standards for affordability assessments which have emerged from robust rounds of consultation over half a decade.

We expand on these comments in the comments below.

About FinCap

FinCap (the National Building Financial Capability Charitable Trust) is a registered charity and the umbrella organisation supporting the 185 local, free financial mentoring services across Aotearoa. These services supported over 69,000 whānau facing financial hardship in 2023. We lead the sector in the training and development of financial mentors, the collection and analysis of client data and encourage collaboration between services. We advocate on issues affecting whānau to influence system-level change to reduce the causes of financial hardship.

[1] As outlined in the earlier submission linked here: https://www.fincap.org.nz/submission-on-proposed-cccfa-amendments/

[2] See para 20 and 54 here: https://www.mbie.govt.nz/dmsdocument/28285-progressing-financial-services-reform-proactiverelease-pdf

General comments
The approach taken to drafting guidance needs to better reflect the objective stated in the Discussion Document that the Code will "*continue to protect consumers from unaffordable credit by being clear about some basic expectations/standards against the other objectives."*

We welcome the Government's commitment to protect vulnerable borrowers. Lenders responsibly undertaking robust affordability assessments are the best tool available to achieve this. The median client supported by a financial mentor in 2023 was spending 106% of what they earnt, 15.2% of which was towards debt repayment.[3] The median client had $14,096.10 of debt and this had increased by $492.75 since the year before. If they had a car loan, their median shortfall each week was still $104.66 after assistance with budgeting and other actions with their financial mentor. Lending is leading to harm from substantial hardship and unclear guidance leading to further irresponsible lending would only make this worse.

The above statistics reflect trends across tens of thousands of people whose circumstances were not uniform. On this basis we recommend the Government understand vulnerability through the Council of Financial Regulators definition which "*shifts the focus from vulnerability as something certain 'groups' of people experience to vulnerability being a result of a specific event or set of circumstances **which can happen to anyone at any time**"* (emphasis added).[4] If guidance is unclear, it would give a green light to lenders taking shortcuts and making flawed assumptions about a lack of vulnerability through inadequate checking for affordability. This would take financial mentors, disputes schemes and regulators years to catch up in the efforts to resolve the harm caused.

FinCap also observes that this change to the Responsible Lending Code (**the Code**) is likely to just be a placeholder while the wider financial services reforms programme announced by Minister Bayly continues to adjust settings which then flow down to the code.[5] Many lenders and MBIE keep pointing to liability settings as the most significant factor in the conservative decisions about lending that MBIE has been tasked with addressing. These settings are under a separate live consultation.

It therefore makes little sense to significantly erode consumer protections that should be set out through clear guidance in the Code. Chances are, many lenders will not change their approach as they are expecting to make changes to their systems soon and it is more efficient to wait for certainty. This proposed workaround to coax lenders into confidently lending more is likely to be ineffective, when lenders have stated something else is driving the issue.

Instead of reverting back seven years to outdated guidance and then applying minor adjustments, we recommend drafting that builds on the current guidance towards demonstrating a good process for checking affordability for lenders. This should include the adaptation of the current regulations as examples, with the removal, or simplification, of potentially confusing or now unnecessary exceptions within those regulations. This process should reflect a robust application of the current affordability regulations by walking through one pathway of the many in the diagram on page 26 of the current Code.

For instance, the example could demonstrate a responsible lender:
1. Identifying the borrower will rely wholly or in part on income for repayment of the loan. (Which is likely the case with almost all consumer lending).

[3] The statistics in this paragraph are from our recent *Voices* report: https://www.fincap.org.nz/fincap-releases-voices-report-2023/
[4] https://www.fma.govt.nz/assets/CoFR/CoFR-Consumer-Vulnerability-Framework-April-2021.pdf
[5] See: https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/2024-financial-services-reforms

2. Estimate the likely income per week, fortnight, or month.
3. Ask the borrower about each source of income and then verify them based on reliable evidence.
4. Ask the borrower about any likely changes to income.
5. Estimate the likely relevant expenses.
6. Add buffers or adjustments as appropriate.
7. Ask the borrower about their expenses.
8. Verify the expenses, mainly using 90 days of bank transaction records then using some robust benchmarks where reasonable for missing information. Also consider any annual or new costs relating to the purchase the loan is for.
9. Then be satisfied if proceeding to lend, based on the above and on reasonable grounds, that it is likely the borrower will make the payments under the agreement without suffering substantial hardship because income exceeds expenses.

Lenders could vary from the above example, where it is reasonable to do so in the circumstances, and this could be made clear in the guidance.

Many lenders will already be taking the above approach to be compliant with the current regulations, so they will not face further costs from significant systems change. Instead, they will have additional guidance that they can use at discretion, to take a different approach from the example where it is reasonable in the circumstances.

With our recommended alternative approach to the guidance, new lenders in the market, or those unsure of how to comply, will be adequately guided through an example representing responsible lending. Financial mentors, borrowers, dispute resolution schemes and the regulator will be able to have the example as an anchor, when asking a lender how they went about reasonable inquiries about affordability. Outcomes would arise as less irresponsible lending, and an increased likelihood of resolving the issues with the irresponsible lending that does occur, compared to what would eventuate if the current approach in the Discussion Document is implemented.

Responses to Consultation Questions

Q1. Do you have any concerns with changes proposed to paragraph 5.1, or other changes we should consider?

To better reflect the requirement in the CCCFA, we recommend the addition of 'reasonable' to the initial statement at 5.1 so that it reads *'…a lender should be reasonably satisfied that…'* Our reasoning for this is a lender could misinterpret that their judgement as to what is enough meets the obligation in the legislation when this might be well below a reasonable standard.

Financial mentors and the whānau they work with report that what reflects necessities and financial commitments that are non-discretionary will vary between different borrowers. Spending towards a pet's health often will not cease as a fixed financial commitment, for example. For clarity, it is important that MBIE makes it clear that examples in the drafting are non-exhaustive by adding drafting such as '*the examples listed below are non-exhaustive and lenders should reasonably consider what necessities and financial commitments are non-discretionary for a potential borrower.'*

Financial mentors report whānau borrowing from Buy Now Pay Later lenders, Work and Income, friends, and family as well as other lenders who are captured by the CCCFA when trying to relieve substantial hardship. We support the proposed drafting at 5.1.c. but this could be strengthened by adding a range of examples of what other borrowing could look like so that lenders do not take a narrow view.

Q2. *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?*

Borrowers should not be in a situation where they will be unable to pay off credit card debt without substantial hardship. As discussed in the general comments section above, our recent *Voices* report shared that debt repayments on top of essentials payments were sending the median whānau supported by a financial mentor into a weekly shortfall. Being able to pay off the full balance of credit card could prevent this ongoing burden and associated harm.

The current drafting at 5.3 is too vague in guiding lenders to consider that a borrower might pay more than the minimum payment. It would be clearer and more effective to adapt the current regulation 4AL(2)(b) as an example in the proposed para 5.3. This says that credit card repayments should be calculated as repayable within 3 years when assessing affordability or 3.8% of the credit limit. Lenders should already be complying with this regulation, so it carries little cost to add it to guidance if they choose to follow examples in the Code verbatim.

Q3. Do you see any other guidance on this topic as desirable? If so, please explain

Please see the response to the above questions and our general comments on the approach to drafting we recommend in the above general comments section of this submission.

Q4. Do you have any concerns with the guidance proposed in paragraph 5.5? Is so, what changes should we consider?

Clear guidance should explicitly state that 'by default' it is not acceptable to lend to someone in a cashflow deficit or where the repayments from the agreement will cause a cashflow deficit. Lending in such scenarios is irresponsible and will lead to harm, unless there is the possibility to significantly adjust expenditure. Such adjustments are rarely something that happens immediately.

FinCap anticipates that, in almost all cases, borrowers will not be planning to use means other than regular income to make payment. For this reason, the guidance throughout *chapter 5* should be structured to focus more on the likelihood of repayment that will rely on income. It should be emphasised that relying on means other than regular income is, for most forms of lending, not a normal situation. This focus will improve comprehension and clarity for readers towards better outcomes.

Q5. 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.

Yes. It is rare for a borrower's life and finances to be static and steady. Reasonable surpluses, buffers and adjustments will often be needed to prevent this fact leading to substantial hardship, especially where the affordability of a loan is marginal, based on estimates.

There needs to be guidance for lenders on ways to responsibly account for potential underestimation of ongoing expenses or overestimation of income that will lead to substantial hardship. This guidance in the Code should adapt the current relevant regulations as an example. Lenders would still be able to vary their process from the example where they could show it is reasonable in the circumstances. Other commentary we have heard from lenders and MBIE is that conservative lending decisions are more likely to be driven by the CCCFA liability regime, rather than clear guidance on how to responsibly lend, like we recommend.

Q6. Do you have any concerns with the changes proposed to guidance on inquiries into income, or believe we should consider any other changes?

A lender should not be lending to a potential borrower in cashflow deficit or who will face this because of repayments. Borrowers should not be coerced into having assets secured in an agreement as the only means of making it affordable. Instead, they should be left to volunteer that they intend to pay by selling an asset, if the sale of that asset will not cause substantial hardship (for example a tradesperson's tools needed for income). The proposed guidance at 5.7.c. talks about means other than income which the borrower could use to meet payment under the agreement. MBIE should ensure it does not draft guidance that unintentionally encourages lenders to justify lending as affordable based on a borrower having to sell property or assets, when they intended to pay using regular income.

Financial mentors often support whānau who are navigating issues caused by constantly varying income. This can create issues with Work and Income overpayments and lead to unpredictable cash flow shortages. FinCap strongly supports the proposed drafting at 5.8 in general. However, it should be clearer through the deletion of the word '*consider*' and instead state that lenders *'should adjust any volatile, irregular or variable income.'*

Often a borrower will have upcoming changes in their life that could significantly reduce their income. The person might be aware that they are coming to the end of fixed term employment, about to retire, be made redundant, or go on parental leave. These are part of a non-exhaustive list of known factors that could reduce a borrowers income and mean a loan repayment would cause substantial hardship. Guidance should also be included that reflects the current regulation 4AJ(2)(b) to ask the borrower about any likely changes in income. This is a reasonable action a responsible lender should undertake when inquiring about affordability.

Q7. 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?

Financial mentors have reported that many spending patterns will not dramatically change suddenly and simultaneously. An example of spending that could be ignored by a lender but will almost certainly cause substantial hardship if material to the affordability of a loan, is outgoings dedicated towards an addiction to smoking or vaping. Lenders should be guided to consider that spending likely to reflect an addiction could be unlikely to cease. While this could lead to sensitive conversations, it is an unavoidable factor that needs consideration as to whether loans are affordable.

The borrower could often purchase takeaway meals due to the nature of their working hours. Guidance should also provide such situations as an example of where lenders should not assume a sudden change in spending, especially if they have not discussed the assumption that leads to affordability with the borrower.

Financial mentors have also relayed situations where they have successfully requested affordability assessments and noted that the lender has not considered costs that will emerge related to the purpose of credit being requested. A clear example of this, that could be shared in the Code, is there needing to be consideration of petrol, general maintenance and registration costs where a consumer is seeking a loan for a car when they do not already have one.

Q8. Do you have any concerns with other changes proposed to guidance on inquiries into expenses, or believe we should consider any other changes?

In general, it would be better to create clearer guidance through adapting much of the more comprehensive drafting of the current regulation 4AE as an example of what types of expenses a responsible lender assessed.

To improve clarity, it would be better to state existing electricity, gas, water, rates and telecommunications costs be considered where already present or likely to be taken up in relation to the purchase from the loan. Just noting '*utilities*' might not clearly guide lenders to consider all of these costs that are essential and, if anything, are only likely to increase over time.

Fixed financial commitments will often include a fixed term contract for services with a significant exit fee. A common example is gym memberships. FinCap opposes the structure of such arrangements and sees this as a consumer protection issue where it is unreasonably expensive for whānau to exit contracts they are getting no benefit from. However, they still exist and should be included as an example of something lenders consider might be material to the affordability of a loan.

Financial mentors also point out that lenders can often fail to correctly identify costs like the repayments of fines, so this could be a good example to include.

As in our above response to *Consultation Q1.* it should be clear, through a statement in the drafting, that the examples given are nonexhaustive.

Q9. 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?

Yes, they would be worthwhile as many borrowers will be sharing expenses and the way this is done will be material to the affordability of lending. Including paragraphs 5.28-5.32 in the current Code

would create clear guidance on the factors a responsible lender would consider including whether the way expenses are shared are likely to change during the period of the agreement.

Q10. 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?

Yes. Financial mentors report many whānau they support in substantial hardship having been regular users of Buy Now Pay Later loans. FinCap continues to recommend that these lenders be required to assess affordability under the relevant requirements of 9C(3) of the CCCFA.

Q11. 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, we are concerned. The circumstances of each borrower will be different. Where assumptions are made that changes to expenditure will occur that are material to the affordability of the loan, these should be run by the borrower. The Code should recommend a discussion with the borrower at this stage to both check the assumption is likely to eventuate, and that the borrower is aware of the need to adjust spending or face substantial hardship. Not including such guidance could easily lead to bill shock and associated, but avoidable, consumer harm.

Q12. Do you have any concerns with the 2017 guidance on methods of inquiry? Please explain.

The proposed drafting at 5.11.b. could be made to reflect the requirement more clearly in the CCCFA by adding '*reasonably*' to read '*other information the lender reasonably considers reliable…*'

Otherwise, this section needs much more drafting because, as it is currently drafted, it removes a lot of the current guidance that exists between regulations and the current Code. To clearly set out guidance it should instead give examples of an actual minimum threshold of inquiries that could be reasonable. For example, reviewing 90 days of bank statements with a reminder to consider or adjust for annual expenses that might not be captured on those statements.

FinCap recommends that this section of drafting is instead updated with adapted examples from the current recommendations 4AK to 4AN. This is because these regulations reflect actions lenders have been taking that have reflected responsible lending. However, there could still be improvements to prevent issues with affordability that financial mentors have seen arise, as reflected in our comments in the response to the next question.

Q13. Do you believe further guidance on use of statistical information is necessary? If so, why?

Some financial mentors are concerned that lenders have been using benchmark calculations based on Australian studies for calculating likely expenses. This again points to how requirements already well put in the current regulation, like 4AN pointing to New Zealand statistical information as a basis of calculation, should be transferred into new guidance to make it clear.

Also, in addition to our response to the previous question to adapt the current regulations into guidance, we see an opportunity for further guidance to prevent issues with benchmarking that financial mentors have seen.

FinCap has a tool where financial mentors can quickly share examples of lending they consider to be unfair. A third of the 21 responses to this tool so far saw the financial mentor share that they thought

the loan was unfair because *'the lender claimed the loan was affordable by relying on unrealistic or inaccurate statistical data.'* All seven were assessed by the financial mentor as experiencing hardship, when the examples were shared.

More detailed examples shared by some mentors have included a concern that some lenders are deliberately ignoring individual circumstances even when this information is available to assess. Instead, they are defaulting to using benchmarks to assess the likelihood of repayment, which are at odds with the actual variability in expenses of borrowers. Guidance should tell lenders that it is responsible to use the most reliable information about individual circumstances available for assessment. This is especially needed where it is likely that a relatively small, flawed assumption about costs could be material to affordability.

Q14. Do you agree paragraph 5.14 is desirable to make lenders aware of their obligation under the Privacy Act 2020?

Yes, it is good that lenders communicate what they are doing and why with borrowers, to check they are not making flawed assumptions or misusing information.

Q15. What might be the implications of using the 2017 guidance on verification? What changes, if any, would you suggest?

The 2017 guidance is too vague. As above and for the same reasons we submit that there should be changes in the proposed Chapter 5 of the Code so that relevant aspects of regulations 4AK to 4AN are adapted as examples. It should also be clear that responsible lenders should not ignore information they have about expenses and elect to use benchmarks that reflect a lower cost.

Q16. Do you have any other feedback on guidance relating to verification or use of information provided by intermediaries?

The reminder that the lender is responsible for ensuring compliance with 9C(3) in the CCCFA is useful guidance that should stay. Such information can help a financial mentor confidently raise a complaint where a lender claims a third party is responsible for a breach, when this is not helping the supported borrower resolve the resulting substantial hardship.

Q17. 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?

Possibly. Feedback from lenders and analysis from MBIE appears to indicate that the liability settings have the greatest influence on lender's risk appetite. This approach to guidance might assist in guiding lenders where it is unnecessary to do further checking. However, who is vulnerable to substantial hardship may not always be immediately obvious, and some initial checks will likely always be necessary. Financial mentors have recently reported an increase in double income whānau and mortgagees requesting their support.

Q18.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?

Generally, a financial mentor can trace back whether a borrower was facing a cash flow deficit at the time the loan was given. There should be clear guidance that lenders undertake more extensive inquiries where there are signs of a cashflow deficit or low/no spending on essentials. This would make

it clear to mentors that there are grounds for a complaint where a loan led to substantial hardship when the cashflow deficit should have been known from the start.

The protection offered at 5.21 should not be weakened to a '*may*' instead of a '*should*.' If there needs to be an exception for home loans then it should be stated as an exception rather than making the guidance less clear for all lending.

Financial mentors are often frustrated that consolidation or refinancing have 'locked in' financial difficulties for the whānau they support where the new lender should have considered a referral to a financial mentor or other supports. Therefore, the proposed drafting at 5.22a should be made clearer and would be a better mitigation by, instead, requiring a lender is '*reasonably satisfied that the borrower was meeting payments under the existing agreement(s) without suffering substantial hardship*.'

The reflection of a high-cost credit regulation in the proposed Code drafting of 5.23 should be made clearer by signposting the drafting at 5.28 of the current Code. This additional drafting would provide clearer information on how a high-cost lender should obtain information to ensure it does not breach the regulation by not making reasonable inquiries.

Q19.Do you have any views on the need for guidance on record keeping and changes we should consider?

We support a reminder of this critical obligation here.

Financial mentors often face difficulties getting these documents when they request them from lenders. We recommend a signpost is added to the guidance at 2.10 of the current Code on working constructively with the borrower's representative. This addition for clearer guidance could mitigate the risk of a borrower disengaging while the process for support drags on, or the risk of a financial mentor's capacity being wasted.

The proposed guidance notes that how a lender sets out the records it provides can vary. However, financial mentors have fed back that a general standard on how aspects of the information are provided could help them check for any potential issues with the assessment and raise them with the lender. One suggestion could be for the guidance to suggest that lenders consider demonstrating their modelled affordability using the 'classic budget worksheet' available at https://www.moneytalks.co.nz/resources/.

Q20. Do you have any views on the need for guidance on assessing affordability of high-cost credit and whether changes are desirable?

This drafting is vital and should remain. As mentioned in our response to *consultation Q.17* this drafting is effective in describing the reasonable inquiries that should be made for these higher risk loans.

Q21. Do you have any views on guidance for assessing affordability in the case of pawnbroking?

FinCap has had ongoing reports from financial mentors of concerning conduct by pawnbrokers in 2024.[6] We have also heard that the High Court has made a judgement largely in favour of the Commerce Commission's view on how the CCCFA applies to this form of lending. For these reasons,

[6] See for example: https://www.rnz.co.nz/international/pacific-news/514380/pawnbrokers-under-spotlight-for-helping-desperate-for-money-pasifika-people

guidance on affordability for pawnbroking should continue to be included in the Code and updated to be stronger, if relevant, based on the recent High Court decision.

Q22. 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?

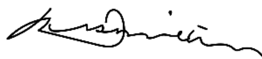
Please refer to our general comments section at the start of this submission on the alternative approach that should be taken to the drafting of guidance.

Q23. Do you have any suggestions for how this content could be presented more clearly or usefully to users?

Please refer to our general comments section at the start of this submission on the alternative approach that should be taken to the drafting of guidance.

Please contact Jake Lilley, senior policy advisor at FinCap on 027 278 2672 or at jake@fincap.org.nz to discuss any aspect of this submission.

Ngā mihi



Ruth Smithers
Chief Executive
FinCap