



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

DISCUSSION DOCUMENT – MAY 2024



## **Ministry of Business, Innovation and Employment (MBIE) Hīkina Whakatutuki – Lifting to make successful**

MBIE develops and delivers policy, services, advice and regulation to support economic growth and the prosperity and wellbeing of New Zealanders.

### **MORE INFORMATION**

Information, examples and answers to your questions about the topics covered here can be found on our website: [www.mbie.govt.nz](http://www.mbie.govt.nz).

### **DISCLAIMER**

This document is a guide only. It should not be used as a substitute for legislation or legal advice. The Ministry of Business, Innovation and Employment is not responsible for the results of any actions taken on the basis of information in this document, or for any errors or omissions.

ISBN 978-1-991143-78-5 (online)

May 2024

### **©Crown Copyright**

The material contained in this report is subject to Crown copyright protection unless otherwise indicated. The Crown copyright protected material may be reproduced free of charge in any format or media without requiring specific permission. This is subject to the material being reproduced accurately and not being used in a derogatory manner or in a misleading context. Where the material is being published or issued to others, the source and copyright status should be acknowledged. The permission to reproduce Crown copyright protected material does not extend to any material in this report that is identified as being the copyright of a third party. Authorisation to reproduce such material should be obtained from the copyright holders.

# Contents

- How to have your say ..... 4**
- Glossary..... 6**
- Introduction ..... 7**
  - Context of financial services reforms..... 7
  - What does this discussion paper do?..... 7
- How and why the Code is changing ..... 7**
  - The purpose and legal status of the Responsible Lending Code ..... 7
  - Why are changes to the Code needed? ..... 8
  - What are we trying to achieve with these changes? ..... 8
- The approach we have taken to replacing Chapter 5 ..... 9**
  - Language used in the Code ..... 9
- Proposed content of new Chapter 5 with commentary and questions ..... 10**
  - Guidance..... 10
- Annex 1: 2017 version of Chapter 5..... 23**

# How to have your say

## Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by **5pm on 10 June 2024**.

Your submission may respond to any or all of these issues. Where possible, please explain your views, such as by including relevant examples.

Please use the submission template provided at: [[Proposed changes to the Responsible Lending Code](#)]. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission:

- By sending your submission as a Microsoft Word document to [consumer@mbie.govt.nz](mailto:consumer@mbie.govt.nz)
- By mailing your submission to:

Consumer Policy  
Building, Resources and Markets  
Ministry of Business, Innovation & Employment  
PO Box 1473  
  
Wellington 6140  
New Zealand

Please direct any questions that you have in relation to the submissions process to [consumer@mbie.govt.nz](mailto:consumer@mbie.govt.nz).

## Use of information

The information provided in submissions will be used to inform MBIE's policy development process and will inform advice to Ministers on potential reforms to financial markets conduct requirements. We may contact submitters directly if we require clarification of any matters in submissions.

## Release of information

MBIE will publish the submissions on our website at [www.mbie.govt.nz](http://www.mbie.govt.nz).

Submissions may be subject to release under the New Zealand Official Information Act 1982 and requests under the Privacy Act 2020.

## Official information

Submissions may be requested under the Official Information Act 1982. If you have any objection to the release of any information in your submission, please set it out clearly in your submission.

Please clearly indicate which parts you consider should be withheld, together with the reasons for withholding the information and the grounds under the Official Information Act 1982 you believe

apply. We will take such objections into account and will endeavour to consult with submitters when responding to requests under the Official Information Act 1982.

### **Private information**

The Privacy Act 2020 governs how we manage personal information (e.g., collection, use, holding, disclosure, etc.). Any personal information you supply to us in the process of making a submission for this consultation will only be used for the purpose of assisting in the development of policy advice in relation to this review, to attribute submissions or for contacting you about your submission. We may also use personal information you supply in the course of making a submission for other reasons permitted under the Privacy Act 2020 (e.g. with your consent, for a directly related purpose, or where the law permits or requires it).

Please clearly indicate in the cover letter or email accompanying your submission if you do not wish for your name, or any other personal information, to be disclosed in any summary of submissions or external disclosures. You have rights of access to and correction of your personal information as explained on the MBIE website at [www.mbie.govt.nz](http://www.mbie.govt.nz). If you include the personal information of another individual in your submission, they also have the right to access and/or correct of their own information.

### **Other information**

If there is other information that you would like to submit to MBIE for consideration in this consultation but do not want it publicly disclosed, please do clearly set that out in your submission for MBIE to consider.

# Glossary

CCCFA	Credit Contracts and Consumer Finance Act 2003
Commission	Commerce Commission
Interest rate	A charge that accrues over time and is determined by applying a rate to an amount owing under a credit contract (and includes a default interest charge)
MBIE	Ministry of Business, Innovation and Employment
Minister	Minister of Commerce and Consumer Affairs
Code	Responsible Lending Code
UK	United Kingdom

# Introduction

## Context of financial services reforms

- 1 The Government is reforming the regulatory landscape for financial services in two phases. The objectives of the reform are to:
  - a. simplify and streamline regulation of financial services (including reducing duplication)
  - b. remove undue compliance costs for financial markets participants
  - c. improve outcomes for consumers.
- 2 This paper relates to the first phase of these reforms, namely the removal of detailed affordability requirements from regulations that were made in December 2021 under the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). This decision was announced by the Minister of Commerce and Consumer Affairs, Hon Andrew Bayly, on 21 April 2024, and necessitates changes to Chapter 5 of the Responsible Lending Code (**the Code**).
- 3 We are also currently consulting the public on possible reforms for Phase 2 of this process. We are doing this through three discussion papers, which are titled:
  - a. *Fit for purpose consumer credit legislation*
  - b. *Fit for purpose financial services conduct regulation*
  - c. *Effective financial dispute resolution.*

## What does this discussion paper do?

- 4 This discussion paper seeks feedback on possible changes to the Code to support lenders to continue meeting the requirement in the CCCFA to “make reasonable inquiries, before entering into the agreement, and before making a material change . . . so as to be satisfied that it is likely that . . . the borrower will make the payments under the agreement without suffering substantial hardship” (section 9C(3)(a)(ii)). We refer to this requirement as the **lender responsibility** throughout this paper.
- 5 We have released an exposure draft of content to replace current Chapter 5 of the Code. This paper includes all the same proposed text with commentary and questions in order to solicit feedback that will help us identify issues or improvements before a final version is issued by the Minister.

# How and why the Code is changing

## The purpose and legal status of the Responsible Lending Code

- 6 The Code elaborates on the lender responsibility principles in section 9C of the CCCFA and provides guidance to lenders on how they may comply with these principles. This includes “the nature and extent of inquiries a lender should make before entering into an agreement” and “the processes, practices, or procedures that a lender should follow . . . when making reasonable inquiries referred to in section 9C(3)(a)”.

- 7 Although the Code is secondary legislation, it is not binding. Lenders are able to comply with the lender responsibility principles in other ways. The Code does, however, offer lenders some protection from liability. This is because evidence of a lender's compliance with the provisions of the Code is to be treated as evidence of their compliance with the lender responsibility principles (section 9E(3)).
- 8 The Code is issued by the Minister of Commerce and Consumer Affairs under section 9G of the CCCFA, following the process required by that section. The same process is required for the Minister to make material changes to the Code (under section 9I).

### **Why are changes to the Code needed?**

- 9 Chapter 5 of the current Code is largely premised on the affordability regulations, which are being revoked. A new Chapter 5 is needed in order for the Code to continue to fulfil its purpose. It will need to do this in a way that reflects the change in policy regarding affordability assessments.
- 10 The problem with the affordability regulations was that the requirements in those regulations were largely inflexible and, in certain cases, more onerous than justified by the risks to borrowers. This unnecessarily increased costs for lenders and borrowers, and is thought to have resulted in some consumers being denied credit they can in fact afford.
- 11 The main characteristic of the affordability regulations that contributed to this problem was the fact the requirements applied to almost all lending, with limited exceptions and limited flexibility for lenders to adjust their approach to assessing affordability based on the risk profile of the lending.

### **What are we trying to achieve with these changes?**

- 12 It is important we avoid perpetuating problems we identified with the process prescribed by the affordability regulations that are being revoked. This means enabling lenders to responsibly change how they assess affordability.
- 13 The objectives for revising Chapter 5 are to:
  - a. continue to protect consumers from unaffordable credit by being clear about some basic expectations/standards
  - b. promote and facilitate fair, efficient and transparent markets for credit by giving lenders the confidence to:
    - i. make inquiries that are more or less extensive depending on the risk profile of the lending
    - ii. have flexibility and discretion in their processes that enables them to approve credit they are satisfied is likely to be affordable.

### **Process and timeline**

- 14 Submissions on this paper close at 5pm on 10 June 2024. Following this, we will review the feedback and make recommendations to the Minister, before he issues final amendments to



the Code. We expect changes to the Code to come into force at the same time as revocation of the affordability regulations.

# The approach we have taken to replacing Chapter 5

- 15 Based on the objectives noted above, and feedback from a Code Advisory Group, we have developed the proposed content for Chapter 5 by:
- a. starting with the text from the 2017 version of the Code (which was the last version that preceded the creation of affordability regulations – see **Annex 1**)
  - b. updating this text to:
    - i. reflect relevant changes to the CCCFA since 2017
    - ii. address areas where we think that guidance could better support lenders to understand what may be required to comply with the lender responsibility.
- 16 In updating the 2017 text, we have drawn mostly from material in the 2023 version of the Code that we consider unproblematic. Note that we intend to make any changes to other chapters that are necessary as a consequence of changes to Chapter 5.

## Language used in the Code

- 17 Although the Code is secondary legislation, it is written less formally than other legislation. Our aim is to make it as accessible and user-friendly to lenders of all types as possible.
- 18 We welcome feedback on whether and how the proposed content could be more user-friendly.

## *Use of the word 'should' versus 'may'*

- 19 Certain language in the Code has important implications for what gives a lender evidence of their compliance with the provisions of the Code (as per section 9E(3)):
- a. The word 'must' is used when referring to statutory obligations in the Act or Regulations and indicates actions a lender must take to be compliant.
  - b. When the Code says that a lender 'should' do something, it is intended to reflect our understanding that the action is required by the lender responsibility and to show compliance with the Code.
  - c. The Code also uses the word 'may' in a number of ways that differ depending on the context. When it says that a lender 'may' do something, this is usually intended to indicate that the action:
    - i. might be required by the lender responsibility; or
    - ii. is one way (among others) a lender could meet the lender responsibility.

### *Status of commentary and examples*

20 The draft Code contains commentary and examples for illustrative purposes, which do not purport to set out additional processes, practices, or procedures for lenders to follow. These are not provisions of the Code against which evidence of compliance is to be assessed.

# Proposed content of new Chapter 5 with commentary and questions<sup>1</sup>

## Guidance

- 5.1. To meet this lender responsibility, a lender should be satisfied that it is likely that the borrower will make the payments under the agreement without undue difficulty as well as:
- a. meet necessities (such as accommodation, food, utilities, transport, required medical expenses, **clothing, costs associated with any dependents (such as childcare)**); and
  - b. meet other financial commitments (such as repayments on existing debts, **insurance**);
- without having to:
- c. **further borrow from another source in order do any of the above;**
  - d. sell or realise property or assets other than **in accordance with the borrower's intentions at the time of approval.**<sup>2</sup>

This paragraph is largely unchanged from the 2017 chapter. It provides an indication of what sacrifices would tend to cause a borrower 'substantial hardship' for the purposes of the lender responsibility in section 9C(3)(a)(ii) of the CCCFA.

The highlighted examples are added. We are conscious that the more examples we add, the more they look like they are supposed to be an exhaustive list (which is not intended).

The addition of subparagraph c) is based on UK guidance, and recognises that substantial hardship is also likely if the borrower is only able to service the loan, meet necessities or meet other financial commitments during the agreement by increasing their indebtedness (such as by borrowing money from a family member).

We have also tried to simplify the wording of subparagraph d).

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

<sup>1</sup> Highlights are used to indicate material deviations from the 2017 Chapter.

<sup>2</sup> Subject to **paragraph 5.29** in relation to pawnbroking.

- 5.2. Where the interest rate under the agreement can vary, a lender should take account of the risk that interest rates may rise. **For example**, to mitigate the risk that potential increases adversely impact on a borrower's capacity to make the payments required, the lender might:
- a. use a single, sensitised interest rate (which includes a 'buffer') regardless of the loan's actual interest rate;
  - b. use the loan's actual interest rate plus a margin (which functions as a 'buffer'); or
  - c. apply an interest rate floor, to ensure the interest rate applied reflects higher likely average interest rates over the longer term when operating in a low interest rate environment.
- 5.3. **For revolving credit contracts, a lender should take into account that a borrower may wish to make payments that:**
- a. **in the case of a credit card, are greater than any minimum required payments, such as by applying a reasonable buffer to any minimum required payment;**
  - b. **in other cases, make payments that are sufficient to repay the full amount of the loan within a period that is reasonable in the circumstances.**
- 5.4. For revolving credit contracts, a lender should take into account that a borrower may use credit up to the credit limit.

The highlighted content added to paragraph 5.2 and paragraph 5.3 is from the current Code.

The examples in 5.2 are examples of how buffers might be applied when forecasting the cost of payments required by the agreement. None of these actions would be required to comply with the Code.

We have so far heard that lenders find the guidance in 5.3 helpful.

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?

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

## Purpose of inquiries

- 5.5. To meet this lender responsibility, a lender should make reasonable inquiries into:
- a. **a borrower's income and expenses, where a borrower may rely on that income to make some or all payments under the agreement;**
  - b. **means other than income that the borrower will rely on to make any payment under the agreement;** and

c. the **likelihood of repayment**.

Paragraph 5.5 conveys the relevance of understanding the borrower's financial position, as well as credit risk. The highlighted words are intended to reflect the view that inquiries into income and expenses may not be necessary where the borrower intends to rely wholly on means other than income to make the payments under the agreement. For example, if the borrower can show the lender, they will soon receive inheritance and use that to fully repay the lender, inquiries into that inheritance may be sufficient without also looking into income and expenses. This possibility is currently recognised by the exception in regulation 4AF(1)(b).

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

- 5.6. A lender should be satisfied that the scope and methods of inquiry are reasonable and will provide a sufficient basis for the lender to be satisfied that it is likely that the borrower will make payments under the agreement without suffering substantial hardship.

Although the proposed guidance acknowledges the possibility of using 'buffers' and 'adjustments' in some situations, it does not have anything resembling the current requirement to apply either a 'reasonable surplus' or use 'buffers' or 'adjustments' (regulation 4AF(2)(b)). These are intended to be used currently to account for uncertainty about whether the borrower's means will be sufficient to avoid substantial hardship and mitigate the risk those means are over-estimated or expenses under-estimated. This requirement has resulted in what might be viewed as overly conservative approaches by some lenders.

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.

## Scope of inquiries

- 5.7. A lender's inquiries into the borrower's **income or other means of making any payment under the agreement**, may include inquiries into:
- the borrower's current income level;
  - the sources and stability of the borrower's income, including likely changes;
  - any other means the borrower has, or expects to have, of making any payment under the agreement** (such as proceeds from the borrower's intended sale of assets).
- 5.8. **A lender should consider adjusting any volatile, irregular, or variable income, for example discounting seasonal income, bonuses, overtime, rental income, or investment returns.**

Paragraph 5.7 is broadened to account for cases where means other than income may be relevant to affordability of the loan.

Paragraph 5.8 is taken from the current Code. It encourages lenders to adjust their estimate of income in certain cases. We have so far heard that lenders find this guidance helpful.

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

- 5.9. A lender's inquiries into the borrower's **expenses** may include inquiring into:
- a. the borrower's expenses to meet necessities to maintain a reasonable standard of living (such as accommodation, food, utilities, transport, **clothing**, required medical expenses, **costs associated with any dependents (such as childcare)**)
  - b. the borrower's other financial commitments, **such as insurance**, including repayments on existing debts and the extent to which existing debts are to be repaid from the credit advanced
  - c. other regular **or frequently reoccurring** expenditure **which may be material to the affordability of the loan** (such as tithing, **transfers to support family overseas**)
  - d. likely changes in the borrower's relevant expenditure.

## Commentary

*This part of the Code provides examples of how the purpose for which the borrower is seeking credit might make it clear to a lender that the borrower's relevant expenditure is likely to change or cause them to inquire further with the borrower:*

- *where the loan is for the purchase of a home the borrower would live in, it would be reasonable for the lender to omit existing rent, once those payments are expected to cease*
- *where the loan is for the purchase of a vehicle, it might be reasonable for the lender to inquire into any changes in the borrower's total vehicle licensing, maintenance and on-road costs.*

- 5.10. It is possible for only part of a given expense category to be a necessity — for example, basic clothing and school uniforms may be a necessity, but expensive designer clothing may not be.

Paragraph 5.9 mirrors the expense categories set out in paragraph 5.1, with the addition of the third category, which we propose to narrow. The ‘may’ is a permissive approach to supporting lenders to decide which expenses are relevant.

The 2017 equivalent of paragraph 5.9.c was: “other regular expenditure that the borrower intends to make (such as tithing, pay TV subscriptions)”. The intention of the change is to capture less-essential expenses that are likely to remain important to the borrower and material to affordability, but exclude expenses that the borrower could more easily forgo or that are less significant. Another approach would be to instead refer to: “any non-discretionary regular or frequently recurring outgoings that are material to the estimate of relevant expenses (excluding savings and investments)” (from the current definition of ‘listed outgoings’ in regulation 4AE).

Paragraph 5.10 is from the current Code.

We have also considered including in this section:

- Guidance on identifying joint expenses and on how to treat them
- Guidance on inquiring into use of Buy Now Pay Later facilities – but our impression is lenders generally have a good understanding of how to treat these (if different to revolving credit contracts, on which there is guidance proposed)
- Guidance on when lenders should check or make borrowers aware of any assumptions they are making about a likely reduction in certain expenditure.

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?

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

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?

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?

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.

- 5.11. A lender’s inquiries into the borrower’s **likelihood of repayment** may include inquiries into:
- a. the borrower’s credit history, which may be obtained through the results of a credit check
  - b. other information that the lender considers reliable to assess the likelihood of repayment.

5.12. Depending on the circumstances, it may be reasonable for the lender to make inquiries into other matters to be satisfied that it is likely that the borrower will make payments without suffering substantial hardship.

### Method of inquiries

- 5.13. In making the reasonable inquiries, a lender may obtain information:
- a. directly from the borrower (including any supporting documents);
  - b. that it holds about the borrower, provided the lender is satisfied that the information is current;
  - c. about the borrower from reliable third parties such as government departments, credit reference agencies or valuers; or
  - d. which is generated based on statistical information relating to an appropriate class of borrowers, provided that:
    - i. the statistical information is reliable and current; and
    - ii. use of this method is reasonable in the circumstances (for instance, if a component of household expenditure is estimated using statistical information, there is a low risk that the estimate will be materially lower than the particular borrower’s expenditure).

5.14. Where a lender is using information it already holds about the borrower in accordance with paragraph 5.13 above, and has any doubts as to whether it is using that information correctly, the lender should confirm with the borrower the correct use of that information.

Paragraph 5.13 is unchanged from the 2017 chapter. It is intended to avoid prescribing what method lenders should use to obtain the information they need to be satisfied the loan is likely to be affordable.

Paragraph 5.14 is based on requirements in the regulations to check information the lender holds about the borrower with the borrower in accordance with Information Privacy Principle 8 in the Privacy Act 2020. See for example, regulation 4AK(2)(a)(i) and (ii).

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

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

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

- 5.15. In conducting inquiries, information (including supporting documents) may be obtained from the borrower. It will usually be reasonable for a lender to rely on the information provided to them by the borrower where this information is:
  - a. consistent with information the lender already holds about the borrower (for instance, because the borrower is an existing customer);
  - b. within the usual range of information for that type of borrower (for instance, if a borrower with two children provides information about their rent that is within the standard range for the rental of a three bedroom house); or
  - c. supported by documents from a reliable third party, such as Inland Revenue.
- 5.16. Where the lender has reasonable grounds to believe any information provided by the borrower is not reliable, they should take reasonable steps to verify that information.
- 5.17. A lender may rely on information provided to it by a financial adviser or intermediary as though it had been provided to it by the borrower.
- 5.18. A lender should require financial advisers and intermediaries to implement and maintain appropriate policies and procedures to collect information from the borrower and perform any necessary verification, and to train their staff on the Code and the lender responsibility principles. The lender, not financial advisers or other intermediaries, remains responsible for ensuring the lender complies with its responsible lending obligations.

The above guidance on verification of information is that provided in the 2017 chapter. To some extent, this reflected the presumption in section 9C(7) of the CCCFA that a lender can rely on information provided by the borrower, unless they have ‘reasonable grounds’ to believe the information is unreliable. Although that provision has since been repealed, we are seeking feedback on the 2017 guidance because of our understanding that verification (particularly of expenses), as required by the affordability regulations, contributes to disproportionate processing costs and delays in some cases.

The guidance on information provided by intermediaries (paragraphs 5.17 and 5.18) is materially the same as in 2017 and the current Code.

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

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



## Extent of inquiries

- 5.19. The scope, method **or other extent** of inquiries that are reasonable for a lender to make to be satisfied of the matters set out in **paragraph 5.1** may differ depending on the circumstances.
- 5.20. A lender should make more extensive inquiries where there is a greater risk that the borrower will not be able to make payments under the agreement **without suffering substantial hardship**. This **may** include where:
- the size of the loan is large relative to the borrower's ability to repay;
  - the borrower's credit history suggests repeated challenges making payments under credit contracts or paying for necessities on time (e.g. utilities bills);**
  - the borrower is a **vulnerable borrower**; or
  - the credit agreement is a **high-cost credit agreement**.
- 5.21. More extensive inquiries **may also be reasonable in circumstances where** the consequences of the borrower not being able to make payments under the agreement may be serious (**or more serious than under the existing agreement, in the case of a material change to that agreement**). This includes where:
- the potential consequences include the loss of a significant asset; or
  - the default interest plus default fees are high relative to the amount of the loan or credit limit.
- 5.22. A lender may make less extensive inquiries where:
- the risk that the borrower will not be able to make payments under the agreement without suffering substantial hardship is lower; and
  - the consequences of not being able to make those payments (compared with the consequences associated with the current agreement, in the case of a material change to that agreement) are less serious.
- This includes cases where:
- the lender is refinancing existing debt, or making a material change to an existing contract, without a material increase in the regular payments the borrower would be required to make, and the borrower appears to have made payments under the existing agreement(s) without suffering substantial hardship
  - the lender's inquiries are at a given point sufficient to establish that it is obvious in the circumstances of the particular case that the borrower will make the payments under

the agreement without suffering substantial hardship, so as to make any further inquiries disproportionate.

5.23. In circumstances described by **regulation 4AO(1)**, a lender should make more extensive inquiries and apply greater care (such as through use of a generous surplus or buffers/adjustments) than they otherwise would in order to be satisfied it is likely that the borrower will make the payments under the agreement without suffering substantial hardship.

One of the core problems with the affordability regulations was that they do not adequately encourage lenders to differentiate their approach to assessing affordability based on risk. This section is intended to support a risk-based approach that works in both directions, namely, by lenders:

- taking greater care / being more thorough where the risk is particularly elevated, and
- relaxing their approach in cases where that risk is particularly low, including the circumstances currently described by the exceptions in the affordability regulations (i.e. refinancing and cases of 'obvious' affordability).

We are interested in whether this section achieves that and what changes we should consider to achieve that.

The 'may' in paragraph 2.20 is intended to give lenders greater flexibility to consider other factors that may influence affordability risk. However, the intention is not for lenders to undertake further inquiries (or inquiries they would not normally make) in order to assess this risk.

The consideration in paragraph 5.21 (relating to consequences of default) is now a 'may' compared with a 'should' in 2017. This is to avoid the implication that all home loans should be treated as requiring more extensive inquiries. We have also proposed changes to differentiate changes to existing contracts (e.g. increasing the credit limit on a home loan or credit card) in terms of assessing risk.

New paragraph 5.23 is intended to clarify that greater inquiries will always be appropriate for high-cost credit contracts described by regulation 4AO(1). This clarification was less necessary while the affordability regulations applied to high-cost credit contracts.

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?

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?

## Record keeping

### Commentary

*This part of the Code illustrates the kind of information that lenders should consider keeping to meet sections 9CA(1) and (2) of the CCCFA. These records are kept for 'successful' assessments in which a lender has entered into an agreement or agreed a material change with a borrower.*

*Lenders are required to ensure their records are fit for their intended purpose, including disclosure on demand to the Commission, dispute resolution service, the borrower, or guarantor.*

*However, the way information is presented by a lender under section 9CA(3) to (6) may depend on the way in which the lender collected and recorded information, verified that information where required, and made its assessments under section 9C(3)(a), (4)(a), and (5)(a).*

- 5.24. A lender should keep records that are sufficient to demonstrate the scope, method and extent of inquiries they undertook, whether in accordance with provisions of this chapter or otherwise.
- 5.25. A lender should keep records of any information they obtained from their inquiries into income, other means of making payments under the agreement, expenses and likelihood of repayment.
- 5.26. If assumptions were used to estimate the likely payments required by the agreement (such as for variable interest rates and revolving credit contracts), it may be appropriate to keep records showing how those payments were estimated.
- 5.27. In recording how the lender satisfied itself as to the matters in section 9C(3)(a)(ii), the lender may choose to capture a concise summary of the lender's decision or some other record of how the lender satisfied itself. This may include references to its policies or procedures and how they were applied.

In 2017, there was no requirement in the CCCFA to keep records of inquiries into affordability. While there is guidance on this in the current Code, that guidance is based on the affordability regulations and goes into far more detail than we consider appropriate in this version. The 'should's in this section reflect what we believe lenders would need to keep in order to comply with section 9CA. There is unlikely to be as much discretion as to how to meet this obligation.

19.

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

## High-cost consumer credit contracts

### Commentary

*This part of the Code provides guidance for lenders under high-cost credit agreements when assessing whether the borrower has existing high cost loans or has had high cost loans within the preceding 90 days.*

*Under section 45F and section 45G of the Act, lenders are prohibited from entering into high-cost credit contracts with certain borrowers. Regulation 4AO applies a rebuttable presumption of substantial hardship if the lender has reasonable evidence that the borrower has defaulted in payment on a consumer credit contract in the preceding 90 days.*

*In the case of a high-cost consumer credit contract, a lender may not enter into a high cost credit contract with a debtor who:*

- a. has unpaid balance on any high-cost consumer credit contract with another creditor (s 45F(1)(a));*
- b. has had, at any time within the preceding 15 days, an unpaid balance on any high-cost consumer credit contract with another creditor (s 45F(1)(b));*
- c. has entered into 2 or more high-cost consumer credit contracts at any time within the preceding 90 days (s 45G(1)); or*
- d. has been in default under one or more loans in the preceding 90 days. (see section 45F and section 45G).*

### Lender's inquiries – high cost lending

- 5.28. In making reasonable inquiries, a lender should obtain information through all of the following:
- a. explaining to the borrower what a high-cost loan is;
  - b. asking the borrower if they have entered into any high-cost loans in the past 90 days with another lender, and if so, determining the dates on which those contracts were entered;
  - c. asking the borrower if they currently have any high-cost consumer credit contracts with another lender, or have repaid any high-cost consumer credit contracts with another lender over the past 15 days;
  - d. collecting information from the borrower that would enable the lender to determine whether the borrower's recent or existing loans are high cost loans – eg copies of the contracts, or if these are unavailable, standard contracts or loan disclosures that may give a range of the interest rates of the relevant loans;

- e. verifying the information provided by the borrower and checking for any contracts that may have been omitted through:
  - i. asking the borrower about any other names they use, and checking their own loan record systems and those of any associated lender;
  - ii. bank statements (looking for deposits from other lenders, or outgoings to other lenders);
  - iii. reviewing credit reports for enquiries or defaults;
  - iv. asking the borrower for evidence that a high-cost consumer credit contract with another lender has been repaid; and
  - v. going back to the borrower to clarify any discrepancies.

This is the section on high-cost lending from the current Code.

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

## Pawnbroking

### Commentary

*Pawnbroking transactions are subject to and must comply with both the Act and the Secondhand Dealers and Pawnbrokers Act 2004 (SDPA).*

*For a pawnbroking transaction, a borrower can make payments under the agreement in the form of either:*

- a. monetary payment of the redemption price (as defined under the SDPA); or*
- b. the sale of the pledged item by the lender on behalf of the borrower.*

- 5.29. In assessing whether it is likely the borrower can make payments without substantial hardship, the lender under a pawnbroking transaction may inquire into and assess:
- a. whether the borrower can pay the redemption price through monetary payments without substantial hardship by making inquiries in accordance with guidance set out in **paragraphs 5.5 – 5.22** above; or
  - b. whether the borrower can make the payments through a sale of the pledged item without substantial hardship (instead of making the reasonable inquiries in accordance with guidance set out at **paragraphs 5.5 – 5.22 above**). Sale of the pledged item may cause substantial hardship to the borrower if the item is essential to the borrower.

- 5.30. If the lender makes an assessment under **paragraph 5.29.b**, the lender should be satisfied that an item is not essential, taking into account the borrower’s circumstances.

Guidance on pawnbroking has not materially changed since 2017 and no changes are proposed.

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

Other feedback on the draft Code is welcome.

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?

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

# Annex 1: 2017 version of Chapter 5

## GUIDANCE

- 5.1. To meet this lender responsibility, a lender should be satisfied that it is likely that the borrower will make the payments under the agreement without undue difficulty as well as:
- a. meet necessities (such as accommodation, food, utilities, transport, required medical expenses); and
  - b. meet other financial commitments (such as repayments on existing debts)
- without having to realise security or assets (other than any security or assets that the borrower is, at the time of approval, willing to dispose of or realise the value of; and could dispose of or realise the value of).<sup>3</sup>
- 5.2. Where the interest rate under the agreement can vary, a lender should take account of the risk that interest rates may rise.
- 5.3. For revolving credit contracts, a lender should take into account that a borrower may wish to make payments that are greater than any minimum required payments. This may include applying a reasonable buffer to any minimum required payment.
- 5.4. For revolving credit contracts, a lender should take into account that a borrower may use credit up to the credit limit.

## INQUIRIES

- 5.5. To meet this lender responsibility, a lender should make reasonable inquiries into a borrower's **income, expenses and likelihood of repayment**.
- 5.6. A lender should be satisfied that the scope and methods of inquiry are reasonable and will provide a sufficient basis for the lender to be satisfied that it is likely that the borrower will make payments under the agreement without suffering substantial hardship.

### Scope of inquiries

- 5.7. A lender's inquiries into the borrower's **income** may include inquiries into:
- a. the borrower's current income level
  - b. the sources and stability of the borrower's income, including likely changes

---

<sup>3</sup> Subject to 5.14 in relation to pawnbroking.

- c. where relevant to the type of credit agreement (for instance, bridging finance), the likely proceeds from the borrower's intended sale of assets.
- 5.8. A lender's inquiries into the borrower's **expenses** may include inquiries into:
- a. the borrower's expenses to meet necessities (such as accommodation, food, utilities, transport, required medical expenses)
  - b. the borrower's other financial commitments, including repayments on existing debts and the extent to which existing debts are to be repaid from the credit advanced
  - c. other regular expenditure that the borrower intends to make (such as tithing, pay TV subscriptions)
  - d. likely changes in the borrower's expenditure.
- 5.9. A lender's inquiries into the borrower's likelihood of repayment may include inquiries into:
- a. the borrower's credit history, which may be obtained through the results of a credit check
  - b. other information that the lender considers reliable to assess the likelihood of repayment.
- 5.10. Depending on the circumstances, it may be reasonable for the lender to make inquiries into other matters to be satisfied that it is likely that the borrower will make payments without suffering substantial hardship.

## Method of inquiries

- 5.11. In making the reasonable inquiries, a lender may obtain information:
- a. directly from the borrower (including any supporting documents);
  - b. that it holds about the borrower, provided the lender is satisfied that the information is current;
  - c. about the borrower from reliable third parties such as government departments, credit reference agencies or valuers; or
  - d. which is generated based on statistical information relating to an appropriate class of borrowers, provided that:
    - i. the statistical information is reliable and current; and
    - ii. use of this method is reasonable in the circumstances (for instance, if a component of household expenditure is estimated using statistical information, there is a low risk that the estimate will be materially lower than the particular borrower's expenditure).



## Extent of inquiries

- 5.12. The scope and method of inquiries (as referred to at 5.7–5.11) that are reasonable for a lender to make to be satisfied of the matters set out in 5.1 may differ depending on the circumstances. A lender should make more extensive inquiries where:
- a. there is a greater risk that the borrower will not be able to make payments under the agreement. This includes where:
    - i. the size of the loan is large relative to the borrower’s ability to repay
    - ii. the borrower is a **vulnerable borrower**; or
    - iii. the credit agreement is a **high-cost credit agreement**; or
  - b. the consequences of the borrower not being able to make payments under the agreement may be serious. This includes where:
    - i. the potential consequences include the loss of a significant asset; or
    - ii. the default interest plus default fees are high relative to the amount of the loan or credit limit.

## GUIDANCE

### PAWNBROKING

- 5.13. For a pawnbroking transaction, a borrower can make payments under the agreement in the form of either:
- a. monetary payment of the redemption price (as defined under the SDPA); or
  - b. the sale of the pledged item by the lender on behalf of the borrower.
- 5.14. In assessing whether it is likely the borrower can make payments without substantial hardship, the lender can inquire into and assess:
- a. whether the borrower can pay the redemption price through monetary payments without substantial hardship by making reasonable inquiries in accordance with the guidance set out at 5.5–5.12 above; or
  - b. whether the borrower can make the payments through a sale of the pledged item without substantial hardship (instead of making the reasonable inquiries in accordance with the guidance set out at 5.5–5.12 above). Sale of the pledged item may cause substantial hardship to the borrower if the item is essential to the borrower.
- 5.15. If the lender makes an assessment under 5.14.b, the lender should be satisfied that an item is not essential, taking into account the borrower’s circumstances.

# GUIDANCE

## VERIFICATION

- 5.16. In conducting inquiries, information (including supporting documents) may be obtained from the borrower. It will usually be reasonable for a lender to rely on the information provided to them by the borrower where this information is:
- a. consistent with information the lender already holds about the borrower (for instance, because the borrower is an existing customer);
  - b. within the usual range of information for that type of borrower (for instance, if a borrower with two children provides information about their rent that is within the standard range for the rental of a three bedroom house)/; or
  - c. supported by documents from a reliable third party, such as Inland Revenue.
- 5.17. Where the lender has reasonable grounds to believe the information is not reliable, the lender should take reasonable steps to verify the information provided by the borrower.
- 5.18. A lender may ask for or receive information from brokers or other intermediaries acting on behalf of the borrower. Where that is the case:
- a. A lender may rely on information provided to it by a broker or intermediary as though it had been provided to it by the borrower.
  - b. A lender should require brokers to implement and maintain appropriate policies and procedures to collect information from the borrower and verify it, and for the broker to train their staff on the Code and the lender responsibility principles.