Note: Proposed changes to the Code are not indicated because the Chapter has been substantially re-written. Please see the associated discussion document for an explanation of the changes.

Exposure Draft of the Responsible Lending Code

5. Inquiries into and assessment of substantial hardship (borrowers)

Legal obligations

Lender responsibility

A lender must, in relation to an agreement with a borrower, make reasonable inquiries, before entering into the agreement, and before making a material change referred to in subsection (8), so as to be satisfied that it is likely that the borrower will make the payments under the agreement without suffering substantial hardship (see section 9C(3)(a)(ii) of the Act).

Record keeping

The lender must keep records about the inquiries made by the lender under section 9C (including the results of those inquiries). Those records must demonstrate how the lender has satisfied itself as to the matters in section 9C(3)(a), (4)(a), and (5)(a) (see section 9CA of the Act).

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.[1]

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.

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**.

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** or **other means of making any payment** under the agreement may include inquiries into:

[1] Subject to **paragraph 5.29** in relation to pawnbroking.

a. the borrower’s current income level;

b. the sources and stability of the borrower’s income, including likely changes; or

c. 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.

5.9. A lender’s inquiries into **expenses** may include inquiries 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. changes in the borrower’s relevant expenditure that are likely.

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 will 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.

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.

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.

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:

a. the size of the loan is large relative to the borrower's ability to repay;

b. the borrower's credit history suggests repeated challenges making payments under credit contracts or paying for necessities on time (e.g. utilities bills);

c. the borrower is a **vulnerable borrower**; or

d. 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:

a. the potential consequences include the loss of a significant asset; or

b. 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:

a. the risk that the borrower will not be able to make payments under the agreement without suffering substantial hardship is lower; and

b. 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:

a. 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

b. 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.

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.

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:

- *has unpaid balance on any high-cost consumer credit contract with another creditor (s 45F(1)(a));*
- *has had, at an any time within the preceding 15 days, an unpaid balance on any high-cost consumer credit contract with another creditor (s 45F(1)(b));*
- *has entered into 2 or more high-cost consumer credit contracts at any time within the preceding 90 days (s 45G(1)); or*
- *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.

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:

- *monetary payment of the redemption price (as defined under the SDPA); or*
- *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.