A Financial Ombudsman Service

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Consumer Policy
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Submissions on draft changes to chapter 5 of the Responsible Lending Code

We provide these submissions based on our experience investigating consumer credit complaints. In the 2022/2023 year we formally investigated 274 disputes, with 45% of those being about consumer credit (86 about general consumer credit loans, 17 about mortgage loans, and 20 about credit cards).

Through our work, we are well-placed to see where lenders are not meeting the requirements of the responsible lending principles, and to make suggestions about how gaps in the 2017 Code can be filled.

Question 4

We submit that paragraph 5.5 could include wording that the purpose of the inquiries into income and relevant expenses is to assess whether the income will exceed the borrower's **current** expenses, and any other **foreseeable expenses** that may become due (for example, the borrower's annual vehicle insurance premium). This is because we often see cases where the lender does not factor in expenses that the borrower will need to meet in the foreseeable future, because those were not expenses that showed on the borrower's last three months of bank statements. Arguably this could be captured by 5.9(d) – likely changes in the borrower's relevant expenditure. However, we think the wording should be more detailed here.

Question 5

Yes, the Code should provide guidance on the use of surpluses and buffers to account for uncertainty that the loan will be unaffordable. We suggest the Code says that there **should** be a buffer or surplus factored into all affordability assessments. We are often investigating complaints where the expenses effectively match the income, and in these cases we usually decide the lending is unaffordable because there is no 'wiggle room'.

We do not think it would be helpful for the Code to be so prescriptive that it would say what the actual buffer or surplus should be, or how one might be calculated. However, we consider that if there was guidance that a buffer or surplus **should** be included in all affordability assessments, this would hopefully ensure that lenders' affordability assessments are realistic. Further, it would be helpful for us to be able to point to Code guidance that a buffer/surplus should have been factored into the affordability assessment, when we are investigating complaints.

Question 6

The inclusion of paragraph 5.8 is very helpful because we see cases where a lender hasn't noticed red flags about unstable income and hasn't adjusted the income accordingly. We think Code guidance on this point would encourage lenders to look out for red flags about a person's income.

We also consider that the Code should say that a payslip or WINZ confirmation of income amounts is **required** to verify income, in every case. Often, information on the payslip indicates that income may be unstable. For instance, it would only be from looking at a payslip that you could see that a person is working overtime. A responsible lender should then check whether the borrower is likely to continue having overtime work available to them and adjust the stated income downwards if the borrower won't have it available.

Likewise, a WINZ confirmation can show whether the borrower has dependants. We find that in a lot of complaints we investigate, one of the issues is that the lender says they did not know the borrower had dependants or did not know the borrower had as many dependants. However, if some evidence of the income (besides the amount deposited into the borrower's bank account) was obtained, it would have made the borrower's financial position clearer.

We do not think it would be an overly prescriptive or time-consuming requirement on lenders to require evidence to confirm income, nor do we think it would be an overly difficult task for borrowers to provide this information. This is particularly because we regularly see the detrimental effects, especially on vulnerable consumers, of lenders getting the income figure, and the number of dependants, wrong. These consumers struggle to pay their loans, often borrowing from family or cutting back on essential spending for a few months, but then typically fall over paying the loan.

Question 7
We consider the wording of paragraph 5.9(c) provides a good balance between not being too prescriptive, but giving a good (and common) example of the type of expenses that lenders can sometimes miss as being ongoing regular expenses.

Question 8
We consider that the wording of paragraph 5.9 should be: 'A lender's inquiries into the borrower's expenses **should** include inquiring into', not '**may** include'. In our view, at a bare minimum, a lender would need to factor in, or at least consider, all the examples at paragraph 5.9(a) – (d), in all cases.

Question 9
We think it is worthwhile retaining guidance on joint expenses. The 2021 guidance is helpful because we often have cases where a sole borrower is taking out a loan, but they share expenses with others. However, we think that the concept of apportionment of expenses in the 2021 Code is problematic where there is a family unit (i.e. where just one of the partners is getting the loan). When the lender has apportioned in this situation, it often means the affordability assessment is unreliable. This is because it is inevitable that the family finances are much more intertwined than any assessment that attempts to artificially separate them, will portray. We think there should be guidance that where there is a family unit, the whole family's income and expenses need to be considered, even if only one of the partners is the borrower.

Questions 10 and 11
We think it would be helpful to have guidance saying that if a review of the borrower's bank statements show that the person is regularly using BNPL, this could be considered a regular recurring expense. Conversely, if there is small BNPL use, it could be considered discretionary and an expense that you would expect a borrower to cease if they began to find it difficult to pay their loan.

On a related note, we consider there is room in the Code for guidance (perhaps by way of a Code example), about the situations where a lender should be taking steps to enquire with the borrower whether they will forego expenses that appear to be discretionary, but where, if the borrower continued those expenses, it would render the loan unaffordable.

For example, we have investigated cases where the lender would have been able to see from the bank statements that a person regularly uses BNPL, across multiple providers, and we say they should have treated BNPL as a regular ongoing expense. Some lenders will push back and say that all BNPL spending is discretionary and

doesn't count as a regular expense, even though, if the borrower continued the spending behaviour their outgoings would exceed their income. In our view, that level of BNPL use likely indicates that the borrower will continue with the same spending behaviour after the loan is granted. In a case like this, we think a lender should have a conversation with the borrower to say that they would need to agree to stop the BNPL spending before the lending is approved.

The alternative is to ensure there is robust Code guidance around buffers and surpluses. Further we consider that the buffer or surplus amount chosen by the lender in a particular case may need to factor in not only a 'general' buffer amount, but an additional amount on top of that to mitigate the risk of a borrower not foregoing what could be considered 'discretionary spending' after the loan is granted.

In other words, a lender might need to factor in a higher buffer/surplus in a case where a borrower's budget is very tight and they appear to have a lot of discretionary spending, compared to a case where the borrower's budget is tight, but their bank statement shows they have very little discretionary spending.

Question 12
We think the guidance should say that a basic expectation/standard is that 90 days of bank statements (of all the borrower's bank accounts) **should** be provided in every case where income is being relied on to pay the loan. We continue to see affordability cases where bank statements have not been obtained and this immediately raises a question as to whether the lending is unaffordable.

Further, the information on bank statements is a helpful verification tool for most expenses without having to see, to use rent payments as an example, the rental agreement. The only time that further verification would be required, again using the case of a rental expense, would be if, for example, the amount stated by a borrower for rent or the amount on the bank statement seems unreasonably low for the borrower's circumstances.

Questions 13 and 15
We consider the 2017 guidance on statistical information is good, but we suggest changing the word 'class' of borrowers, because that can have negative connotations.

We think a lender only needs to use benchmarks / statistical information where the borrower has not included a particular expense in their application form (for example medical expenses), or where the amount stated by the borrower or on the borrower's bank statements for a particular expense appears too low or too high. For example,

using a benchmark for a weekly ‘food expense’ can be helpful, because people often spend on discretionary food in addition to their (typical) weekly full shopping trip. Rather than trying to verify what a person has been spending on food, it’s easier to just use a benchmark with the expectation that a borrower can cut down on their discretionary food spending, and are very likely to, in order to meet their loan repayments.

This can be compared with a utility expense (for example an internet bill), which is usually a regular amount showing on the person’s bank statement. In that case you wouldn’t need to use a benchmark.

It could be helpful to provide an example at paragraph 5.16 to guide lenders about situations where they might need to do more to verify an expense. We suggest an example could be where a borrower says that they pay $250 per week in rent, when they have children, which on the face of things seems unrealistic. A responsible lender should obtain a rental agreement to confirm the rent amount, and in the absence of that, they could apply a benchmark rent amount for a 3-bedroom home in the relevant city.

Question 17

We think paragraph 5.20(a) should not only be about the size of the loan compared to the borrower’s ability to repay, but it should also be about the amount of the **repayments** compared to the borrower’s ability to repay. Although the size of the loan is relevant and it’s helpful to have the guidance about this, for the consumer, it’s not so much the size of the overall loan, but their being able to make their repayments week to week, from their income.

Question 19

We consider that the proposed record keeping guidance will be workable. One helpful addition would be that where there has been a co-borrower situation, and then there is an affordability complaint sometime later after the co-borrowers have separated, the lender should redact the name of the party who has not made the complaint and send through the full file to the dispute resolution service.

We have noticed a recent trend where lenders tell us they cannot provide any information about the other co-borrower’s financial situation at the time the loan was approved. This is problematic because it hinders our ability to meaningfully investigate whether the loan was affordable. Sometimes the ex-partner will sign a release form, but more typically the complainant can no longer track them down.

Please contact us if you would like to discuss our submissions in more detail.

Yours sincerely

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