What is Responsible Lending and how do you determine it?

As a Responsible Lender, I'm sure you have checks and balances in place to check that your customer can afford the top up or new loan you are about to give them, right? But how do you really know that they can afford this loan and it isn't going to put stress on them and their family?

Loan stress has been identified as major contributor to cause long term effects on the quality of life and welfare of vulnerable consumers.*

As a Financial Counsellor for EAP (Employee Assistance Program) I see many clients from all sorts of backgrounds that are coming to us under financial stress. Often this stress is caused by unaffordable debt payments, often after taking on extra debt when they were already struggling.

This then raises the question time and time again, as to why they were able to borrow money they could not afford to pay back? Did the last company that gave them a loan, not check for affordability properly?

Often we then find that the company did check, but those checks were not sufficient, were based on incorrect information or there has been changes since the application.

Here are 7 red flags that your customer may already be under financial stress:

1. They are using the debt to pay for essential bills, such as power, rent, debt arrears
2. They live up to the limit of their overdrafts and/or their credit cards are maxed out
3. They are consolidating debt, because they are having difficulty keeping up with the debt they already have
4. They are on a low income relative to the number of dependants, and are relying on government support to get by
5. The amount they spend on food relative to the number of people they are supporting is minimal ($60 - $100/wk/adult is normal)
6. They are not able to put any money aside for savings, or redrawing back straight away the savings
7. There is minimal discretionary spending showing on their bank account, and it is mainly bills, food and petrol.

If you customer is already under stress, you need to question whether it is appropriate to lend more money to them if they are already struggling. There may be more suitable options such as getting money out of Kiwi Saver under hardship; renegotiating current loans or getting by without.

If in doubt, refer to them to a local free Budget Advisor or a Financial Counsellor if they work for an EAP company (most large government and corporate companies are in it).

If you have any questions about determining affordability and making sure your company is doing the right checks and balances to determine affordability, please contact the author for more advice.

Shula Newland is Manager and Owner of FULL Balance Financial Coaching, which has been providing practical, independent, affordable Financial Planning and Budgeting Advice to those seeking support with their financial decisions, for over ten years.

*Therese Wilson "Responsible Lending or Restrictive Lending Practices? Balancing Concerns Regarding Over-Indebtedness with Addressing Financial Exclusion" in Michelle Kelly-Louw, et al. *The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems* (Ashgate, Hampshire, 2008) 91 at 100. (Wilson)