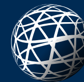

Strategi
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BEST PRACTICE GUIDANCE NOTE

CHANGES TO THE RESPONSIBLE LENDING CODE 31 JULY 2024

IN PARTNERSHIP WITH

FINANCIAL SERVICES FEDERATION

VERSION 1, AUGUST 2024

Introduction

A new version of the Responsible Lending Code (RLC) was effective from 31 July 2024. The updated Code was a part of changes resulting from the Credit Contracts and Consumer Finance Amendment Regulations (No2) 2024.

This Guidance Note is for all those lending to or providing regulated financial advice to retail clients seeking loans which are captured under the Credit Contracts and Consumer Finance Act 2003 (CCCFA).

This guidance note covers:

- The reasons for the repeal of the CCCFA affordability regulations;
- Key changes to the RLC;
- Practical steps to ensure compliance;
- Document updates and advice processes; and
- How to meet CPD and compliance obligations.

Overview of changes and why they were required

The Credit Contracts and Consumer Finance Amendment Regulations (No2) 2024 (the amendment regulations) removed the regulatory burden associated with prescriptive affordability requirements and redundant COVID-19 exemptions from the Credit Contracts and Consumer Finance Regulations 2004. Regulation 4AO (High-cost consumer credit contracts: presumption of substantial hardship) was retained.High-cost consumer credit providers are still required to undertake detailed affordability assessments to ensure that the borrower can make the repayments under the loan without suffering substantial hardship.

The RLC was amended to provide lenders with guidance on how they could meet lender responsibilities under CCCFA now that the more prescriptive affordability requirements no longer apply. The RLC is not a compliance safe harbour. Instead, the Code provides non-binding guidance and lenders can choose to comply with the lender responsibility principles in other ways. However, if it can be evidenced that a lender followed the Code, then this will be treated as evidence of compliance with lender responsibility principles provided other obligations and actions are compliant.

Why were the changes made?

The CCCFA changes made in December 2021 required lenders to collect more detailed information from borrowers before lending them money or extending further credit under an existing loan. Borrowers were required to provide details around income, expenses and why they needed loans. The intention behind these changes was to better protect borrowers from taking on unaffordable debt and provide greater clarity for lenders when assessing loan applications.

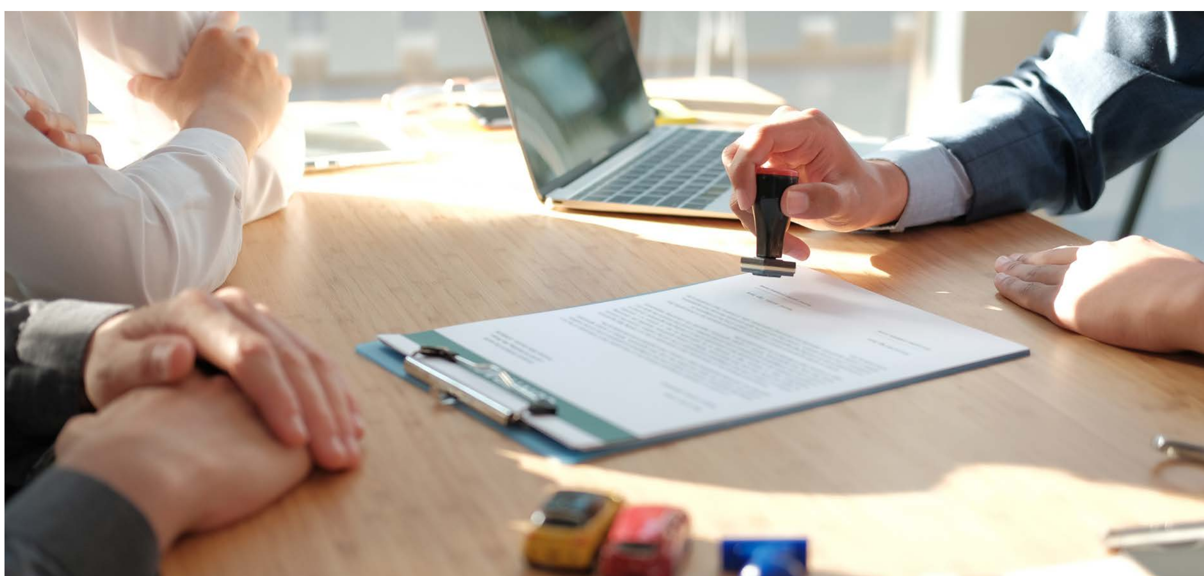
The 2021 changes have proved controversial and ultimately short-lived. They quickly gave rise to complaints for being overly restrictive, requiring intrusive information from potential borrowers and causing long wait times for applications to be processed. There were a number of media stories about creditworthy borrowers being refused loans due to spending too much money on Christmas shopping, takeaways and streaming services. The changes, combined with interest rate increases in late 2021, restricted access to credit from responsible credit providers, including borrowers whose circumstances make them more vulnerable and who are the people the 2021 changes aimed to protect. The 2021 changes also appear to have caused a forced retreat of first home buyers from the housing market.

The 2024 changes "clarify" how lenders should approach the assessment of bank statements when calculating potential borrowers' expenses, how lenders can adjust expenses to account for likely future reductions in borrowers' discretionary spending and how the exception for "obvious" affordability should be applied.

Chapter 5 of the previous Code was largely premised on the affordability regulations, which have now been revoked. A new Chapter 5 was therefore needed in order for the Code to continue to fulfil its purpose and reflect the change in policy regarding affordability assessments.

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 was thought to have resulted in some consumers being denied credit they can in fact afford.

The main characteristic of the affordability regulations that contributed to this problem was the fact the requirements applied to 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.



Key changes to the Responsible Lending Code

Guidance

The highlighted words have been added.

> **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,
>
> **a.** as well as:
>
> **i.** meet necessities (such as accommodation, food, utilities, transport, required medical expenses, clothing, costs associated with any dependents (such as childcare)); and
>
> **ii.** meet other financial commitments (such as repayments on existing debts, insurance);
>
> **b.** without having to:
>
> **i.** further borrow from another source in order do any of the above; or
>
> **ii.** sell or realise property or assets other than those the borrower has indicated a clear intention to use to make any payment under the agreement.

The highlighted examples were added to provide more guidance. However, the addition of these examples should not be interpreted to mean this is an exhaustive list. It should be noted that use of the word 'must' means it is referring to statutory obligations in the CCCFA or regulations and it indicates actions a lender must take to be compliant.

However, when the Code says that a lender 'should' do something, it is intended to reflect an understanding that the action is required by the lender responsibility obligations and to show compliance with the Code.

In the case of 5.1, lenders can add other items they think are relevant to borrower expenditure. Therefore, lenders have more flexibility in how they can assess affordability.

Paragraphs 5.2 and 5.3

The example in paragraph 5.2 is designed to suggest an approach that is reasonable and appropriate but it is a 'should' rather than a 'must'. Lenders can select an alternative way to take into account that interest rates may rise.

Paragraph 5.3 has removed the concept of a 'buffer' or 'adjustment' and has provided greater flexibility for lenders to determine what they believe is reasonable.

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 a borrower's capacity to make the payments required, the lender might:

a. use a single, sensitised interest rate that is higher than the loan's actual interest rate;

b. use the loan's actual interest rate plus a margin; or

c. apply an interest rate floor, to ensure the interest rate applied reflects higher likely 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. are greater than any minimum required payments

b. are sufficient to repay the full amount of the loan within a period that is reasonable in the circumstances.

Purpose of inquiries

Paragraph 5.5 gives lenders greater flexibility as it enables lenders to avoid having to undertake inquiries into income and expenses where the borrower intends to rely wholly on means other than income to make repayments under the agreement. Examples could be the sale of a house or receipt of an inheritance. If this was known, then the lender would be expected to make reasonable enquires into that sale or inheritance to have comfort it was likely to occur.

5.5 To meet this lender responsibility, a lender should make reasonable inquiries into a borrower's i**ncome, expenses** and **likelihood of repayment.** However, inquiries into income and expenses may not be necessary where the borrower intends to rely wholly on means other than income to make payments under the agreement, in which case a lender should make reasonable inquiries into those means. Means other than income may include, for example, proceeds from the planned sale of an asset or savings that will become available during the term of the agreement.

Paragraph 5.7

The latest update to the Code is less prescriptive and provides increased flexibility for lenders to consider the individual circumstances of borrowers. However, paragraph 5.7 requires Lenders to have a defendable basis for their decision making and has suggested guidelines such as minimum surplus, buffers or adjustments as tools to support decision making.

> **5.7** A lender should consider the risk of materially overestimating the borrower's income or other means, or materially underestimating their relevant expenses. A lender should consider the extent of any steps that may be reasonable in the circumstances to address any such risk, which may include, for example, use of a minimum surplus, buffers or adjustments.

5.7 Scope of inquiries

This section- paragraphs 5.8-5.18 has been expanded. It now provides an increased level of examples to help lenders assess a borrower's ability to repay in different circumstances and help lenders better determine what they believe is reasonable in those circumstances. It enables lenders to identify what is a necessary expense and what is a luxury and to make a reasonable assumption that the borrower may reduce discretionary expenditure once the agreement has been entered into. However, the lender is still expected to confirm any assumption with the borrower.

Method of inquiries

Paragraphs 5.19-5.24 relate to the method of inquiry when assessing loan affordability. Where a borrower is wanting a new loan or an increase, then there is no need to undertake a full analysis of income and expenditure. The lender can use existing information it already holds but before doing so, the lender should check that the information is still correct.

> **5.20** Where a lender is using information it already holds about the borrower in accordance with paragraph 5.19 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.

The section on method of inquiries is not substantially different to the 2023 version of the Code. However, it is worth noting that paragraphs 5.23 and 5.24 place a responsibility on a financial adviser or intermediary to ensure the information provided to the lender is correct. This needs to be considered in conjunction with the lenders Fair Conduct Programme if the lender is a financial institution (bank, NBDT or insurer). A lender should require financial advisers/financial intermediaries to have the necessary policies and procedures in place to collect and check borrower information and for their staff to be trained on the Code and lender responsibility principles.

5.20 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.

5.24 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 nor other intermediaries, remains responsible for ensuring the lender complies with its responsible lending obligations.

Extent of inquiries

Paragraphs 5.25-5.28 relate to the extent of enquiries.

One of the core problems with the affordability regulations was that they did not adequately encourage lenders to differentiate their approach to assessing affordability based on risk. The updated section on extent of inquiries is designed 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 the approach in cases where that risk is particularly low, such as refinancing and cases of ‘obvious’ affordability.

Inquiries should be more extensive if the credit agreement is a high-cost credit agreement (paragraph 5.26 a iv).

Record keeping

Paragraphs 5.29-5.33 relate to record keeping.

The record keeping guidance in the previous Code was based on the affordability regulations. The record keeping section in the latest version of the Code provides firm guidance on the kind of information lenders should keep. The ability for lenders to take what they believe are reasonable steps to assess affordability in individual borrower circumstances now necessitates lenders being more diligent with record keeping. They need to be able to justify the assumptions they made relating to income, expenditure and overall affordability and be able to produce this when required by the regulator. Paragraph 5.33 is worth noting.

5.33 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. To the extent a lender wishes to demonstrate compliance with provisions in this chapter, they should keep records of the reasons for the decisions this chapter suggests they should make (such as the steps referred to in paragraph **5.7** that may be appropriate).

Practical steps to ensure compliance

- Thoroughly understand the 31 July 2024 RLC, then undertake a gap analysis between the updated Code and your lending guidelines document(s). Amend your lending guidelines to how you wish to operate, but cross reference to check that all aspects of the RLC and Lender Responsibilities are met. If you are intending to deviate from the RLC guidance, then document your rationale and how your intended approach still meets lender responsibilities.
- Document any new assumptions you are now using to assess affordability and how these are justified.
- Review your record keeping policy to ensure all the appropriate information is being captured and stored.
- Ensure all lending staff are updated on the revocation of the affordability regulations, the changes to the RLC, changes to company policies and lending guidelines and changes to any forms and templates. This training should be noted in a training register so evidence can be provided to the regulator on who attended the training, the content of the training and date of the training.
- Ensure directors and senior managers are fully aware of the changes and have implemented all necessary controls to ensure the new Code is followed. Document director and senior manager upskilling the same way you need to for staff.
- Review all marketing literature including the website, brochures and templates to ensure they align with the RLC and your amended lending guidelines.
- Review any lending calculators or spreadsheets used to assess affordability and update to reflect any changes you have made. Where necessary, get the calculators and spreadsheets independently checked.
- If using financial advisers/financial intermediaries, then ensure they have the competence, knowledge and skill, plus policies and processes to understand the 31 July 2024 RLC and collect and verify the correctness of information submitted.
- The business needs to be able to identify whether it is meeting its compliance obligations and if not, then quickly fix the issue and put things right. One prudent way to do this is to engage Strategi Compliance to undertake an independent CCCFA compliance assurance review.

Document updates and advice processes

As noted above, if the business intends to alter its processes and take a less rigid approach to assessing affordability, then it is likely a number of documents may need amending plus the advice/loan assessment/approval process may need altering.

Calculators and application forms may need amending. Any changes to any documents and processes should go through a signoff process to ensure they are correct and meet the RLC and Lender Responsibilities.

Staff will need training on any changes. All documents and templates should have good version control. This will enable you to remove from circulation any old documents and introduce new documents. If document version control is not yet in place, then it is recommened it be implemented immediately.

Check your systems and processes to ensure they capture and store the relevant information. Use the changes to the RLC as a catalyst to introduce a more streamlined approach.

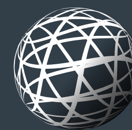
Have an external organisation such as Strategi Compliance undertake a compliance check of your policies and procedures.

How to meet CPD and compliance obligations

Continuing professional development for staff, senior managers and directors is important as awareness of legislation, regulation and the RLC helps demonstrate a positive compliance culture. When legislation and regulation provides increased flexibility to lenders, then the need to train staff to a higher level often becomes more important. Highly trained staff usually translates to fewer errors, an increased ability to apply a risk based lending approach, plus an increased level of borrower satisfaction.

Embrace the changes to the RLC and the revocation of the affordability regulations so the business is able to provide more loans to potentially a larger group of borrowers. However, the cost of getting things wrong is huge so seek professional compliance advice and obtain an annual compliance checkup from Strategi Compliance.

Demonstrate a high level of professionalism and gain confidence that your key staff are knowledgeable about Responsible Lending. There is now a **Consumer Credit (Micro-credential) (Level 5)** that is the benchmark for demonstrating completence, knowledge and skill. This NZQA approved qualification is available for under $1000 per employee and having staff with his nationally recognised qualification will demonstrate a commitment to good customer outcomes and compliance with your obligations.



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