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Signing up to a loan



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This guide is the first of a series of three which explain what you need to know if you are borrowing money. These guides will give you practical guidance about your rights and what you need to be aware of:

- before signing up to a loan
- during your loan, and
- if you have problems with your loan.

The Credit Contracts and Consumer Finance Act 2003 (**CCCF Act**) is a law that helps protect you when you are borrowing money for personal or domestic reasons. The CCCF Act sets out rules that your lender must follow when lending you money. These rules mean:

- you can get information to help you shop around for the best loan
- lenders must make enquiries to make sure you get a suitable and affordable loan
- lenders must help you understand what you are agreeing to.

1. Shopping around for a loan

Shopping around before you choose a lender is the first step in making sure you get a loan that suits your needs.

Under the credit laws, lenders must make information about their loans freely available to you at their offices or on their websites. This information will help you to compare interest rates and fees and other loan features between lenders.

I got an email from a company that offered to lend me some money, I think I'll do it.

I've got a better idea, let's look online and choose the best one to talk to.



For example, when buying a car you do not have to get finance from that car dealer. You can shop around to find the best finance deal for you.

The loan for this car is so expensive!

There's a better deal down the road. We can get the car here but let's see if we can get the loan at the other lender's place first.



Be cautious of loans that are offered with rewards, gifts, prizes, cash-backs and other inducements – and make sure that you are getting a good deal on the loan as a whole. For example, a car dealer may offer a \$3,000 cash back if you purchase a particular car, or a bank may offer to pay \$1,000 for your legal fees for your housing loan.

It can be hard to compare deals that not only have different interest rates and fees, but which add in rewards as well. Sometimes the rewards are a cost that is hidden in the loan terms, and you will end up paying more as a result. You should take a close look at the rewards you are offered as well as the terms of the loan and work out how much it will cost you overall.

If you have already signed up for a loan but see a better deal later, can you change to a new lender?

Yes, you are entitled to exit a loan early by repaying what you have borrowed, including any fees that your current lender charges for repaying the loan early. Keep in mind the new lender is likely to charge you fees for setting up a new loan. For more information, see question 6: *Can you get out of a loan contract?*

Before you switch lenders, be sure to compare the overall cost and terms of your current loan with the new loan and work out whether you will be better off if you switch. Once you add in the costs of switching, it might not be worth it. Go to the Sorted website www.sorted.org.nz to work out the best deal for you.



The loan you are offered can vary greatly from lender to lender. Always compare a few different lenders to find the best deal for you.

2. What can you expect from your lender?

Your lender must meet a set of ‘**lender responsibilities**’ to you throughout your loan. This means that your lender must act carefully and responsibly at all times, and treat you reasonably and with respect. When entering into your loan, the most important lender responsibilities are that the lender must:

- make enquiries to check that the loan is **suitable** for your needs
- make enquiries to check that you can **afford** the loan
- help you to **understand** the key terms of the loan before you enter into it
- ensure the loan agreement is **not oppressive** and that they do not treat you oppressively. (For more on this, please see the third guide in this series: *Problems with your loan* www.comcom.govt.nz).

Your lender must check whether the loan is suitable for you

Your lender needs to check it is likely that the loan will meet your needs and be suitable for you.

Expect your lender to ask questions about:

- The amount of credit you need.
- The purpose of the loan. For example, you may need the loan for a sudden unexpected short-term cost (such as an air ticket or medical costs) or to make a planned long-term purchase, such as a household appliance or a car. Different kinds of loans can be better in different situations.
- Whether you will need any flexibility attached to your loan (for example, you may wish to be able to change how often you make your payments, or to re-borrow any amounts that you repay).
- Whether you want to be able to pay off lump sums during the loan.
- Whether the loan will include extra products, for example loan insurance, extended warranties or repayment waivers (see box below).



Your lender must check that the loan is suitable for you.

Loan or credit-related insurance is insurance connected to your loan which is designed to protect you and your lender if the goods or property over which the lender has security (see box out on page 10 for what this means) are damaged or lost, or something happens that affects your ability to repay the loan.

An **extended warranty** is an agreement where the lender agrees, for a fee or premium, to repair or replace defective goods after the normal warranty period no longer applies. Extended warranties can provide you with additional protection over and above what you would have under the Consumer Guarantees Act 1986. Lenders sometimes offer extended warranties for goods that they have security over.

A **repayment waiver** is an agreement where you pay an extra amount to the lender on the condition that the lender will waive the right to any unpaid amounts if you become unemployed, injured, sick, disabled or if you die.

See *Section 5* later in this guidance to find out more about insurance, waivers and warranties that may be connected to your loan.

Your lender must check whether the loan is affordable for you

Your lender must make enquiries to check whether you are likely to be able to make your loan payments without suffering **substantial hardship**.

What does 'without suffering substantial hardship' mean?

The test is whether you can afford to make repayments on your loan without undue difficulty, while paying for all your necessities and meeting other financial commitments.

Necessities include such things as accommodation, food, power, telephone, transport and required medical costs. Other financial commitments might include repayments on existing debts or child support payments.

Your lender also needs to check that you can make payments without having to sell goods you did not intend to sell when you signed up to the loan.

Expect your lender to ask you questions about:

- your income (for example, what you earn, how regularly you get paid and how long you have been in your job)
- your expenses (for example, what you pay for accommodation, food, childcare costs, and debts)
- your credit history and whether you are likely to be in a position to repay the loan.

Your lender also needs to see documents that prove your financial situation. When you meet with a lender about a possible new loan, they might ask for all relevant financial documents (for example, payslips, bank statements, mortgage documents, existing loan contracts and insurance documents). Even if they do not ask for them, it's a good idea to show them these documents. Having them with you will help you to answer the lender's questions and will help the lender to understand your current financial situation.

You may wish to consider getting advice from a budget adviser, to help work out whether you are in a position to be able to pay back a loan.



Your lender must check that you can afford to pay back the loan without undue difficulty.

Your lender must help you to understand your loan

Before you sign up, your lender is required to provide you with **key information** about your loan in writing. This is called a disclosure document (see box on page 7 for more about this). Your lender also must help you to understand what you are committing to before you sign up, by discussing the key information in the disclosure document with you and by answering your questions.

To help you understand the loan, a lender should:

- Clearly highlight the key features of the agreement (for example, by providing a copy of the agreement and circling key features while explaining them, or ensuring key features are highlighted clearly on an online loan application). Key features you should look out for include the term of the loan, interest rates, fees, the repayments you will need to make, and whether security is being taken over anything else you own.
- Give you plenty of time to fully consider the loan (for example, by giving you information to read off-site, and the time to consult with another person).
- Provide access to an interpreter or information in another language, if you do not have a good understanding of the English language.

A lender may also recommend that you seek legal advice. This can assist if you are not sure what you are committing to.

If you do not understand something about the loan, make sure you ask. If the lender is aware that you have not understood some aspect of the agreement, they must explain it to you in a way you understand.

Take your time and do not sign up to an agreement unless you are really clear about it.



Your lender must help you understand the key terms of the loan before you enter into it.



3. What is the total cost of your loan?

Your lender must provide key information in writing to you in what is called the 'disclosure document'. Your lender must discuss this key information with you before you sign up – this includes all the costs of the loan.



The document you receive before you sign up to a loan is called a **disclosure document**. This document contains all the key information you need to know about the loan. Carefully read this information and ask your lender to explain if there is anything you do not understand.

The two main costs are:

- the amount of **interest** you will pay over the life of the loan
- the **fees** that you will be charged and the fees that you could be charged if different things happen throughout the loan.

Remember, there may be other optional costs associated with your loan which could add to the total amount you will have to repay (for example there might be extra costs if you choose to draw down your loan early).



If you think the interest and fees are too high, you do not have to sign the contract – ask the lender to clarify, take more time to think about it, shop around, or get some independent advice.

Interest

Interest is what a lender charges you for having the use of their money. Two important things to consider are the **interest rate** and the **total interest** you will have to pay over the life of the loan.

Interest rate

The lender must clearly state the **annual interest rate** in the loan documents – which is the rate of interest that will be charged per year. This will often be called 'per annum', 'pa' or 'per year'.

Sometimes, lenders refer to monthly, weekly or daily interest rates which can be confusing.

However, they should all display an annual interest rate **as well**. When you are comparing the cost of loans make sure you compare the right interest rate. The **annual interest** is the best rate to compare.

If you are unsure whether the interest rate stated is annual or not, ask the lender.



Advertising of interest rates: This lender was advertising 8% interest. Some borrowers thought it was an annual interest rate when the rate was actually a weekly interest rate – see the ‘pw’ in small print after the 8%. The annual interest rate worked out to be 416%.

To see what this means in practice, let’s say you take out a loan of **\$100** and want to pay it back in equal monthly payments within one year:

At a **weekly** interest rate of 8%, it would cost you a total of **\$428** (includes \$328 interest) to pay it back.

At an **annual** interest rate of 8%, the same loan would cost you a total of **\$108** (includes \$8 interest) to pay it back.

Lenders compete with each other on their interest rates so these can vary widely depending on such things as the lender, the type of loan, and your credit history. It is worthwhile to look at the information that lenders have to provide to you and use it to shop around.

Total interest payable

Lenders must also make clear to you the **total interest** to be paid under the contract **before** you sign up, both in their discussions with you and in the disclosure document you receive before you sign up to the loan. Total interest means the all-up amount of interest that you will pay if the loan goes for its full term.

The term of the loan (its duration) is a factor that has a big influence on how much total interest you will pay on a loan.

The only time a lender does not have to tell you the total amount of interest is where it is unknown. Examples are credit card contracts, which allow you to re-borrow amounts that you have paid off, or loans that will take more than 7 years to pay off, like many housing loans.

If you are not sure what the total interest on your loan is, then ask your lender to clarify and to point it out in the disclosure document – **before** you sign up.

Can you be charged interest on some of the extra products (like insurance) you receive?

Yes. For example, insurance premiums may be added to the total balance of your loan at the start and so you will be paying interest on the cost of the insurance throughout your loan. Make sure you consider these extra costs when making your decision to take out the loan and/or the insurance.



Interest can make your loan expensive in the long term even if the weekly rate seems very low. Check the annual interest rate and how much interest you will have to pay over the life of your loan.

The longer you take to pay off your loan, the more interest you will pay, and so the more the loan will cost you in the end. You may be surprised how much extra your loan will cost you if you pay it over a longer period.

Example: You get a loan to buy a \$5,000 car. The lender is charging you 20% interest.

If you pay the loan off **over 2 years** in equal monthly payments, you will pay

\$6,107

including \$1,107 interest

If you pay the loan off **over 3 years** in equal monthly payments, you will pay

\$6,689

including \$1,689 interest

That's nearly **\$600** extra (about 10% of the cost of the car) that you would have to pay back for extending the loan **for 1 extra year**.

Note: this example does not include the cost of any fees.

If you want to work out how much your loan will cost you, you can use the debt calculator at www.sorted.org.nz/tools/debt-calculator.

Fees

What fees should I look out for?

Lenders can charge many different fees, but they fall into three main groups:

- **Credit fees:** such as the fee you pay for setting up the loan (called an 'establishment fee') and fees for repaying your loan early.
- **Default fees:** fees that are payable if you break the terms of your loan, for example by missing one or more payments.
- **Third party fees:** fees that your lender passes on to you from another person or company, such as fees for getting a credit check or registering a 'security interest' (see box on page 10 for what this means).

There are some important rules about the fees a lender can charge:

- Before you sign up, the lender must give you a written description in the disclosure document of all the fees that you must pay and those you may have to pay, if different things happen during the loan.
- Credit and default fees must be reasonable and third party fees have to be passed on to you without the lender adding anything extra on top.



Check all the fees you may have to pay for setting up a loan, missing repayments or repaying your loan early. Your lender must tell you what these are before you enter into the loan.

Your lender also needs to give you information about what to do if you have a problem with your loan or your lender, and how to contact your lender's dispute resolution scheme. This information must also be included in the loan disclosure document given to you before you sign up.

A lender must be registered on the Financial Service Providers Register and be a member of a dispute resolution scheme, which is a free service that you can use if you have problems with your lender. For more information, see the third guide in this series: *Problems with your loan* www.comcom.govt.nz.

What is meant by security or a security interest?

Sometimes your lender may ask you to give them what is called a '**security interest**' in something you own or that you are paying off. This means that they can take the item from you and sell it if you miss payments or otherwise break the terms of your loan contract. For example, your lender may take security over the car that you are paying off. If you miss repayments on your car loan, your lender could seize your car and sell it (unless you quickly catch up on your payments and pay any default fees and default interest owing).

However, lenders may **not** take security over – or repossess – some specific consumer goods and documents.

Consumer goods that cannot be subject to a security interest:

- Beds and bedding
- Cooking equipment including stoves
- Medical equipment
- Portable heaters
- Washing machines
- Refrigerators

The only exception to this rule is where you took the loan out specifically to purchase one of these household items. For example, if you have taken out a loan to purchase a bed, then the lender can use the bed as security for the loan, and therefore the bed could be repossessed if you fall behind and miss payments. There is more information on what you can do in these kinds of situations in our third guide in this series:

Problems with your loan www.comcom.govt.nz.

Documents that cannot be subject to a security interest:

- Travel documents
- Identification documents
- Bank cards

The contract needs to clearly identify any items you give the lender security over – if you cannot make your repayments, your lender can only take those things listed. Think carefully about the things you provide as security as you may lose them in the event you cannot make your repayments.

4. When do you need a guarantor?

Sometimes a lender will require you to provide a guarantor. A **guarantor** is someone who is prepared to pay off your loan if you are unable to do so. Their agreement with your lender is called a guarantee. Having a **guarantee** can help you to get a loan in situations where the lender would otherwise be unwilling to lend to you.

Your guarantor can expect most of the same things that you can expect from your lender (see *What can you expect from your Lender?* on page 3).

In summary:

- Your lender must also provide your guarantor with key information about your loan in the disclosure document, before they sign up. The terms of the guarantee must be clear and concise.
- Your lender must take steps to make sure your guarantor is reasonably aware of what they are committing to before they sign the guarantee. For example, if your guarantor has a low income but owns a house, they must make a decision, before they sign the guarantee, about whether they are prepared to sell the house in the event that you are unable to meet your loan payments.
- Your lender must make enquiries to check whether your guarantor is likely to be able to make your loan payments without suffering substantial hardship. See the box on page 5 to see what 'without suffering substantial hardship' means.

The CCCF Act contains these protections for guarantors because being a guarantor can be risky, and your guarantor is responsible for paying the loan if you stop repaying it.

5. What should you know before buying insurance, waivers or warranties?

A lender may recommend or require you to buy insurance, a waiver or a warranty when you take out your loan. See the box on page 4 for more information about what these products are.

In some cases, a lender can make you take out insurance, waivers or warranties under the terms of the loan. For example, if the lender has a **security interest** over something you own (see box on page 10 to see what this means), such as a car, home, or appliances bought on credit, they can require you to insure the item. If they have a good reason, your lender can even insist that you buy a particular insurance policy. But remember if you do not want to buy the insurance, waiver or warranty you can always look around for a loan from a different lender.

However, as a responsible lender, your lender needs to be satisfied that any insurance, warranty or waiver they sell you will be likely to meet your needs and objectives. You can expect your lender to ask you questions about your needs, for example they might ask whether you have existing insurance. They should also explain the key features of the product to you, what is excluded, and any conditions that you must meet when making a claim. The lender must also be satisfied that you are likely to be able to afford the product, without causing you substantial hardship. And of course the extra cost of the product will come on top of your new loan payments.

Your lender has a responsibility to clearly explain to you exactly what will be covered under any insurance policy, warranty or waiver that they sell you as well as what will not be covered, and any conditions that apply.

For example, some lenders offer mechanical breakdown insurance to cover the cost of any mechanical problems you have with your car while paying off a car loan. But in order to claim on your mechanical breakdown insurance the contract may state that your car will need to be warranted, registered, and recently serviced. So make sure that you understand exactly what is covered and what is not. If you do not understand – let the lender know. You can ask them to let you take the policy away and talk to a budget advisor or someone else that you trust in order to help you understand.

Are these products compulsory?

It depends on each loan, but it can be reasonable for a lender to make insurance, warranties or waivers compulsory for some loans. Make sure you understand whether the lender is requiring you to buy the product (in order to get the loan they are offering you) or whether you have the option to buy it or not. If you have an option to buy the product, think about its cost, the benefits and reassurance it provides, and the likelihood that you will need it before you sign up.

If you are considering buying a warranty for items that you are buying with your loan, be aware that your lender may already have legal obligations to you if the goods are defective.

In most cases, the person or business who sells you the goods and arranges the warranty has to tell you what extra benefits the warranty delivers over and above your rights under the Consumer Guarantees Act. For more information see our fact sheet *Extended warranties* www.comcom.govt.nz.

If you do want to buy the product, make sure you only buy a product which is right for you and meets your needs.

You do not have to buy insurance, a warranty or a waiver if the lender does not have a good reason for making you. For example, a lender should not make you buy income protection or redundancy insurance if you are not employed and don't have a job lined up.

If you have existing insurance that covers some of the risks that your lender wants covered, you may not have to buy it. For example, your lender may require you to have adequate home contents insurance before they will lend you money to buy household goods. If you have a current contents insurance policy, you should discuss that with the lender – it may be sufficient for the lender's and your needs.

You can always try another lender if you think you already have adequate insurance but a lender is requiring you to buy more. You may be able to find a lender who will not require you to buy more insurance.



Don't be pressured into buying extra insurance if you think you already have sufficient cover.

6. Can you get out of a loan contract?

Yes, you can get out of any loan contract – but it can be costly to do so.

Before you sign up for a loan, make sure you think very carefully about what you are agreeing to and whether you can afford it. By signing a contract, you are agreeing to its terms and to meet your end of the deal.

Early repayment of a loan

You can end a loan contract at any time by repaying the total amount of the loan, including any fees that apply to early repayment. If you think you might want to repay a loan early, then you should look carefully at what that might cost you before you enter into the loan and discuss it with your lender.

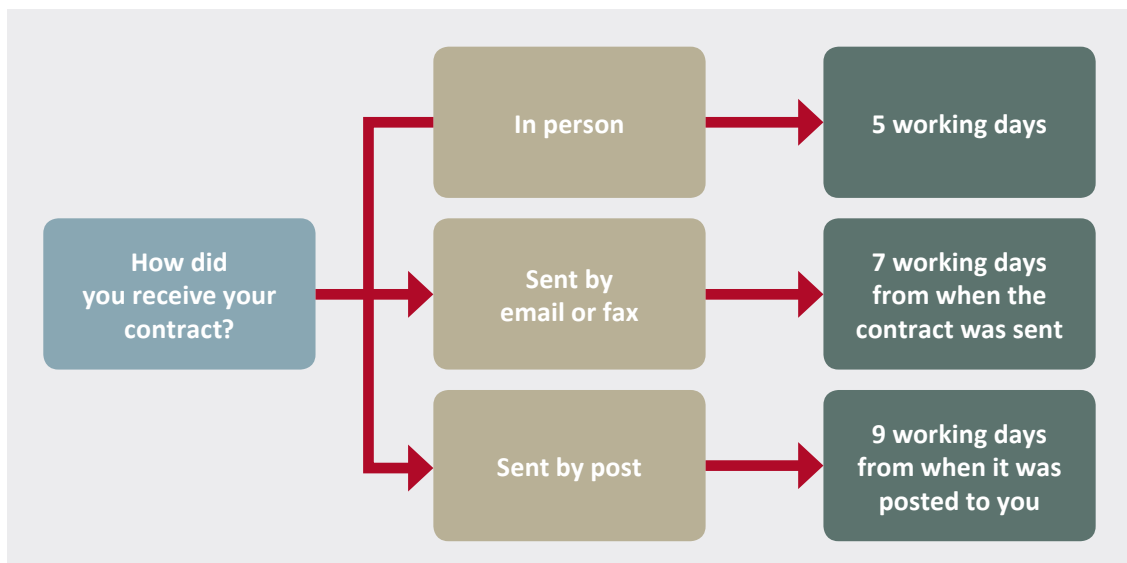
'Cooling off period' at start of loan

There is also a short window at the start of a loan when you can change your mind and get out of the contract. This short period is called the 'cooling off period'.

Length of cooling off period

The number of working days you have to cancel your loan contract depends on how you received the completed loan contract. Use the chart below to work out how long you have to cancel your contract. (Note: these timeframes start from when you receive your disclosure document.)

How long do you have to cancel your new loan contract?



If you cancel your contract within these timeframes, you may still have to pay fees and lender's costs for the time that you have had the loan but these fees should be less than you would have to pay if you try to repay outside the cooling off period.

You should always cancel your contract in writing, so that you and the lender have a record of what happened in case there is any dispute. You generally cannot return items you have purchased on your loan if you have taken them away with you or they have been delivered. In most cases you will have to find another way to finance them.



Be quick if you change your mind after you sign up to a loan.

7. What will happen if you miss a payment?

If you miss a scheduled loan payment you may be charged extra fees. These extra fees are called **default fees**. Make sure you check what fees you will have to pay if you miss one or more payments (ie, if you 'default' on your loan).

You may also have to pay a higher rate of interest, called a default interest rate. However, your lender can only charge you the default interest rate on the amount you are late paying back – not on the whole amount of the loan. Any default interest rate must be set out in the initial disclosure documents and, if not, the lender cannot charge it.

The default interest rate is usually significantly higher than the ordinary interest rate, so make sure you know what the default interest rate is before you sign up. For more on default interest rates, and how lenders may charge them, please refer to the third guide in this series: *Problems with your loan* www.comcom.govt.nz.



Check what interest rate you will be charged if you miss a payment. Default interest rates can be very high!

8. Where to go for further advice and information

You can contact your local Citizens Advice Bureau at www.cab.org.nz or 0800 367 222, Community Law Centre at www.communitylaw.org.nz, or Budget Advice Services at 0508 283 438.

You or your adviser can also complain to the Commerce Commission if you think your lender has breached their obligations in any way. We are not able to take action on every complaint we receive but we can investigate and take enforcement action in appropriate cases. You can make a complaint through our complaint form at www.comcom.govt.nz or by calling us on 0800 943 600.

Want to know more?

There are two other guides in this series that give you practical guidance about your rights and what you need to be aware of:

- during your loan
- if you have problems with your loan.

Check out our fact sheets on the CCCF Act at www.comcom.govt.nz.

Further guidance on lenders' responsibilities to borrowers can be found in the *Responsible Lending Code* www.consumerprotection.govt.nz.

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This is a guideline only and reflects the Commission's view. It is not intended to be definitive and should not be used in place of legal advice. You are responsible for staying up to date with legislative changes.

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