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Dear Mr Mikula

Consumer Leases: Outstanding Issues for Resolution

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on The Treasury's discussion paper *Consumer Leases: Outstanding Issues for Resolution*.

Briefly, this submission:

- argues that the purpose of any reform of regulation of consumer leases should be to:
 - allow the National Credit Code to distinguish consumer leases from credit based on the substance of the arrangements rather than their form; and
 - remove incentives for businesses to structure credit contracts as leases by removing unnecessary differences in regulatory burden between the two (including in disclosure)
- recommends that the definition of 'consumer lease' in the National Credit Code should provide that:
 - a consumer lease cannot provide either a right or obligation to purchase;
 - a consumer lease must allow the consumer to return the goods being leased at any time without penalty; and
 - a contract where the intent of the parties (as determined by objective factors) is that the consumer will ultimately purchase the goods is a credit contract;
- supports amendments to the National Credit Code to require consumer lease providers to disclose:
 - cash value of goods;
 - amount paid in excess of cash value;
 - total cost of the lease;
 - a nominal interest rate; and
 - the cost of ancillary products and servicesin lease agreements and a financial summary table, noting that many consumers do not understand important features of existing credit disclosure arrangements;
- in addition, we recommend that consumer lease providers should be required to disclose total cost of lease agreements in marketing material if that material provides other information on cost (such as a 'per week' cost);

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- Supports the proposals that lessors, as part of their responsible lending assessment, would be required to make specific inquiries as to:
 - whether a consumer wants to own the goods; and
 - the costs and benefits of using a lease.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Whether a lease with an option to purchase should continue to be deemed a sale by instalments

We welcome this opportunity to discuss how consumer leases should be defined. As we have argued in the past, we believe many Rent to Own arrangements currently on the market are in substance credit contracts that are structured as consumer leases as an avoidance technique. The aim behind any new definition must be to allow the National Credit Code (**the Code**) to distinguish between credit contracts and consumer leases based on the substance of the arrangements, rather than their form.

Any amended definition should also discourage businesses from re-drafting contractual terms to ensure that their contracts are regulated in a more 'light-touch' fashion, particularly around price disclosure but also rights of the trader to repossession. Our casework experience is that some credit providers have adapted contracts so as to be considered consumer leases rather than loans. For example, Motor Finance Wizard began offering consumer leases after Code amendments meant its 'interest free' loan arrangements were regulated as credit contracts. We note Motor Finance Wizard still promote its service through the phone number 1300 CAR LOAN despite clients contacting us presenting with consumer leases, not credit contracts. We welcomed the numerous changes made in the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* to make regulation more consistent between credit and leases, but there is much more to be done, particularly in disclosure. We discuss this more below.

With the above in mind, we propose that the definition of consumer lease should have three elements:

1. A consumer lease cannot provide either a right or obligation to purchase

The key element of the existing definition of consumer lease—that the contract does not give the consumer a right or obligation to purchase the goods—is still a necessary part of the definition and should remain in the Code.

We agree with Treasury that a contract which includes an obligation to purchase goods should be regulated as a sale by instalments. However we do not agree that leases

should be permitted to give the consumer a right or an option to purchase at a later point. This is unnecessary and facilitates a loophole for avoidance.

A customer under a consumer lease is currently free to offer to purchase goods they are leasing and lessors are able to respond by quoting a purchase price and negotiating a sale. This is no different to (for example) a consumer offering to buy shop fittings, display stock or something marked 'not for sale' in a retail store. We accept that if a customer has leased household goods for an extended period that they will often want to purchase those goods (rather than renting them indefinitely or returning them) and it will often be in the interests of the lessor to allow consumers to do so. We think this is natural market behaviour and shouldn't be prevented.

However, there is a substantial difference between (on one hand) a consumer being free to offer to buy leased goods just as they may offer to buy any goods at any time and (on the other hand) a contract which explicitly provides a right for a consumer to purchase or which is entered with the expectation that the consumer will purchase. A contract which actively facilitates the purchase of the leased goods starts to blur the distinction between credit and leases. Consumer lease providers have demonstrated that, given the chance, they will exploit blurry definitions by designing Rent to Own arrangements to minimise regulatory burden for themselves but confuse and in our view mislead consumers.¹ That being so, it is important that the law discourages regulatory avoidance by ensuring that contracts occupying a 'blurry' area between two categories are regulated as the category that carries more burden—in this case, as credit.

As we have said, consumers should not be prevented from offering to purchase goods they are leasing, nor should lessors be prevented from accepting or negotiating an offer made to them. Lessors should be permitted to tell lessees that lessees may make offers to purchase. Lessors should also be free to approach lessees themselves with an offer to sell (unless this is part of a standard practice which effectively renders leases a sale by instalment). All of this activity can occur under any lease regardless of whether a lease explicitly includes a right or option to buy. No further regulatory intervention is required to permit it.

However, the following conduct is not consistent with the standard understanding of a lease and should result in a contract being regulated as credit:

- including a right to purchase under a lease agreement;
- entering a lease agreement where it is always the intent that the consumer will purchase;
- a lessor offering to sell leased goods to a lessor as a part of normal business practice after a particular term or after a particular amount is paid in repayments;
- representing to a customer that an arrangement includes an implicit permission to purchase, for example that if the customer makes an offer to purchase under certain circumstances it will be accepted.

¹ See, eg, Consumer Action, *Media Release—ASIC asked to investigate Radio Rentals and its 'rent try \$1 buy' offer*, 2 November 2012, available at: <http://consumeraction.org.au/media-release-asic-asked-to-investigate-radio-rentals-and-its-rent-try-1-buy-offer/>.

Allowing leases to include a right to purchase (either explicitly or implicitly) will give lessors another opportunity to continue to structure contracts so that they are technically consumer leases (by only offering a 'right' to purchase) but that are substantially credit contracts (because the fixed term, termination fees or other factors mean the consumer has no real choice to do anything but purchase).

A major source of harm from current Rent to Own arrangements is that people are in our opinion misled about the nature of the agreement they are entering. This happens because lessors want to have it both ways—the lower regulation of a lease but the ability to capture the sale by instalment market. The current definition in the Credit Code facilitates this behaviour because it is easy for lessors to avoid giving a 'right' to purchase but still allow the consumer to own the goods at the end of the term through tricky contract terms. Treasury's proposal to allow leases to give 'rights' but not obligations will not change that behaviour. Providers of problematic Rent to Own arrangements would not have to change their contracts at all to comply with the new definition so all current problems will continue.

The prohibition on allowing a right or obligation to purchase must remain as it is an essential part of the normal definition of a lease. However, it must be complemented by two other elements to prevent current avoidance techniques, discussed below.

2. A consumer lease must allow a consumer to return the goods being leased at any time without penalty.

In a genuine lease, a consumer has the flexibility to rent goods for as long as they choose and return them at any time if they no longer want them or cannot afford them. A genuine lease will not require a consumer to rent for a minimum period or pay a minimum amount for the goods. By contrast, a credit contract requires a certain, pre-determined minimum amount to be paid under the contract (and in doing so reduces the consumer's flexibility and increases certainty for the credit provider). One of the reasons why Rent to Own models currently on the market operate like credit contracts is that they effectively require consumers to pay a pre-determined price for the leased goods, by imposition of minimum terms and termination fees.

We recommend that the Code provide that:

- a consumer lease cannot set a minimum term; or
- if a consumer lease does set a minimum term, it cannot charge a fee for termination that does not represent the genuine costs incurred by the lessor for the early termination. These fees could consider costs for collection of the goods (an estimate of this amount should be provided in advance) but should also take account of the lessor's responsibility to mitigate their loss by considering present value to the lessee of being able to lease the same goods again.

3. A contract entered where the intent of the parties (as determined by objective factors) is that the consumer will ultimately purchase the goods is a credit contract, not a lease.

In a genuine consumer lease, both parties intend that the consumer will merely rent the goods for the time being, even if the consumer chooses in future to purchase or wants to leave their options open. However, if one or both parties intend at the outset that the

consumer will purchase the goods, the agreement cannot be considered a genuine lease and instead should be regulated as a sale by instalments. For example, if a contract is promoted or sold as 'Rent to Own', 'Rent to Buy', suggests the consumer can 'keep' the goods or uses other similar terms, it must be assumed that at least one party believes the consumer intends to purchase the goods at some point.

We recommend that the Code's definition of consumer lease be amended to provide that where the intent of one or both of the parties at the point of entry to the contract (as determined by objective factors) is that the consumer will purchase the leased goods, the contract is a sale by instalments. This could be achieved by:

- prohibiting use of terms like 'Rent to Buy', 'Rent to Own', 'Rent to Keep' or words of similar effect in conjunction with a consumer lease. This prohibition could operate much like the existing restrictions on use of terms like 'pre-approved',² 'impartial' or 'independent'³;
- requiring lessors to ask the consumer whether they want to own the goods as part of their responsible lending assessment (as already proposed by the consultation paper).

Disclosure Requirements

We agree with the position in the discussion paper that enhanced disclosure of the cost of consumer leases will promote a more efficient market. Proper disclosure allows consumers to more easily compare the price offered by one consumer lease provider against others, and also to compare the cost of a lease compared to purchasing outright or purchasing on credit. Our casework experience is that many consumers do not fully appreciate the cost of a consumer lease as they are enticed by a per week or per month amount. It is a well-known principle of behavioural economics that people are bad at computation⁴ and as described below, in some consumer lease advertisements, minimum terms are not provided making it impossible for a consumer to calculate the overall cost. Disclosure that facilitates comparison not only assists consumers but encourages an efficient and competitive market for consumer leases.

Having said that, research also suggests that consumers do not understand important features of consumer credit contracts after reading disclosure documents prescribed by the Credit Code.⁵ This research led to improved disclosure through key fact sheets for credit cards and home loans. Our view is that any new disclosure requirements must be informed by this research and ensure it is consumer tested. As outlined further below, it is our view important that any disclosure requirements are required as early as possible in a transaction (i.e. the stage of marketing) as our view is that consumers often commit to purchasing decisions long before provided with regulated disclosure documents.

² National Credit Code, 128(aa)

³ National Credit Code, 160B

⁴ New Economics Foundation, *Behavioural Economics—7 principles for policy makers*, available: <http://www.neweconomics.org/publications/behavioural-economics>

⁵ Paul O'Shea, *Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign*, report for the Standing Committee of Officials on Consumer Affairs, 12 March 2010.

Disclosure of cash value, amount paid in excess of cash value and total cost

We support the proposals that consumer lease providers should be required to disclose:

- cash value (or a genuine estimate) of goods;
- the amount payable in excess of cash value; and
- total amount payable under the lease.

This information is necessary to plainly show the premium being charged by the lease provider and allow consumers to make an informed choice about whether a lease is the best option for them. We support these amounts being disclosed in a one page financial summary table (such as the examples included in the discussion paper).

When disclosing cash price, a lessor should be permitted to provide a reasonable estimate of cash value where it would be difficult to specify an exact value (for example, for second hand goods). However lessors should be considered to be in breach of the law if they cannot show that their estimate is genuine.

Disclosure of cost in advertising

In addition to disclosure in contracts and a financial summary table, lessors should be required to disclose information about cost in marketing materials under certain circumstances.

Currently, credit providers who advertise the amount of any repayment in an advertisement for a credit contract must also disclose an annual percentage rate and information about fees and charges that are payable.⁶ An advertisement which discloses an annual percentage rate must also disclose a comparison rate.⁷ We recommend a similar requirement apply to consumer leases—if any indication of cost of the lease (such as a 'per week' amount) is provided then the total cost of the lease should also be provided. At present, all lessors that we know of advertise prices on a 'per week' or 'per day' basis without giving an indication of total cost (even where the minimum total cost is unambiguous because the contract requires a set minimum term). In our view, simply providing a per week figure does not give the consumer a balanced view of the true cost of the lease.

Disclosure of a notional interest rate

We support the disclosure of a notional interest rate to assist consumers to compare the cost of a consumer lease or Rent to Own contract with the cost of procuring the same goods on credit. However, we believe it is more important that cash value, amount paid in excess of cash value and total cost are clearly disclosed.

Disclosure of cost of ancillary services and products

We support a requirement for lessors to disclose of the cost of ancillary products and services such as insurance or servicing. We agree with the suggestion in the discussion paper that these requirements could mirror the requirements on credit contracts in section 17 of the National Credit Code.

Consumer lease providers argue that these bundled ancillary items are part of the reason consumer leases provide good value over buying retail or on credit. It is important that lessors

⁶ National Credit Code, section 150.

⁷ National Credit Code, section 160.

disclose the cost of these items so consumers can judge for themselves. It is especially necessary to disclose the cost of 'extras' like repair or replacement of faulty goods that lessors may already be required to provide for free under the consumer guarantee provisions of the Australian Credit Law.

Responsible Lending Requirements

We support the proposal that lessors would be required to make a specific inquiry as to whether a consumer wants to own the goods as part of their responsible lending assessment. This is directly relevant to whether the contract is suitable for the consumer relative to other options available for purchasing. It could be presumed that a consumer wants to own the goods if the contract has been advertised as 'Rent to Own' or in similar terms.

We also support the proposal that lessors should make a specific inquiry as part of the responsible lending requirements as to the costs and benefits of using a lease. This is particularly necessary at present because lessors are not sufficiently disclosing the costs of their lease (as discussed above).

The discussion paper suggests that it may not be necessary to inquire about the costs and benefits of a lease if the lease gives an option to purchase the leased goods. We disagree. In our view it is still necessary to make this inquiry as there will still be cost-benefit differences between leasing and other options for a consumer who intends to own (not least in price).

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

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