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6 July 2016

Rent to Own 2003 Limited  
241a Linwood Avenue  
East Linwood  
Christchurch 8011

Email: [lotvrentals@clear.net.nz](mailto:lotvrentals@clear.net.nz)

Attention: Lois Dick, Director

Dear Ms Dick,

### **Credit Contracts and Consumer Finance Act 2003: Warning**

1. The Commerce Commission has been investigating Rent to Own 2003 Limited (RTO) under the Credit Contracts and Consumer Finance Act 2003 (CCCF Act).<sup>1</sup> We have now completed our investigation and are writing to alert you to our concerns.

#### **Summary**

2. After weighing up the factors set out in our Enforcement Response Guidelines,<sup>2</sup> we have decided to issue this warning letter and provide advice to assist RTO to meet its statutory obligations. We will not be taking any further enforcement action against RTO in relation to the issues identified in this letter at this time.
3. The Commission is issuing a warning to RTO as it considers that RTO risked breaching the CCCF Act by:
  - 3.1 entering into consumer credit contracts that provided for credit fees that risked breaching the reasonableness requirement in section 41, specifically a:
    - 3.1.1 Security Registration/Credit Check (SRCC) fee; and
    - 3.1.2 fee for RTO's mortgage repayment insurance (MRI)that in each case appeared to exceed RTO's reasonable costs closely associated with the activity giving rise to the fee;
  - 3.2 requiring some debtors to take out comprehensive MRI when they did not qualify for redundancy cover under the insurance at the time the loan was entered into.

<sup>1</sup> All section references are to sections of the CCCF Act unless otherwise stated.

<sup>2</sup> Available at <http://www.comcom.govt.nz/the-commission/commission-policies/enforcement-response-guidelines/>.

#### **AUCKLAND**

L13, Forsyth Barr  
55 Shortland Street  
P.O. Box 105-222  
AUCKLAND 1143, NEW ZEALAND  
2499952.3

#### **WELLINGTON**

L9, 44 The Terrace  
P.O. Box 2351  
WELLINGTON 6140, NEW ZEALAND  
Tel: (04) 924 3600 Fax: (04) 924 3700  
Main Office

4. If any of this behaviour is continuing at the present time, we recommend that you take immediate action to address our concerns by seeking:
  - 4.1 legal advice on complying with the law; and
  - 4.2 accounting and/or actuarial advice in setting the amount of your MRI fee.
5. On the basis of the available evidence, the Commission considers that RTO's fire insurance fee was unlikely to trigger, or breach, the reasonableness requirement in the CCCF Act. We will therefore not be taking action in relation to that fee at this time.

### The investigation

6. During our investigation, the Commission looked at RTO's MRI, SRCC and fire insurance fees.
7. The investigation related to the period between 1 April 2012 and 28 February 2015.
8. During the course of the investigation, RTO provided a sample of 27 loan contracts, of which 24 were entered into in November 2013 (Sample Loans).

### Mortgage Repayment Insurance

#### *MRI fee*

9. In return for a fee of between [ ]% and [ ]% of the amount borrowed, RTO agreed to waive amounts payable under the loan agreement if the debtor died, became disabled, or was made redundant. The MRI is a "repayment waiver" under the CCCF Act.
10. RTO has stated that all debtors under the age of 65 were required to take out the MRI unless they had similar insurance cover from another provider. You have provided information showing that 93% of loans entered between 1 April 2012 and 28 February 2015 included MRI. The remaining 7% of loans did not have MRI because the debtors were over 65 (or very close to) or MRI was omitted in error.<sup>3</sup>
11. The MRI was not calculated on the basis of an actuarial formula. You have said that no account was taken of the debtor's individual circumstances.
12. Between 1 April 2012 and 28 February 2015, RTO booked \$ [ ] in revenue from the MRI fee. During the same period, RTO appears to have paid out only one claim under the MRI, totalling \$ [ ]. RTO has not provided information about the costs it incurred in relation to the MRI fee.
13. RTO charged \$ [ ] in MRI fees in relation to the Sample Loans.

<sup>3</sup> [ ] of the [ ] contracts entered into during 1 April 2012 and 28 February 2015 have MR [ ]%. Of the [ ] contracts that did not include MRI: [ ] are with debtors over 65 or close to 65; and [ ] contracts should have had MRI included however were mistakenly set up in the ARGOS system with the incorrect loan type meaning that MRI did not automatically calculate.

### *Exclusions*

14. The redundancy cover under the MRI was subject to significant exclusions. This means that some debtors may never obtain the full benefit of the MRI coverage they purchased from RTO.
15. As an example, some of RTO's customers were unemployed or in seasonal employment. Under the MRI, they paid for redundancy cover which they were ineligible for at the time the loan was entered into. These debtors may have become eligible for redundancy cover if they obtained permanent full-time employment during the loan term and retained that employment for 12 months.

### **Security Registration Credit Check fee**

16. RTO charged a SRCC fee of \$[ ] to all contracts. The fee was designed to recover the costs of credit checks and registration of secured chattels in the Personal Property Securities Register (PPSR).
17. RTO have stated that the SRCC fee was mandatory for all loans and chattel security was registered on the PPSR for all loans, however, a credit check was not conducted for all debtors.
18. RTO's financial statements for the 2013 and 2014 financial years showed that RTO booked total revenue of \$[ ] from SRCC fees. In the same period, RTO's PPSR and credit check expenses were \$[ ].
19. In addition to this RTO supplied further details of the period from 1 April 2012 to 28 February 2015, which showed that RTO conducted credit checks on only 42%<sup>4</sup> of customers charged the SRCC fee.

### **Fire insurance**

20. The evidence indicated that RTO's fire insurance was an optional service during the period under investigation, and therefore was not a credit fee. As such, the reasonableness requirements of section 41 of the CCCF Act were not triggered.

### **Relevant sections of the CCCF Act**

21. The term "credit fees" is defined in section 5. Credit fees are, generally speaking, fees or charges payable by the debtor under a credit contract. The definition includes some insurance premiums if the creditor requires the debtor to obtain insurance cover from a particular insurer. The definition excludes a charge for an optional service.
22. Section 41 states that a consumer credit contract must not provide for a credit fee that is unreasonable.

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<sup>4</sup> RTO has been invoiced for [ ] credit checks in relation to [ ] loans entered.

23. Section 44 sets out the relevant reasonableness test. Section 44, at the relevant time,<sup>5</sup> stated that in determining whether a credit fee is unreasonable, the court must have regard to:
- (a) in relation to the matter giving rise to the fee, whether the fee reasonably compensates the creditor for:
    - (i) any cost incurred by the creditor (including the cost of providing a service to the debtor if the fee relates to the provision of a service); and
    - (ii) a reasonable estimate of any loss incurred by the creditor as a result of the debtor's acts or omissions; and
  - (b) reasonable standards of commercial practice.
24. The recent Supreme Court decision in *Sportzone Motorcycles Limited (in liq) v Commerce Commission* [2016] NZSC 53 gives good guidance on section 44. The Supreme Court makes it clear that a creditor can only recover, through a credit fee, costs that are sufficiently close and relevant to the particular transaction covered by the fee.
25. Section 69(1) states that:
- A creditor ...must not, in connection with a consumer credit contract ...make any unreasonable requirement as to the terms on which the debtor ...is to take out or obtain credit-related insurance, a repayment waiver, or an extended warranty.
26. Under section 69(2), a requirement will be unreasonable if:
- (a) it is not reasonably necessary for the protection of the legitimate interests of the creditor ...; or
  - (b) it is not reasonably justifiable in light of the risks undertaken by the parties to the arrangement.

### **The Commission's view**

27. This letter constitutes a formal warning. The Commission's view is that RTO's conduct risks breaching the CCCF Act.
28. In the circumstances of this case, we have decided to conclude our investigation in relation to the issues discussed below by issuing you with this warning. We will not be taking any additional action in relation to these matters.
29. We would, however, take this warning into account if such conduct were to continue or if you were to engage in similar conduct in the future. We may also draw this warning to the attention of a court in any subsequent proceedings brought by the Commission against RTO.

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<sup>5</sup> Section 44 was replaced, on 6 June 2015, by section 31 of the Credit Contracts and Consumer Finance Amendment Act 2014.

### **The amount of the MRI fee and requirement to take out the MRI**

30. We consider, based on the evidence, that the MRI fee charged by RTO was likely to have been compulsory for debtors under 65. If that is the case, the MRI fee was a credit fee for debtors under 65 for the purposes of the CCCF Act.

#### *The amount of the MRI fee*

31. We are of the view the amount of MRI revenue RTO booked between 1 April 2012 and 28 February 2015 was so high it appeared to exceed RTO's reasonable costs closely associated with the activity giving rise to the MRI fee.
32. Because of this we consider that the amount of the MRI fee charged by RTO to debtors aged under 65 in the Sample Loans risked exceeding the reasonableness requirements of section 41.

#### *The requirement to take the MRI*

33. You have told us that some of RTO's debtors were unemployed or in seasonal employment. Debtors under 65, for which the MRI is compulsory, were required to pay for a comprehensive MRI product when they were ineligible for redundancy cover at the time the loan was entered into.
34. We consider that requiring a debtor to take out comprehensive MRI is unreasonable in the situation where they are unable to lodge a claim for some of the benefits of the insurance. We are of the view that requiring debtors to purchase MRI in these circumstances risks breaching section 69(1).
35. We note that some of the Sample Loans were taken out by beneficiaries, who we assume were unemployed at the time the loan was entered into. Some of these debtors appear to have paid the same MRI fee for comparable loans as debtors in employment.

### **Charging a SRCC fee where no costs are incurred**

36. The SRCC fee was likely to have been a credit fee as it was payable by debtors under a credit contract. We note that it was charged to all customers and was therefore likely to have been compulsory. In circumstances where RTO had not conducted a credit check, the costs to RTO were less than the amount charged to the debtor.
37. In our view, a SRCC fee charged to a debtor was likely to be unreasonable where RTO's costs were less than the amount of the fee charged. Such a fee risks breaching section 41 of the CCCFA. A full SRCC fee should only be charged when a security registration and credit check are conducted. Fees should not be charged in circumstances where the service may not be provided.

### **Penalties for breaching the CCCF Act**

38. Only the courts can decide if there has actually been a breach of the CCCF Act. The court can impose penalties where it finds the law has been broken.
39. Credit providers who breach the CCCF Act may:

- 39.1 be unable to enforce the contract or any right to recover property or any security interest;
- 39.2 have to refund money or pay compensation;
- 39.3 have to pay statutory damages;
- 39.4 be convicted of a criminal offence and fined up to \$600,000 per offence for companies and \$200,000 for individuals (note that the penalties that apply to conduct that occurred prior to 6 June 2015 are lower: up to \$30,000 per offence);
- 39.5 have contracts changed by the court if the contracts are oppressive;
- 39.6 be banned from operating within the finance industry.

### **The Commission's role**

- 40. The Commission is responsible for enforcing and promoting compliance with a number of laws that promote competition in New Zealand, including the CCCF Act. The CCCF Act is designed to protect consumers when they are borrowing money and enable them to make informed choices about using credit.

### **Further information**

- 41. You should be aware that our decision to issue this warning letter does not prevent any other person or entity from taking private action through the courts.
- 42. This warning letter is public information and will be published on our website. We may also make public comment about our investigations and conclusions, including issuing a media release or making comment to media.
- 43. We have published a series of fact sheets and other resources to help businesses comply with the CCCF Act and the other legislation we enforce. These are available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz). We encourage you to visit our website to better understand your obligations and the Commission's role in enforcing the CCCF Act.
- 44. You can also view the CCCF Act and other legislation at [www.legislation.co.nz](http://www.legislation.co.nz).

**Next steps**

45. Please advise what action RTO will take in response to this warning. A written response should be sent to [ \_\_\_\_\_ ] either by post to [ \_\_\_\_\_ ] or by email to [ \_\_\_\_\_ ]

Thank you for your assistance with this investigation. Please contact [ \_\_\_\_\_ ] if you have any questions in relation to this letter.

Yours sincerely

[ \_\_\_\_\_ ]  
Consumer Manager  
Competition Branch