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### **Credit Contracts and Consumer Finance Act 2003 – Compliance Advice: Credit related insurance, repayment waivers, and extended warranties**

The provisions of the Credit Contracts and Consumer Finance Act 2003 (the ‘CCCF Act’) relating to consumer credit contracts and consumer leases came into force on 1 April 2005. Section 111 of the CCCF Act gives the Commerce Commission (the ‘Commission’) the responsibility for promoting compliance with the CCCF Act.

The Commission’s functions under the CCCF Act are to:

- monitor trade practices in credit markets, consumer lease markets and buy back transaction markets;
- take prosecutions in relation to breaches of the Act;
- take civil proceedings under the Act; and
- make available appropriate information for the guidance of consumers, creditors, lessors.

The Commission has reviewed the uptake of credit-related insurance products by debtors in connection with consumer credit contracts and consumer leases. This review was prompted when, during the course of the Commission investigations, debtors alleged that creditors had not discussed any requirement to purchase credit-related insurance products as part of their consumer credit contracts and had not provided details of those products prior to the debtor signing their credit contract.

The Commission also understands that some creditor’s processes or software applications default to include credit related insurance, repayment waivers or extended warranties (the ‘product’). This means that the cost of the product is automatically included in the initial unpaid balance of the consumer credit contract unless the debtor specifically ‘opts out’ of the purchase.

## **Background**

In summary section 5 of the CCCF Act defines credit related insurance as:

- insurance over goods used as security for the credit contract;
- cover for the gap between the amount an insurance policy pays out if secured goods are destroyed and the amount outstanding under the credit contract that those goods provided security for;
- consumer credit insurance; that is cover for the outstanding obligations of a debtor under a credit contract in the event of their injury, unemployment, sickness, disability or death.

A repayment waiver is an agreement between the debtor and the creditor in which the creditor, for an additional payment from the debtor, agrees to waive any amount due in the event of their sickness, injury, unemployment or death.

An extended warranty is an agreement between the debtor and the creditor in which the creditor agrees to repair or replace defective goods outside the normal warranty period.

## **The Commission's Approach**

Where a creditor fails to ensure that a debtor understands that they do not need to take out the product we will take the approach that the creditor has required the product within the meaning of the Act.

It should be noted that the Commission's approach to these issues is not a binding legal interpretation but simply reflects the Commission's enforcement approach. Parties are able to take action privately under the CCCF Act. A creditor that acts in accordance with the Commission's approach will not necessarily be immune from private third party proceedings.

If the creditor has required the debtor to acquire the product, the creditor must ensure that:

- the requirement to purchase the product is reasonably necessary for the protection of its legitimate interests or the requirement to purchase the product is reasonably justifiable in light of the risks undertaken by the parties to the arrangement (section 69);
- a copy of the terms of the product is supplied to the debtor within 15 working days (section 70);
- the payment for the product is disclosed in the initial disclosure statement (section 17);
- the payment for the product complies with the provisions of subpart 6 of the Act relating to fees (sections 41-45).

Furthermore if the creditor fails to obtain the debtor's agreement to acquire the product but nevertheless charges the debtor for it, the creditor is likely to be in breach of s13(c) of the Fair Trading Act which states:

*“No person shall, in trade, in connection with the supply or possible supply of goods or services or with the promotion by any means of the supply or use of goods or services,—  
(c) make a false or misleading representation that a particular person has agreed to acquire goods or services”*

Where the debtor has not agreed to acquire the insurance and approaches the creditor to cancel, they should receive a full refund.

### **Insurance Rebates on Prepayment of the Credit Contract**

The Act provides that if a consumer credit insurance contract is financed under the consumer credit contract, the insurance contract will terminate, if and when the debtor fully prepays the consumer credit contract. The creditor must then provide the debtor with a rebate on the premium. The CCCF Act sets out a formula that the creditor must use to calculate the rebate.

There is a limited exception to this rule, where the consumer credit insurance contract provides an additional benefit or insurance cover to the debtor or where the insurance cover is in connection with other credit contracts.

It is the Commission's view that if a creditor requires (taking into account the Commission's approach to when a product is required) the debtor to acquire an insurance product with an additional benefit they are likely to breach the CCCF Act in that the additional benefit:

- is unlikely to be necessary to protect the creditors' legitimate interests;
- is unlikely to be reasonably justifiable in light of the risks undertaken by the parties to the arrangement.

### **Breaching the CCCF Act**

The Commission notes that there can be serious consequences for credit providers who breach the CCCF Act detailed below:

- the creditor may be unable to enforce the contract;
- the creditor may be liable for a set statutory penalty;
- the creditor may be prevented from behaving in a particular way or may be banned from operating within the finance industry;
- the creditor may be convicted of a criminal offence and face a fine and/or imprisonment; and
- the creditor may be ordered to pay compensation or to refund money to the debtor.

The Commission's approach to the CCCF Act will evolve alongside legal developments which will include Court judgments and enforcement experience.

Yours sincerely

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