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Review of the small amount credit contract law – Interim Report December 2015

All other products regulated by the Credit Act are subject to a cap on costs. Is there any reason why users of consumer leases for low-value household or electronic goods should not have the benefit of this protection?

A consumer lease is substantially different to other products regulated by the Credit Act (see below for more detail). Although lower prices are always better for the consumer, consumer leasing businesses would no longer be viable under the proposed caps.

If a cap on the cost of leases were to be introduced, is there a reason for lessors not to be subject to the 48 per cent cap that applies to credit contracts in general?

If a 48% cap was introduced, the consumer leasing industry would no longer be viable given the higher operational costs of establishing and servicing the lease. There are fundamental differences between a consumer lease and a credit contract. These differences include:

- **Delivery Costs**: Unlike a credit contract where the funds are electronically transferred at minimal cost, a lessor physically delivers a product to a consumer's house and installs it. This is a significant cost to the lessor.
- **Showroom/Warehousing Costs:** Although lessor business models vary, the majority operate under a showroom/warehouse model e.g. Radio Rentals & Mr Rental. Unlike SACC lenders, lessors require a showroom to display products and a warehouse to store, distribute, service and refurbish stock. The showrooms also provide a convenient customer service point for existing customers that wish to discuss their account or lodge a service request for their rental product.
- **Financing Costs:** When a SACC credit contract is established, the loan amount is drawn down and the SACC provider only pays finance costs at this point. In contrast a lessor incurs finance costs as soon as the product is purchased and does not draw an income from this until the product is leased to a customer, which can be months later.
- **Free Servicing & Maintenance:** Most lessors offer servicing & maintenance that exceed the statutory obligation under Australian Consumer Law. This includes covering repair costs where the issue is not covered by warranty. Replacement products are often given to customers in situations where their product cannot be repaired in a timely manner or the product is an essential item such as a washing machine or fridge. In these situations, the lessor:
    - Collects the product that requires repair
    - Diagnoses the problem
    - Organises the repair with manufacturer or local repairer, or in some cases undertakes the repair in-house

- Once the product is repaired, contacts the customer, books re-delivery of the repaired product and collects the replacement product.
- Prepares the replacement product for re-rental – cleaning, servicing and electrical testing.

All of the above contribute to the higher running cost of a consumer lease vs credit contract.

To get a better understanding of the margins and the cost of maintaining a lease, we can look at Radio Rentals/Thorn Group. They have publicly available financials and also have majority market share in the sector. Although their lease prices are in excess of the cap their margins are comparable to other listed retailers.

GST Implications

It was noted in the interim report that the 10% GST on a consumer lease is offset by the lessor's ability to claim depreciation on the leased goods. This is an incorrect statement. See example below:

SACC loan		**Consumer Lease**	
Loan Amount	$1000.00	Equipment Value	$1000.00
Interest Charged (48%)	$480.00	Interest Charged (48%)	$480.00
Application Fee (20%)	$200.00	Application Fee (20%)	$200.00
Total Received	$1680.00	Total Received	$1680.00
Depreciation of Asset	NA	Depreciation of Asset	$1000.00
GST Payable	NA	GST Payable	$152.73
Gross Profit	$680.00	Gross Profit	$527.27
Gross Profit %	68%	Gross Profit %	52.7%
• The SACC provider achieves an increased mark-up of 15.3% as no GST is charged.			

As you can see in the above example depreciation has no offset affect. After the GST is paid the lessor's margin is significantly less than the SACC provider.

Should there be a limit on the maximum term of a consumer lease?

Most lessors offer a term which is consistent with the life cycle of the goods e.g. phones tend to have a shorter lease term (24 months) vs a fridge that has a longer lease term/life cycle (36-48 months). I have not seen any evidence that lessors are entering customers into lease terms that exceed the products life cycle. For this reason, no maximum term should be regulated.

How should the cash price for determining a cap on leases be determined?

Determining the cash price has many complexities. Some additional items that were not considered in the interim report are:

- **Ageing Stock -** A consumer may be able to buy the product for less than the lessors original purchase price. Does the cash price need to continually adjust and if so how would this be implemented on scale? Most lessors wouldn't have the systems to handle this complexity and the cost of implementing such a system even it was possible would be significant.
- **Retail product life cycle** – as a product ages the price reduces. The cash price of a product will change as it goes through its retail life cycle eg. the cash price of an iPhone 6 is cheaper today than it was when it was released. How does a lessor monitor these price movements and would it be reasonable to expect the lessor to adjust their prices continually?
  As an example a lessor may buy 10 x iPhone 6's for $1000.00 and determine a cash price of $1050.00. The rental price is then calculated on this cash price. Given the retail life cycle the same product may be purchased a month later at a cheaper price which would result in a cheaper cash price and different rental rate. How does a lessor apply a cap to the same product purchased with different cash prices? If this was a requirement, the lessor would need to list the same item on their website multiple times at different price points. This would be very confusing for the customer and extremely complex and costly for the lessor to implement.
- **2nd Hand Stock** – this was mentioned in the report and I am not sure how this would be implemented.

The above complexities further highlight why a consumer lease should not be classified as a credit contract. Unlike a loan where a cap can easily be applied to the loan amount a product has a floating price throughout its life cycle and a cap is not easily applied.

If a cap on the cost of leases was introduced, how should add on products be treated?

If a cap on leases was introduced, add on products should be incorporated into the cap. This would make it simpler for the customer and easier for lessors to implement.

It must be noted the cap must be sufficient to allow lessors to cover their costs for these additional services.

Are there ways of measuring the value of add on products to the consumer (for example, data on the extent to which consumers utilise those products or make claims under them)?

Servicing/repairs are heavily used by our customer base. As an example from Jan-Dec 2015 we did approximately 350 repairs* and 1175 installs – 1 repair for every 3 installs.

* Repairs are defined as anything we collect and fix offsite or provide assistance to the customer in claiming warranty from the manufacturer eg. call manufacturer, book service, follow up to ensure repair is completed. This figure does not include any repairs that are resolved onsite (customers home) by our staff. Unfortunately, this data could not be collated before the submission cut off.

What are the consequences of including add on services within the cap? Does this pose a particular risk for certain add on features or parts of the market (such as remote areas)?

If add on services are to be included in the cap, the cap would need to be adjusted to cover the lessor's costs to provide these services. A SACC provider does not provide these additional services so it makes sense that the cap would need to be adjusted accordingly.

Including the add on services in the cap without adjustment would mean the lessor could not offer these additional services which many customers rely on.

Should a protected earnings amount be introduced for leases, similar to option 3 canvassed in relation to SACCs?

There is a clear distinction between a SACC and a consumer lease. A customer who enters a SACC, does so to fulfil a short term cash shortfall, whereas a customer enters a lease because they need a product today but cannot afford to buy it for cash. Unlike a SACC, a consumer enjoys the benefits of a consumer lease for the term e.g. having a washing machine to clean their clothes; unlike a loan where the money is spent immediately and the customer is left with a debt. A lessee also has the option of returning the product and ending the lease, which is not an option for SACC customers once the money is spent. The ability to return the product and terminate the lease at minimal or no cost is a particularly important distinction between the two products for consumers experiencing hardship.

The protected earnings cap proposed on SACC's is to limit repeat borrowing by consumers. This makes more sense in the context of a loan where there are no ongoing tangible benefits for the consumer and no ability for the customer to simply 'return' the money. Given this, a protective earnings cap serves no purpose other than to limit the availability of consumer leases, even for customers that pass the affordability assessment.

What levels of discount on the outstanding lease repayments do lessors provide in their termination clauses? Do lessors provide different discounts on the amount attributable to future leases and the charges of future services?

It does seem that some lessors charge termination fees which are in excess of their reasonable costs. Granted there are times when a lessor's costs can be significant, a termination fee equal to the remaining instalments on the lease seems excessive. We have adopted a standard termination fee of 8 weeks rental, which I believe is reasonable and also easy for the customer to understand.