Repayment Waivers

Commerce Commission takes action over unreasonable fees by lenders

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The Commerce Commission has recently laid charges against Acute Finance, a Christchurch based lender specialising in small personal loans. The charges relate to "repayment waivers" sold to Acute's customers in conjunction with loan contracts.

Repayment waivers are arrangements whereby a lender agrees not to pursue the borrower if they are unable to repay their loan due to a specified cause such as redundancy, illness or death. A fee is charged by the lender in respect of the waiver.

The charges

The Commerce Commission has brought five charges against Acute Finance. Four of these relate to allegations that the waiver fee is unreasonable and does not reflect the cost to Acute of allowing the waiver. The fifth charge relates to requirements that borrowers must purchase the repayment waiver. The Commerce Commission argues that this is unreasonable in cases where borrowers are subject to exclusions and would not be able to receive the full benefit of the waiver.

Waivers vs insurance

Insurers sell consumer credit insurance with similar coverage to these repayment waivers. Insurers, by and large, are free to charge whatever premiums the market will accept. So why is the situation different for lenders?

The Credit Contracts and Consumer Finance Act 2003 forbids a lender from charging a fee that is 'unreasonable' i.e. that does not reflect the lender's actual costs. However, insurance contracts are generally not subject to the CCCFA, provided that the insurance coverage is separate to the credit contract. It follows that insurers are free to include a profit margin in their premium and are not subject to reasonable fee requirements. Indeed, the insurance industry is built upon the concept of charging a margin on the expected cost of covering those risks.

However, that is not to say that insurers are free from regulation. The Insurance (Prudential Supervision) Act 2010 sets out a regulatory framework for insurers. The costs of compliance are significant – an important consideration for a lender looking at option 4 below.

Implications for lenders

The Commerce Commissions actions against Acute Finance may well be only the beginning of action against the industry (see further reading below). Depending on the outcome of the case, one could expect the Commerce Commission to take on more and larger lenders.

Lenders selling repayment waivers are left with four options:

1. Stop selling repayment waivers
2. Continue to sell the waivers, set the fees at a reasonable level and gather evidence to substantiate that they are reasonable
3. Sell the waivers as an insurance product through a third party insurer with the lender able to take a reasonable commission
4. Set up their own insurer as many of the larger lenders have done

Whichever option is chosen, the issue of compulsion needs to be addressed. The reasonableness test includes not just the amount of the fee but also whether or not it is reasonable to compel a borrower to pay the fee.

Under option 2 the lender makes no profit on selling waiver – the fee simply covers the expected cost of issuing the waiver. However, it may be that differential interest rates can be charged for loans with or without waivers, enabling the lender to make a margin on the interest rate.

Options 3 and 4 can be fruitful for lenders in some circumstances. Consumer credit insurance is often profitable, but the fixed costs involved in operating an insurer require scale to be economic and the decision for a lender of whether to simply clip the ticket or to underwrite the risk themselves is usually one of size and scale.

Further reading

See the Commerce Commission's media release. The actions against Acute Finance appear to be part of a wider project around consumer credit fees.

Melville Jessup Weaver has experience with insurance premium setting and with fees under the CCCFA including the "safe harbour" formula in the regulations for prepayments.

ABOUT MELVILLE JESSUP WEAVER

Melville Jessup Weaver is a New Zealand firm of consulting actuaries providing advice on superannuation, insurance and asset consulting. The firm, established in 1992, has offices in Auckland and Wellington and is an alliance partner of Willis Towers Watson, a leading global services company and is located on the web at willistowerswatson.com.

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