Balancing Consumer Interests against the Interest of Credit Providers in Fiji: Consumer Credit Act

Ram Karan[1]

Abstract

While it is unconceivable for a modern market economy to exist without credit, the role of credit in the functioning of the market economy hinges on a delicate balance between the knowledge and bargaining powers of consumers on one side and the knowledge and business acumen of credit providers on the other. Although it is commonly claimed that consumer credit legislations serve to achieve this balance, in reality legislations often enhance the interest of credit providers at the expense of consumers. By analyzing the Consumer Credit Act of Fiji and related legislations, this paper shows the major areas of imbalances in the law itself as it relates to the interest of consumers' vis-à-vis those of credit providers.

Role of Credit in the Economy

Trade happens when we exchange something we have with something that we don't have. This system of trade, called *barter*, worked well in subsistence economies. The invention of money changed this dramatically. With money, trade developed beyond barter, and the economy developed beyond subsistence living. Living in modern buildings, going to school, travelling in buses and taxis, driving cars and flying in aeroplanes have all been made possible with money. In addition, money has created a desire in those who do not have such luxuries in life to want them too and those who already have them to want even more. However, as money has to be scarce to maintain its value, it places constraints on consumption. As most people can earn only limited amounts of money, they cannot acquire everything that they need or want.

[1] This paper is based on research carried out for the Consumer Council of Fiji's (CCF's) project on financial protection. I acknowledge the CCF for providing actual cases relating to consumer complaints and feedbacks. I also acknowledge several managers and other personnel in hire purchase and finance companies for useful information on the operation of the Consumer Credit Act.

To enable a consumer to acquire things that he or she wanted but did not have money to purchase, something other than money became necessary. This was 'credit'.

Credit allows a consumer to spend money before he actually earns it. In context, it allows consumers the benefit of goods before they own them. Credit purchase allows consumers to get something now on a promise to pay for it at a later date. Credit has become so popular today that economies of most developed nations revolve around credit. Credit allows consumers to spend more than what they have, thus propelling the economy. Hence, credit drives consumer spending, and consumer spending drives the economy.

Consumer credit, thus, has a huge influence on keeping the economy lively. To encourage production of goods and services, our economy needs consumers to spend. Credit gives both the producers and the consumers the ability to do just that. The problem, however, is that generally there are imbalances in knowledge and bargaining power of the two parties. Many consumers do not know how to use credit wisely, while many credit providers are fully knowledgeable of how to use credit to their advantage, often unfairly. This calls for ways to protect the consumers.

Consumer Behaviour and Credit Regulation

Research in behavioural economics over the last two decades has revealed insights of psychology and economics focusing on issues of bounded rationality, bounded willpower and bounded self-interest. Individuals have limited information processing capabilities, and use heuristics that may cause them to misestimate risks and create predictable biases in their decision making. Individuals are also poor statisticians, manifest a tension between an 'impulsive self' and a 'planner self' and do not always maximize their self-interest (Ramsay, 2005: 8).

It is further argued that individuals generally do not rely on professional advice. Even when individuals know the 'correct' solution, findings suggest some limits on the role of market transactions as a learning process. Individual consumers, unlike businesses, are not driven out of the market if they make errors in market decisions. Moreover, businesses, through their market research, identify and attempt to exploit these irrationalities in consumer behaviour. Behavioural economics, by providing systematic explanations for consumer behaviour, may therefore guide policymakers in designing "debiasing" interventions. This approach referred to as 'a framework of ideas for an era of globalization' attempts to achieve social policy goals through a wide variety of techniques and recognizes that 'markets can't function without a social and ethical framework' (Ramsay, 2005: 5).

Several other findings of consumer behaviour can also be very useful in formulating consumer protection regulations. These include the findings of underestimation of risk and over-optimism. Individuals seem to make systematic errors in risk assessment, overestimating certain risks that can be vividly recalled (e.g. airplane accidents) and underestimating others (e.g. risk of contracting cancer). Likewise, it is established that unemployment or reduced employment is a primary cause of debt problems, but this knowledge is likely to be discounted by a consumer at the time of entering into a contract. Although it is true that there are stories in the media about over-indebtedness and unemployment they tend to get crowded out by marketing and advertising about the good life associated with credit. Recent studies of consumers' attitudes to credit have found that consumers did underestimate this risk and thought that losing a job happened only to other people. As Ramsay (2005: 9) states, most respondents 'suppressed the risks involved, and felt confident (possibly over–confident) in their ability to stay out of trouble …consumers were aware that unexpected events could seriously affect their ability to pay but felt that this was something that happens to others. Most felt losing their jobs, suffering a serious accident or illness were remote possibilities'.

The above quotation illustrates a robust finding of over optimism. This is supported by more than 200 empirical studies of optimism bias. For example most individuals assume that their chances of having an automobile accident are significantly lower than average. Students who take on substantial educational debt on the basis that this is the way to future success may be overoptimistic about their chances of success and underestimate future adverse contingencies. Cases abound.

The concept of bounded willpower recognizes that we may

have time inconsistent preferences. This means that we may have a great willpower at one point in time but it is not sustained over time. This also illustrates the tension between the 'impulsive self' and the 'planner self'. For example, we turn on the alarm meaning to get up at six the next morning so that we can have a healthy walk before breakfast, but when the alarm goes on we turn it off and ignore it (Ramsay, 2005: 9). Impulse is always in battle with rationality.

These findings have very important implications for formulating consumer protection regulations. They show that although consumers may be aware of risks involved with credit, they are often likely to discount them because they tend to be over optimistic. It is these shortcomings of consumers that businessmen exploit when promoting their products. Hence, we can educate and warn the consumers of all the pitfalls of credit and yet fail to protect them. The challenge, therefore, is how to protect the consumers who are exposed to the vagaries of the market. This is one reason why it is said that 'markets can't function without a social and ethical framework'.

To be able to achieve its intended purpose, consumer protection regulation must therefore be encompassed within this social and ethical framework.

Protecting the Vulnerable Consumer Group

The behavioural concepts of bounded rationality, bounded willpower and bounded self-interest at least partially explain why consumers generally are poor protectors of their own interests. This is perhaps one reason why the Consumer Council of Fiji's research and complaints data reveal that almost 96%, if not all the cases, is due to lack of understanding of the terms and conditions of the credit facility. The Council's finding that consumers don't ask the right questions to understand the risks associated with the credit and what protection measures are in place to safeguard their interests, only further confirms that consumer behaviour is characterized by traits as bounded rationality, bounded self interest and the 'impulsive self'. For these reasons they not only do not ask questions, but they probably do not want to ask such questions. Consequently, many consumers take credit contracts lightly and sign them, thereby technically and legally binding them to the credit provider. They do not realize the full implications until they actually get into problems.

To make matters worse, contract documents are often drafted in fine print with legal terms, which average consumers find confusing and contradictory, and difficult to comprehend. Often these are considered mere paperwork comprising 'standard' documents that have to be signed with any credit provider. This is, thus, generally seen as an unavoidable requirement, irrespective of which credit provider the consumer goes to. So, if one wants credit, one just signs it; reading and analyzing legal documents serve no useful purpose. These are some reasons why some consumers get into credit contracts that are drafted in such a manner that they dilute the consumer's right to remedy, causing immense ambiguities and lack of protection where there is breach of contract by the credit provider. It is, therefore, not surprising that some consumers are 'caught in a never-ending debt cycle' as found by the Consumer Council of Fiji.

The view espoused by behavioural economists poses practical questions about the design of disclosure regulation. It is argued that disclosures benefit primarily middle income consumers and not low income consumers; they often come too late to have an impact on shopping; consumers have only a vague idea of how to use the Annual Percentage Rate (APR) and often focus on monthly payments rather than the APR; and disclosures are too complex (Ramsay, 2005: 14).

Credit disclosure regimes have not generally been premised on systematic theorizing about the role of information in markets beyond the idea of the importance of transparency to the workings of consumer markets. The development of disclosure law has been characterized by adaptation and experimentation. There has been adaptation over time to the growth of variable rate loans and open-ended credit such as credit cards. Some countries no longer require an APR for open ended credit or credit cards.

There have been experiments with different forms of disclosures including the following: 'wealth warnings' on loans secured against a home; the 'Schumer box' that provides a concise statement of credit card costs and fees on solicitations for credit; disclosure of the time required to pay an unpaid balance if a consumer only pays the minimum balance on the credit card; disclosure of the occurrence of negative amortization; the fact that interest continues to accrue on payment "holidays" on loan repayments; and heightened disclosures to potentially vulnerable groups along with the control of certain expressions in advertisements (Ramsay, 2005: 15).

The most common and legally required method of disclosure of the terms and conditions of a credit transaction are contained in the credit contract. Credit contracts often come in various forms

such as hire purchase agreements, loan and mortgage documents, consumer lease, guarantees and bill of sale. All these contracts are technical and legally binding documents. Such documents are often drafted in fine print with various 'legal' terms and conditions that purport to give consumers rights and responsibilities but in reality, consumers do not fully comprehend the complex legalities within the documents.

Often bad or unfair market practices are encountered where certain terms and conditions in the credit contracts are drafted in such a manner that these dilute consumers' right to remedy, thus causing immense ambiguities.

Increasing consumer indebtedness as a result of over reliance on credit has become a worldwide problem. According to the Reserve Bank of Australia, for example, each Australian adult is currently in debt to the value of around US$56,000, compared to the debt of American adults of US$44,000. Australians' mortgage, credit card debt and personal loans total over AU$1.2 trillion which is an increase of 71 per cent from just five years ago. Consequently, many Australians are now stretched very close to their limits in terms of debt. If interest rates keep rising as predicted, they might find themselves in a very serious debt crisis (Tripodi, 2010).

Official data on total consumer indebtedness in Fiji is not readily available. However, the frequency of complaints regarding repossession of hire purchase goods lodged with the Consumer Council of Fiji and mortgagee sales of family homes advertised in newspapers indicate that many consumers in Fiji might also be caught up in a never-ending debt cycle which has devastating effects on the wellbeing of many individuals and families. This is not only a personal problem or even a national one; it is a global problem that can have serious social and economic consequences. To combat this escalating problem, a review of the consumer protection regulations of Fiji has become crucial.

Consumer Credit Act 1999, Consumer Credit Amendment Act 2006 and Regulations 2009

Prior to the Consumer Credit Act 1999, credit transactions occurred mainly by contractual agreements prepared by credit providers. Consumers had no option but to accept the terms and conditions imposed by the credit providers; there was no legal protection for them. The Consumer Credit Act 1999, Consumer Credit Amendment Act 2006 and Regulations 2009 were enacted to remedy this imbalance in power of the two parties.

These legislations set minimum compliance requirements when credit documents are drafted and executed, as well as provide for full disclosure of terms and conditions to the consumer at the time of signing and execution (s12-s15). In addition, hardship clauses (s65-s74) provide for the right to specified remedy, which the consumer can access and utilize, particularly during adverse economic times when there is greater tendency for credit facilities to be abused. More detailed information relating to specific aspects of the credit contract are provided by the regulations.

Despite the legislation and the associated regulation, consumers continue to complain about unfair practices by credit providers. Of particular concern to the Consumer Council for many years has been the hire purchase system; this has consistently featured in the top ten most recurring complaints registered with the Council annually. In the last four years, the Consumer Council of Fiji received 225 complaints from hire purchase customers alone. The number of such complaints lodged with other authorities, and those complaints not officially lodged at all, are not known.

One reason that has generally been attributed to this situation is the lack of consumer credit education. It is argued that for consumers to have access to just, fair and competitive financial services, it is essential that consumers are educated to allow them to make informed choices in the market. This will empower consumers to borrow wisely and force credit providers to offer fair terms and conditions to the consumers. Consumer education should, therefore, help to correct the imbalance in the bargaining power of the two parties. However, consumer education alone is unlikely to serve as adequate protection for all consumers.

Assumptions for analysis of Consumer Credit Act 1999

Consistent with research findings of consumer behaviour outlined above, this analysis is based on the following assumptions:

- Most consumers have bounded rationality, bounded willpower and bounded self-interest.
- Most consumers are over optimistic about their future financial security.
- Most consumers are unable to shop around and compare products before buying.

- Most consumers place trust in credit providers and do not suspect that they will engage in unconscionable practices.
- Most consumers do not read consumer protection legislations.
- Most consumers cannot understand consumer protection legislations.
- Most consumers treat contract documents as 'standard' and do not read them.
- Most consumers lack resources to seek legal advice before signing contracts or seek redress in the event of disputes.
- Most, if not all, transactions occur between parties of unequal strengths. Individual consumers with limited resources are faced with corporate credit providers with disproportionately superior expertise and resources.

Do Existing Laws Protect Consumers?

The Consumer Credit Act 1999, Consumer Credit Amendment Act 2006 and Consumer Credit Regulations 2009 provide for rights and responsibilities of both the consumers as well as credit providers. It would, therefore, appear that both parties have equal rights and responsibilities and both have equal resources and equal expertise to exercise their rights and honour their responsibilities. In reality, however, the situation seems to be very different. While the credit providers are normally very large corporations with resources to employ experts in finance and legal matters to deal with credit transactions, the average consumer has no such luxury.

Nevertheless, before signing any contract the consumer is reminded (by the law) that if he/she has any concerns he/she has the right to seek information from the Commerce Commission (which absorbed the Department of Fair Trading and Consumer Affairs in October 2010) or the Consumer Council of Fiji or get legal advice (Regulations, Form 2). The consumer is further reminded, again by the law, that if he/she still has any doubts after reading the contract documents, he/she must again contact the Department of Fair Trading and Consumer Affairs (which have now been absorbed into Commerce Commission) or get legal advice (Form 2, cl.25).

According to the Commerce Commission Decree 2010, however, the major function of Commerce Commission is to do with regulation of the market, not dealing with individual consumer problems. Hence, the consumer has to rely only on the Consumer Council of Fiji or on paid private legal service for advice.

All these reminders to seek more information from consumer protection authorities and legal advice give the impression that the legislation empowers the consumers of their rights. In reality, however, most consumers do not have the time to go to consumer protection authorities or have the money to get legal advice. If they have money or financial means, they probably wouldn't buy on credit anyway. In addition, if a consumer, for example, is buying a fridge for $1000, he or she is not likely to spend another $500 to get legal advice even if he or she can afford it.

As can be seen, the provision of the law for the consumers to seek information from consumer protection authorities and get legal advice serves not only to give a false sense of protection, but it can actually work against the interests of the consumer. In the event of a dispute the credit provider can point to the written warning on the contract documents that the consumer was reminded of his/her right to seek further information and get legal advice. If the consumer did not exercise this right then only the consumer would be blamed. If the matter goes to the court, the consumer might not get the sympathy of the court either.

Can a Consumer Succeed in a Legal Battle?

The Consumer Credit Act 1999 provides for consumer redress through applications to courts. Courts may re-open unjust transactions.[2] What this means is that a borrower or guarantor can apply to the court and claim that the credit contract or mortgage that he/she entered into or a change to the contract that was subsequently made, was unjust. Under s70(7), 'unjust' includes unconscionable, harsh or oppressive conduct.

If the court is satisfied with the claim, then it may re-open the alleged unjust transaction and hear both sides of the story. This, however, is not going to be an easy matter to resolve. For, under s70(2), before making a decision the court 'must have regard to the public interest and to all the circumstances of the case'. Public interest can mean different things to different people. In any case, the provision states that the court *may have regard to the following-*

> (h) whether, and if so when, independent legal or other expert advice was obtained by the debtor, mortgagor or guarantor;
>
> (i) the extent to which the provisions of the contract, mortgage or guarantee (before and after any change) and their *legal and practical effect were accurately explained* to the debtor, mortgagor or guarantor and whether or not the debtor, mortgagor or guarantor understood the provisions and their effect (stress added);

Section 72(1) tries to explain what would constitute unconscionable conduct with respect to annual interest rate, changes in interest rate (for example, after defaults in payment), establishment fee, fees or charges for prepayments (i.e. making payments in advance) and fees or charges for termination of a credit contract. S72(2) states that the annual percentage rate or rates is unconscionable if and only if it appears to the court that -

> (a) it changes the annual percentage rate or rates in a manner that is unreasonable, having regard to any advertised rate or other representations made by the credit provider before or at the time the contract was entered into, the period of time since the contract was entered into and any other consideration the court thinks relevant; or
>
> (b) the change is a measure that discriminates unjustifiably against the debtor when the debtor is compared to other debtors of the credit provider under similar contracts.

S72(3) states that 'to determine whether an establishment fee or charge is unconscionable a court must compare it with the total cost of processing an application for credit or compare it with average cost of processing that class of contracts'.

S72(4) states that 'a fee or charge payable on early termination of the contract or a prepayment of an amount under the credit contract would be unconscionable if and only if it appears to the court that it exceeds a reasonable estimate of the credit provider's loss arising from the early termination or prepayment, including the credit provider's average reasonable administrative costs in respect of such a termination or prepayment'.

As these requirements of the law show, determining what con-

[2] Section 70(1) provides that a court may, if satisfied on the application of a debtor, mortgagor or guarantor that, in the circumstances relating to the relevant credit contract, mortgage or guarantee at the time it was entered into or changed (whether or not by agreement), the contract, mortgage, guarantee or change was unjust, re-open the transaction that gave rise to the contract, mortgage, guarantee or change.

stitutes unconscionable conduct is not easy. Rates and costs need to be compared with other rates, and fees and charges need to be compared with average fees and charges or compared with estimated loss suffered by a credit provider. Regardless of how these amounts are calculated, they will always remain debatable. In addition, the law does not even attempt to define what constitute 'harsh' and 'oppressive' conducts.

Of course the court may take all the circumstances of the case as well as public interest into account before making a decision. However, as the law also says that the court may have regard to whether legal or expert advice was obtained by the borrower or guarantor and whether the provisions of the contract were accurately explained to him/her, there is a possibility that the court might find that if only the consumer had sought legal advice the alleged unjust contract, mortgage, guarantee or change could have been avoided. The court may therefore find the consumer at fault. Hence, the very provisions that appear to protect the consumers can actually work against them. How the major parts of the Act and the Regulations protect or fail to protect the consumers or give only a false sense of protection with respect to hire purchase transactions, in particular, are addressed in the next section.

Hire Purchase

Perhaps the most common form of credit transaction that most low income consumers enter into is hire purchase. Here the buyer hires (takes) and uses the merchandise on payment of a deposit and completes the purchase by making a series of regular instalments. The seller retains ownership (title) until the final instalment is paid. Goods that consumers most commonly buy on hire purchase include white goods such as televisions/radio/home entertainment system, fridges, washing machines, stoves and other kitchen equipment; furniture like sofas, cabinets and beds, and home maintenance/improvement equipment like motor mowers, brush cutters, and tools.[3]

For most goods bought under hire purchase the buyer normally

[3] Motor vehicles may also be bought on hire purchase where the vehicle is sold to the finance company, and the buyer hires it after putting a deposit, pays monthly instalments for two or three years before having the option to buy the vehicle outright. This is like a lease with an option to buy. It is more common for vehicles to be bought with a loan secured by the vehicle.

gets a warranty by the manufacturer or dealer, usually specifying that the manufacturer will make any repairs or replace defective parts free of charge for a stated period of time. In other situations the law implies a warranty where no express warranty is made.

Implied in every hire purchase agreement are also conditions and assurances, also called warranties, such as:

(a) a condition that the owner has a right to sell the goods at the time when the ownership (title) is to pass;
(b) a warranty (assurance) that the hirer will have and enjoy quiet possession of the goods;
(c) a warranty (assurance) that the goods will be free from any claim by any other party at the time when the property is to pass from the seller to the buyer. This means that the goods must not have any debt or financing owed on them, i.e. the consumer should have free title to the goods.

A condition must be met for the other party to have the duty to fulfil his/her obligations. It goes directly 'to the root of the contract', or is so essential to its very nature that if it is broken the innocent party can treat the contract as discharged (ended). That party will not therefore be bound to do anything further under that contract. For example, in contract law, if an agreement is signed by one party and sent to a second party with the intention that it will not become enforceable until the second party signs it, the second party's signature would be a condition for the contract to become enforceable.

A warranty is secondary to the main purpose of the contract. It is, therefore, not so vital as to make the contract invalid. A breach of warranty only entitles the innocent party to an action for damages; he or she cannot treat the contract as ended.

Despite these definitions, often it is not clear whether a term of a contract is a condition or a warranty. This has to be decided by courts, having regard to the intentions of the parties.

Also, in every hire purchase agreement there is a condition that the goods are of merchantable quality, except

(a) if the hirer has examined the goods or a sample of them and has been made aware of any defects; or
(b) if the goods are second-hand goods and the agreement states that
 (i) the goods are second-hand; and
 (ii) there is no assurance given about the quality, and the hirer has acknowledged this in writing.

Examination of 225 complaints received by the Consumer Council reveals that there is virtually no problem in relation to the implied conditions and warranties. The major problem appears to be in relation to the manufacturer's (dealer's) warranty 'that the goods are of merchantable quality', i.e., the product does what the manufacturer and seller claim it is supposed to do and for a period normally expected of that kind of products. A fridge, for example, should last a lot longer than 12 months. Of the 156 complaints recorded, 70% were in relation to warranties and conditions. Some examples are:

- Complainant's LPG Stove burner got melted and he was told to pay $20 for repairs.
- Complainant's washing machine was faulty and was not repaired.
- Complainant purchased washing machine and had given for repairs but was told to pay for repairs.
- Complaint on Settee which had broken due to cheap material used to make the settee.
- Complainant bought radio on hire purchase with a one year warranty. Radio was given for repairs and wasn't returned.

In all these cases the goods were apparently of merchantable quality at the time of sale. However, they did not last as long as the consumers expected them to last. This raises the question of the period over which the goods should remain of merchantable quality. The law does not specify any such period for any type of goods. So, can it be assumed that goods can no longer be repaired or replaced at the seller's cost after the initial warranty period is over? The seller will, of course, say 'yes'. But in some countries this is not considered fair to the buyer.

In Queensland (Australia) for example, merchantable quality has been defined to mean that 'the goods must be as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect, having regards to any description applied to them, the price (if relevant) and all other circumstances' (Office of Fair Trading, nd).

The requirement of fitness for purpose implies that the goods must also be capable of enduring for a reasonable period and must not deteriorate seriously or break down. This means that goods must not unduly break down during their normal life-span and that if they

do, the breakdown is often a clear symptom of their inappropriate quality.

One would, therefore, expect a new washing machine, for example, to last considerably longer than 12 months. However, if a consumer paid $50 for it then one could say fair enough - he/she got what he/she paid for. That is, if somebody gets a washing machine for $50, he/she should not expect it to last just as long as the one that somebody paid $500. But a consumer should expect to get 4-5 years out of a decent washing machine.

In Singapore's Sale of Goods Act the term 'merchantable quality' has been replaced by the term 'satisfactory quality' by amendment in 1996. 'Satisfactory quality' is defined as 'meeting the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances' (Abbey Legal Protection, 1012). This means that the goods must also be of reasonable durability.

Apparently, many retailers not only sell poor quality products, they also do not honour the written warranties. These products are both imported and locally made. Ideally, they should be required to go through quality control tests before becoming available to the consumers. However, in the absence of National Products Standards, there is high probability that poor quality products are entering Fiji. A major problem here is that given that there is now increasing free international trade leading to stiff competition both locally and internationally, ensuring that only high quality products enter the market can be very difficult, if not impossible.

Often sellers also offer extended warranties at extra cost, normally as a percentage of the item's retail price. Occasionally, some extended warranties that are purchased for multiple years state in writing that during the first year, the consumer must deal with the manufacturer in the occurrence of malfunction. Thus, what is often promoted as a five-year extended warranty is actually only a four-year warranty.

Extended warranties are normally used to get customers in service agreements that guarantee additional revenue for the business but have no real benefit to the customer. Selling of extended warranties is one example where salespersons are known to impress on the customers to pay additional $100 or so for a 2 to 3 year extended warranty just because they get 10%-15% of this amount as commission in addition to their normal pay.

Extended warranties generally do not cover everything that the standard manufacturers' warranties cover. For example, some parts of products are often expressly excluded but with the exclusions written in fine print which is not easily seen by the consumer. Extended warranties have their own terms and conditions which are often not properly disclosed to the consumers and lead to disputes later.To provide some protection to consumers from poor quality products being sold in the country, the term 'merchantable quality' should be defined to include the requirement that the goods must also be of reasonable durability. This means that goods must not deteriorate seriously or unduly break down during their normal life-span. Full details of extended warranties must also be properly disclosed.

Interest on Hire Purchase

Under the Consumer Credit Act, all credit documents should state the rate of interest per annum for the credit. If there is more than one interest rate, the documents should also state how each rate applies e.g. 7% fixed for first 3 years and variable thereafter. When a debtor or guarantor requests a statement then the credit provider is required to provide:

(a) the current balance of the debtor's account;
(b) any amounts credited or debited during a period specified in the request;
(c) any amount(s) overdue and when each such amount became due; and
(d) any amount payable and the date it became due.

The law also provides the methods for calculating the interest charge. 'An interest charge under a credit contract for a month, a quarter or half a year may be determined by applying the annual percentage rate or rates, divided by 12 (for a month), by 4 (for a quarter) or by 2 (for half a year), to the whole or that part of the average unpaid daily balances to which it applies, except for a hire purchase agreement where Rule of 78 will apply.

The Rule of 78 is a rule which essentially provides the same result as the calculation of interests using the reducing balance method for balances outstanding. The formula for Rule of 78 as given in Schedule 3 of the Act is:

$$C_x = \frac{\sum_{i=1}^{n} i - \sum_{i=1}^{n-x} i}{\sum_{i-1}^{n} i}.T$$

As can be seen, the formula given in the legislation is likely to be intimidating and confusing to most educated people. To help make it understandable the Schedule gives a worked example as follows: Assume that total interest under an agreement which is calculated at the outset is $100.00 (T). The total agreement is for 12 months (n). The credit provider intends to determine the interest charge for the 2 months (x) completed under the agreement. Using the formula:

C= ((1+2+…….+12) - (1+2+……+10)) / (1+2+……+12) * 100
C= (78 – 55) / 78 * 100
C= $29.49, rounded to nearest cent. Thus, the interest charge for 2 months is $29.49.

The formula is expressed as it would normally be written in mathematics.[4] However, an average consumer might find it beyond his or her ability to understand, let alone apply it in a real world case.

The Rule of 78 is used to calculate the interest rebate a consumer gets for paying off the debt earlier than the full term of the credit contract. If the debtor pays off the debt after 2 months, interest charge for two completed months is $29.49. The interest rebate (refund) for remaining 10 months is $70.51. The rebate is $12.82

[4] As seen above, the 'Rule of 78' is based on the sum of the numbers assigned to twelve months (or instalment periods) e.g. 1+2+3+ …….10+11+12 = 78. The amount of interest charge for required months is derived by subtracting the sum of all whole numbers from one to the number of incomplete months under the agreement (both inclusive) (e.g. 1+2+3+ …. +10 = 55) from the sum of all the whole numbers from one to the number of total months in the agreement (both inclusive), (e.g. 1+2+3+ …….10+11+12 = 78) then divided by the sum of all the whole numbers from one to the number of total months in the agreement (both inclusive) (i.e. 1+2+3+ …….10+11+12 = 78) and multiplied by the total interest charge under the agreement.

lower than what it would be under the normal method of calculating interest rebate, i.e. interest charge for 2 completed months according to general rule: \$100/12 x 2= \$16.67, thus the rebate being \$100 - \$16.67 = \$83.33, which is \$12.82 less. That is, the debtor is short-changed by \$12.82, or by 76.9%

Likewise, the interest charge for four months under Rule of 78 is \$53.85, leaving a rebate of \$46.15 if the debt is paid in 4 months/ But under the general rule, the interest charged for 4 months is \$33.33, leaving a rebate of \$66.66. Thus, the consumer is short-changed by \$20.52. i.e. 61.6%.

The differences continue to get smaller until it gets to zero at the end of the credit contract.

If interest is to be charged at the rate specified in the credit contract then the extra interest charged by the Rule of 78 is clearly in breach of the credit contract and therefore illegal. Hence, it can be seen as an interest charge on a debt that did not exist. This situation arises because the law contradicts itself.

Does this formula have to be so complicated?

There is no reason for the rebate formula to be so complicated. This same outcome can be achieved by the generally known inverted 'sum of the periods' digits method, which is easier to understand. Periods can be any payment interval such as months or years. Thus:

- sum of digits for 12 months: (1+2+3+ ……+11+12) = 78
- Interest charge for 1 month: 12/78 x 100 = 15.38
- Interest rebate after 1 month: \$100 – 15.38 = 84.62
- Interest charge for 2 months: Sum of the last two digits (i.e. inverted) divided by sum of the digits for 12 months= (12+11)/78 = 29.49, which is exactly as in the worked example above, with the rebated being \$70.51
- Interest charge for 4 months is: (12+11+10+9)/78 of the total interest, which is \$53.85, again exactly as the rule of 78 produces. The interest rebate after 4 months is \$46.15

Why does the Rule of 78 apply only in the case of hire purchases?

The Rule of 78 is clearly inconsistent with the general rule in the law. Its application results in significant advantage to the credit providers and a significant disadvantage to the consumers. As shown in the example above, if a debt is paid off at the end of the

second month, the credit provider gets 76.9% more interest than they would get if the general rule for calculating interest charge was used. This percentage drops as time passes.

As the rule of 78 allocates higher interest in earlier periods, it unfairly penalizes the hire purchase customer if he/she pays the debt off any time earlier than the full term of the credit contract; the earlier the debt is paid off the heavier the penalty. Apparently, the unnecessarily complex Rule of 78 only serves as a mathematical illusion to confuse and deceive the consumers. As higher interest charges are imposed in the early part of the contract by this rule, a debtor who pays off the debt before the end of the contract term is unfairly penalized and the credit provider generously rewarded. The only way a consumer can avoid this unfair charge is by not paying the debt any earlier than the full term of the contract. This ensures uninterrupted cash inflows to the credit provider.

Additionally, to keep the consumers hooked to their business, the credit providers are known to offer more credit to the debtors before they pay the first debt off. This rule, therefore, acts as an incentive to consumers to remain in never ending debt cycle and for credit providers to perpetuate it.

Remarkably, the Act does not explain why the rule of 78 can be used at all, and why only in the case of hire purchase agreements. Generally, it is the most vulnerable consumers who buy goods on hire purchase. And sadly, by the rule of 78, the Act allows credit providers to legally exploit their vulnerability.

While the credit providers will have no problem calculating the interest by the rule of 78 or using any method, most consumers, on the other hand, will be unable to do the calculations or be unwilling to spend time on something that they might see as a futile exercise. Consumers, therefore, do not know the exact amount of the interest component of the debt either before they sign the contract or after. They are only informed about the amount of payment and the period over which the payments are to be made.

The Rule of 78 provides a heavy penalty to debtors for early repayment of debt, while it provides for an unjustifiable benefit to the credit providers. This is grossly unfair and should be abolished forthwith. The same methods of calculating interest as for other credit transactions and loans should be required to be used for hire purchase transactions as well. Interest may be charged up-front or on reducing balance A schedule of repayments separately showing principal and interest components should also be provided.

Default Interest

The law provides for default interest. In this context, it defines 'annual percentage rate' (as the rate specified in the credit contract as an annual percentage rate e.g. 15% per annum), 'daily percentage rate' (as the rate determined by dividing the annual percentage rate by 365 e.g. 0.041%), and 'default rate' (as a higher annual percentage rate as permitted by S28). While the Act says that the annual percentage interest rate should remain unchanged, it permits a credit contract to provide for a differential rate if the higher rate is imposed only in the event of default in payment, in respect of the amount in default and while the default continues. This means that the higher rate of interest would be charged only on the amount that was in arrears and only for the period it remains unpaid.

Therefore, if a consumer defaults on his/her payment he/she will be penalized by being charged interest at a higher rate than the normal rate. Hence, in the case of hire purchase the consumer gets penalized not only if he/she defaults on a payment but also gets penalized if he/she pays off the debt before the end of the credit period. This provision of the law works in favour of the credit provider, and is patently anti-consumer.

Acceleration Clause and Repossession of Hire Purchase Goods

An acceleration clause gives the lender the right to bring forward the date on which the entire loan becomes due and payable, and he may proceed to repossess and sell the hire purchase good. Typically, this would happen in the event of failure to pay scheduled loan instalments, sale of the good and title transfer (i.e., if the item bought on credit is for sale and title likely to be transferred to somebody else). In the case of default, the contract usually allows for a grace period before the lender can call the loan and begin the foreclosure process.

If the goods are repossessed the credit provider must sell the goods for the best price reasonably obtainable and credit the debtor with a payment equivalent to the proceeds of a sale (less any amount which the credit provider is entitled to deduct from those proceeds).

Disputes, however, often arise mainly with 'best price reasonably obtainable'. Debtors often claim that the credit providers did not get the best price possible while credit providers claim that they did.

A debtor can take the dispute to the court. If the court is satisfied that the goods were not sold for the best price reasonably obtainable, then it may order the credit provider to compensate the debtor for any loss suffered as a result.

The law does not allow a credit provider to recover or seek to recover enforcement expenses from a debtor which are in excess of those reasonably incurred by the credit provider, and if he did this, then the excess must be returned to the debtor.

These legal provisions appear to attempt to balance the interest of the debtors against the interest of the credit providers. However, in reality there might still be many pitfalls for the consumers. As many consumers do not read credit documents carefully they might not be aware of any 'demand features' or other clauses that may be included in the credit documents until they are actually caught up by them. Also, while the law provides for the aggrieved consumers to seek redress in courts, in reality most consumers often have neither the money nor the ability to challenge credit providers in the court.

The law also allows a debtor or mortgagor to surrender the goods by written notice under credit contract. It requires a credit provider to give written valuation of the goods and specifies the rights and responsibilities of the credit provider and the debtor or mortgagor so that the goods are sold as soon as reasonably practicable and for the best price reasonably obtainable. If the goods are not sold as soon as reasonably practicable, or at the time the credit provider and debtor agreed on, or for the best price reasonably obtainable, the court may order the credit provider to credit the debtor with an amount, fixed by the court, exceeding the net proceeds of sale.

This sounds like a good protection to the credit consumer. However, it might be very difficult to enforce this in practice. The credit provider can always submit that he sold the item as soon as it was 'reasonably practicable' and for the best price 'reasonably obtainable'. Since what is 'reasonable' cannot be objectively defined, it will be very difficult for the debtor to prove the credit provider wrong. Besides, many debtors will not have the money to hire lawyers and take their cases to the court.

A more transparent method to sell repossessed property would be by public auction with strict mandatory provisions to govern the auction process, as happen in Australia and some other countries. Unlike mortgagee sales, auctions can reveal the true market value of a property. Auctions are conducted in an open forum where all bids are known and participants are given immediate feedback on the property's value. This process will eliminate long negotiation periods where interests on loan accounts pile up, buyers know they are competing fairly and on the same terms as all other buyers. Needless to say, they will receive comprehensive information on property via due diligence packet. Any consumer taking part in an auction can easily and quickly make market comparisons when he sees biddings at the same place and at the same time.

The law should, thus, be amended to abolish the existing practice of allowing credit providers to sell repossessed property through tender and negotiations and replaced with mandatory requirement to sell by public auction.

Protection under Hardships

The Act provides some protection to consumers who face hardships due to unforeseen circumstances before a credit provider repossesses the goods as a result of non-payment of instalments. The law prohibits a credit provider from starting enforcement proceedings against a debtor or a mortgagor in relation to a credit contract unless the debtor is in default under the credit contract and the credit provider has given the debtor, and any guarantor, a default notice, allowing the debtor a period of at least 30 days from the date of the notice to remedy the default. However a credit provider is not required to give default notice to the hirer or wait for at least 30 days if he believes on reasonable grounds that it was induced by fraud on the part of the hirer to enter into the credit contract.

If a credit provider in a default notice intends to take action because the hirer (debtor) is in default under the credit contract, the debtor or guarantor may remedy the default within the period specified in the notice, and the contract or mortgage is then reinstated and any acceleration clause cannot operate. This gives the debtor additional time to remedy the default.

A credit provider has the right to apply to the court for variation of the order and the court may vary the order to which the application relates, as it thinks fit, or may refuse to vary the order or may revoke the order.

The law requires the mortgagor to inform the credit provider, within 7 days, where the mortgaged goods are and, if the mortgaged goods are not in the mortgagor's possession, to give the credit provider all information in the mortgagor's possession that might assist the credit provider to trace the goods.

The law also prohibits a credit provider or his agent to enter residential premises for the purpose of taking possession of mortgaged goods under a goods mortgage unless a court has authorised the

entry, or occupier of the premises has consented in writing.

If goods have been repossessed the credit provider must give to the mortgagor within 14 days the estimated value of the goods, enforcement expenses, and debtor's rights and responsibilities.

The law prohibits the credit provider from disposing off the goods within 21 days from the date of notice given to the debtor or where stay of enforcement proceedings is in force under this Act or an application under which a court may re-open unjust transactions.

A credit provider must return any good under a mortgage if the amount in arrears (less any accelerated amount) and the credit provider's reasonable enforcement expenses are paid within the 21-day period and the debtor has not committed a further default of the same kind under the credit contract; or the credit contract is paid out.

As can be seen from these provisions, the law does not relieve the debtor from his/her debt but only makes it harder for the credit providers to repossess the goods or take other harsh actions to recover their debts. By imposing a number of requirements on parts of both the credit providers and the debtors, the law attempts to achieve an orderly resolution of the problem. This might also give more time to the debtors to find means of getting out of hardships. However, to minimize the chances of getting into hardships, consumers need to make realistic assessment of the security of their jobs, reliability of any additional income and the necessity of the goods they want to buy on credit.

Conclusion

Prior to the Consumer Credit Act 1999, there was no legal safeguard for the credit consumers. Credit transactions occurred mainly by contractual agreements prepared by credit providers. Consumers had no option but to accept the terms and conditions imposed by the credit providers. The Consumer Credit Act 1999, Consumer Credit Amendment Act 2006 and Regulations 2009 were enacted to remedy this imbalance in power of the two parties.

This study finds that the Act and the Regulations have made little difference. They largely serve to legitimize the practices that existed prior to the enactment of these legislations. In some instances the law expressly allows credit providers to exploit the consumers. For example, interest charge in all cases is to be determined by applying the daily percentage rate to the unpaid daily balances except for a hire purchase agreement where Rule of 78 will apply. Rule of

78 imposes highest interest charge in the earliest part of the credit term, then diminishes and charges the lowest amount in the last period of the credit term. This unfairly allows credit providers to take bulk of the interest in the early part of the credit term and penalizes the consumers who pay the debt off before the full term of the credit. If they default on a payment, they are charged a higher rate of interest on the amount in arrears. Hence, they are penalized not only for failing to make a payment on time, but they also get penalized for paying a debt off earlier than the full term of the contract.

Due to such inequities in the law, consumers continue to be legally exploited by credit providers. In addition, the legislations contain complicated finance terms, legal jargon and complex mathematical formulae which are beyond the ability of average consumers to comprehend, let alone using the legislations for the purpose of negotiating contracts and resolving disputes with credit providers. In reality, consumers are normally given 'standard' contracts to sign, perhaps not much different from the practice that existed prior to the enactment of the Consumer Credit Act 1999, Consumer Credit Amendment Act 2006 and Regulations 2009.

Therefore, just as consumers had no option but to accept the terms and conditions imposed by the credit providers before the enactment of the legislations, they have no option but to do the same today. The legislations have apparently not only served to legitimize the usual practice of the credit providers but the complexity of the legislations also enables them to sneak in terms and conditions in credit contracts that unfairly favour them to the detriment of the consumers' interest. All these problems are further exacerbated by the fact that consumers are generally not motivated to protect their own interest until such time that they find themselves in trouble.

With deregulation of the financial markets and free international trade resulting in cut-throat competition among credit providers, consumer credit market has changed dramatically. The use of credit in retail stores is now far more prevalent, particularly to pay for white goods, furniture and electronic equipment. There has also been a spectacular growth in 'plastic money' (credit and charge cards), leading to a radical change in attitude to credit, from focusing on 'debt' as a last resort to regarding credit as part of a suite of financial services to be routinely used. Luckily, this problem has not become as chronic in Fiji as in most developed nations.

Nevertheless, the imbalance in power of the two parties that the legislations in Fiji attempted to correct has apparently not been

addressed in effect by the law. This study has identified numerous problem areas and made recommendations to correct this imbalance. It must be remembered that credit is useful not only to consumers but also to credit providers. It enables consumers to enjoy the benefits of goods without paying for them upfront and enables credit providers to make a sale without having to wait for cash to be paid. Therefore, if credit is not carefully regulated, it can be immensely destructive not only to the consumers but also to credit providers. Only fair regulation can protect the interest of both parties.

References

Abbey Legal Protection (2012) 'Sale of Goods Law'. January; http://www.google.com/#safe=active&sclient=psy-ab&q=abbey+legal+protection

Banking and Financial Services Ombudsman (2005) *Submission in Response to the Issues Paper: Consumer Credit Review (July)*. Victoria: Australia.

Consumer Affairs Victoria (2006) *Government Response to the Report of the Consumer Credit Review*. State of Victoria.

Consumer Affairs Victoria (2006) *The Report of the Consumer Credit Review*. State of Victoria.

Howell, N. (2004) *Solicitor lending to consumers: a study of interest only loans and asset-based lending practices in Victoria*; September.

Kumar, P. (2010) *Our Home Our Rights: Fighting for Transparency in Mortgagee Sale*, *Consumer Rights Day Celebration*. Suva: Southern Cross Hotel; 15 March 2010.

Nottage, L. (2009) 'Consumer Law Reform in Australia: Contemporary and Comparative Constructive Criticism'. Working Paper No. 24, August, Faculty of Law: The University of Sydney.

Office of Fair Trading, Queensland Govt nd; 'Consumer guarantees applying to goods', http://www.fairtrading.qld.gov.au/consumer-guarantees-goods.htm

Ramsay, I. (2005) 'Consumer Credit Regulation as "The Third Way"?' Keynote Address, Australian Credit at the Crossroads, Australia: Melbourne; 8-9 November 2005.

Tripodi, V. (2010) 'Aussies lead world in personal debt'. http://australia.creditcards.com/credit-card-news/australia-world-credit-card-debt.php.

Author:

Ram Karan is Professor of Accounting at the Fiji National University. Email: ram.karan@fnu.ac.fj