

AN ANALYSIS OF THE ADEQUACY OF LAW RELATING TO HIRE PURCHASE IN SRI LANKA; WITH SPECIAL REFERENCE TO THE CONSUMER PROTECTION

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Introduction

With an increasing demand for a better life, the consumption of goods and services has been gradually raised. However, the increasing demand has not been backed up by adequate purchasing power, which transforms it into an effectual demand (Mukharjee and Hanif 1998). As a result of that, a market has been created for hire purchase (hereafter referred to as HP) system. HP is one of the most commonly used methods to purchase goods on credit. The foundation of HP agrees to purchase goods in instalments over some time. When people use HP, they usually enter into hire purchase agreements with banks, financial institutions or any other institutions that provide the HP facility. HP is a system which a buyer pays a seller for a thing in regular installments while enjoying the use of it and during the repayment period, property (title) of the item does not pass to the buyer. Consequently, the title passes to the buyer upon the full payment of as agreed by the HP Agreement.

In a hire purchase agreement, the 'hirer' (buyer) can utilize the goods, and responsible for maintaining the goods, while the legal

property remains with the lender (lender). Until the last installment is paid, the hirer does not acquire the property of the good. In other words, the property of a good under an HP Agreement can only be transferred to the hirer upon the fulfilment of the condition – the completion of instalment payments. Interestingly, HP provides ample opportunities for consumers to consume goods under better terms and legal certainty.

Accordingly, this research aims to discuss the adequacy of the law of HP in Sri Lanka with particular reference to achieve its objectives by providing better consumer protection. Further, this research intends to examine the existing Sri Lankan law relating to HP as a substantive part of commercial law. Finally, this research aims to make recommendations to enhance Sri Lankan law relating to HP by drawing examples from some selected jurisdictions.

Methodology

This research is a normative research that is based on an extensive review of literature. Legislative enactments and case laws have been used as primary sources in order to carry out this research. Similarly, the Central Bank

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Annual reports, Annual reports of banks and other financial institutions in Sri Lanka, policy reports, journal articles and published researches have been used as secondary sources. This research compares and contrasts Sri Lankan law relating to HP with that of the United Kingdom and Malaysia where we can find developed HP laws.

Results and Discussion

Why HP?

In cases where a buyer cannot afford to pay the asked price for a good as a lump sum but can afford to pay a percentage as a deposit, HP Agreement allows the buyer to hire the goods for a monthly rent, when a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price usually a nominal sum or return the goods to the lender (Adera, A. 1995). Accordingly, the HP system is more critical as it provides more advantages for the hirer as well as the lender, and it would create a win-win situation. However, as Atieno, R. (2001) observed, HP is frequently advantageous to clients that are hirers because it spreads the cost of expensive items over an extended period.

As the HP system attracted more customers as the payment is to be made in easy installments, the aggregate sale of the economy increases while a large volume of sales ensures increased profits to the industry. It is believed that HP encourages thrift among the buyers who are forced to save some portion of their income for the payment of the installments, and this inculcates the habit to save among the people. Furthermore, this

system is a blessing for the small manufacturers and traders, and they can purchase machinery and other equipment on an installment basis and in turn, sell to the buyer charging full price.

Consequently, when considering these significances, HP can be considered as one of the most powerful means to boost the consumption of goods and eventually the economic growth.

Law Relating to HP in Sri Lanka

The law relating to HP in Sri Lanka, primarily contained in the Consumer Credit Act, No. 29 of 1982 (hereafter referred to as CCA) (as amended the Consumer Credit (Amendment) Act, No. 7 of 1990). The CCA provides provisions to define and regulate the duties of parties to HP Agreements and to provide for matters connected therewith or incidental thereto. Section 31 of CCA provides a comprehensive definition to an HP Agreement.

As stipulated in Sections 7 to 19 of CCA, the rights and obligations of a hirer vis-a-vis consider as the obligations and rights of the lender. Furthermore, it provides express provisions regarding the conditions and warranties of an HP Agreement, which provide more excellent protection to the hirer. Moreover, the CCA mandates the availability of HP Agreements and with specific provisions such as the agreement is made and signed by all parties to the agreement; the agreement contains a statement of the hire-purchase price, the cash price of the goods, the deposit paid and a list of the goods to which the agreement relates sufficiently to identify them; and also a copy

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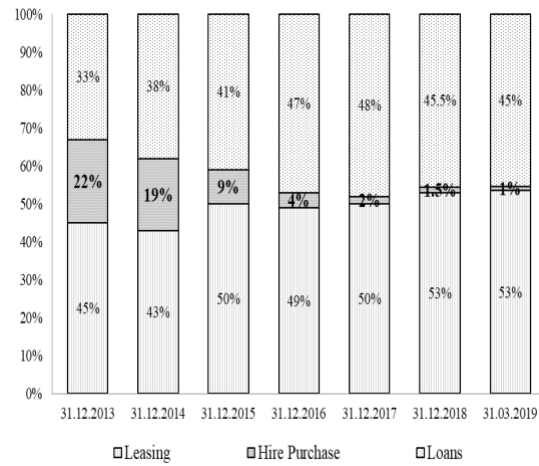
of the agreement is delivered or sent to the hirer within fourteen days of the making of the agreement. In that sense, the CCA provides a substantive legal framework on HP in Sri Lanka.

However, there are some loopholes and shortcomings in the part of the implementation of the CCA in Sri Lanka. Surprisingly, the use of HP is gradually decreased in the recent past, even though CCA provides a protective mechanism to sale and purchase goods. The following section analyses the practical application of the HP in Sri Lanka.

How does HP work?

There has been an increasing trend in Sri Lanka in replacing HP by the leasing and loan facilities. As depicted in the Sector Report (March 2017) - published by the First Capital Equities (Pvt) Ltd, the usage of HP has been decreased over time. The following chart demonstrates the decreasing trend of HP in Licensed Finance Companies (LFC) and Specialized Leasing Companies (SLC) sector in Sri Lanka (the period from 2013 to 2019).

Figure 1: Moving from HP to Leasing and other Loans in NBFIs (2013 – 2019)



(Source: Central Bank of Sri Lanka)

According to the above chart, HP which was 22% of the total loan portfolio of the Non-Banking Financial Institutions (hereafter referred to as NBFIs) by the end of December 2013 had decreased to 1% over nearly five years. The leasing and loans have been acquired considerable growth over the period by replacing HP. As it is observed, when NBFIs apply their risk mitigation technics and product diversifications, they try to reduce their HP portfolio even though HP provides more advantages to the customer rather than leasing. As a result of that, customers' opportunity to enter into HP Agreements has been inappropriately restricted or neglected. It can also be argued that the customers are deprived of the protection available under the CCA. We can identify the following substantive and procedural weaknesses in the law relating to HP in Sri Lanka.

Whether the existing HP law in Sri Lanka is adequate?

Even though the CCA appears to be as comprehensive legislation, it needed to be amended and revised in order to provide better protection to the consumers and incentivize commercial activities. Accordingly, we can identify the following defects in CCA.

- CAA does not provide provisions relating to establish an HP Regulatory Authority (hereafter referred to as HPRA). As a result, there is no authority to supervise, monitor, investigate, examine or regulate the HP system in Sri Lanka.
- CCA is silent regarding the license required to carry on HP business.
- There are no caps or ceiling rates provided in the CCA which determine the interest rate of HP, and any directions to determine the HP price designed by a regulatory. As a result of that, the lenders can apply any interest rate to calculate the HP price. Thus, lenders use interest rates to discourage HP by increasing the HP price. Then, the customers are stimulated to move from HP to leasing or any other similar loan products such as Vehicle Loan, Auto Loan, Consumable Loan, and Mortgage Loans.
- There are no provisions in CCA on the following aspects;
 - Consistency relating to the point of repossession. (The point of repossession can be varied as a result of the discretion of the hirer.)
 - How can the lender reschedule or restructure the existing HP agreement?

- What the penal interest rates are, that can be charged on arrears payments?
Instance
- Conditions for early settlement of the HP price.

Also, due to non-availability of any directions, circulars or guidelines on the above aspects, the lenders exploit HP system and protection available to the costumers. Ultimately, such inadequacies lead HP is to be an unpopular mean of purchasing goods.

What lessons from other jurisdictions?

It is worthwhile, considering the HP related provisions of the United Kingdom and Malaysia in order to make suggestions to enhance Sri Lankan law relating to HP. We can identify the following best practices regarding HP and consumer protection in both countries.

- *Consumer Credit Act 1974 – the United Kingdom*
 - Establishment of the enforcement authorities: The Director-General of Fair Trading, the Local Weights and Measures Authority and the Department of Commerce have to enforce the Act and regulations made under it.
 - A license is required to carry on HP: The Director-General of Fair Trading administers the licensing system set up by the Act. The power to renew, suspend or revoke the license is also vested in the Director-General of Fair Trading.
- *Hire Purchase Act 1967 - Malaysia*

- Appointment of officers: The Minister of Consumer Affairs has the power to appoint a Controller of Hire-Purchase and other members as may be necessary for the purposes.
- Provisions for further protection of customers;
 - i. Option to the hirer: A lender shall provide an option to the hirer for the terms charges under a hire-purchase agreement to be at a fixed rate or a variable rate. A variable rate of terms charges shall be quoted at a margin percentage above the base lending rate.
 - ii. Early completion of agreement: The hirer can complete the purchase of the goods by paying to the lender the net balance due under the agreement with the statutory rebate.
 - iii. Repossession:
 - The lender shall not exercise any power of taking possession without giving a notice in writing, which is which shall not be less than twenty-one days after the service of the notice;
 - The lender shall not, without the written consent of the hirer, sell or dispose of the goods or part with possession thereof until after the expiration of twenty-one days after the date of the service on the hirer of the notice;
 - No person shall undertake repossession of goods undertake repossession of goods comprised in an HP agreement without a written permit issued by the Controller.
- iv. Limitation on terms charges: The terms charges concerning an HP agreement shall not exceed a rate per annum as may be prescribed by any regulations made under this Act in respect of any goods or class of goods.
- v. Booking fee: No lender, dealer, agent or person acting on behalf of the lender shall collect or accept a booking fee from an intending hirer before the receipt of the duly completed form.
- vi. Minimum deposits: Where the minimum amount of the deposit in respect of any goods or class of goods is not prescribed shall be guilty of an offence under this Act.
- vii. Powers of investigation and arrest: Act provides comprehensive provisions relating to criminal offences which boost the effectiveness of the Act.

Therefore, it is clear that the HP law in the United Kingdom and Malaysia provide advanced provisions on HP administration and consumer protection. These provisions can be and should be used as a guide to enhance the HP administration system and consumer protection under HP in Sri Lanka.

Conclusion

The HP system in Sri Lanka has been deliberately neglected and underutilized due to the inadequacy of the existing HP related legal mechanism. Even though the HP system is more critical to an economy as it can contribute to economic growth, it cannot be sustained without a comprehensive legal regime. The above discussion shows that CCA has some weaknesses in the areas of HP administration and consumer protection. This has been a result to exploit HP provisions by the lenders and too unpopular its importance among hirers. This situation can be remedied through enhancing the HP administration and consumer protection under Sri Lankan law. Accordingly, this study recommends that the Sri Lankan CCA should amend to provide greater certainty on the HP system as practiced in the United Kingdom and Malaysia.

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