

Title: EU Directive 2011/90/EU - Additional APR Assumptions IA No: BIS 0343 Lead department or agency: BIS Other departments or agencies:	Impact Assessment (IA)		
	Date: 25/04/2012		
	Stage: Final		
	Source of intervention: EU		
	Type of measure: Secondary legislation		
Contact for enquiries: Diana Sibbald 0207 215 1530			
Summary: Intervention and Options		RPC Opinion: GREEN	

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
-£2.5m	-£2.5m	£290k	No
			NA

What is the problem under consideration? Why is government intervention necessary?

One aim of the EC Consumer Credit Directive (2008/48/EC) "2008 Directive" was harmonisation of consumer protection, transparency and consistency of value for money across the EU to facilitate assured cross border transactions. One strand of this was to improve the standardised approach to producing the Annual Percentage Rates of Charge (APR) on unsecured credit agreements. It subsequently emerged that the original assumptions were ambiguous in some areas, and insufficient in some others, such as charge cards. Thus the EU has issued a new Directive 2011/90/EU "2011 Directive" with amended assumptions for the credit providers to use in the APR calculation.

What are the policy objectives and the intended effects?

Policy objectives are to correct the current distortions of the APRs which are produced by application of the existing assumptions. The intended effect is to secure a more level playing field for lenders and greater transparency and comparability for consumers of like for like products. There may be in turn a consequential boost for competition across similar products from different lenders in the UK, as well as throughout the EU.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

1. Do nothing: this is not possible – non compliance risks infraction.
2. Alternatives to regulation: there is no alternative to amending existing UK regulations.
3. Gold Plating: there is no case for industry-suggested changes, including varying the implementation date: legal advice is there is no scope for varying the date from which these provisions apply: 1 January 2013, as we are obliged by the Directive to introduce the new provisions on 1 January 2013
4. Preferred Option: transpose the Directive using 'Copy Out' as far as possible. The micro businesses exemption is inapplicable for EU regulation.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 12/2017					
Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: n/a	Non-traded: n/a	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: _____ Date: _____

Summary: Analysis & Evidence

Policy Option 1

Description: Implementation of the 2008 Credit Agreement for Consumers

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -2.5	High: -20	Best Estimate: -2.5

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	2.5	n/a	2.5
High	20	n/a	20
Best Estimate	2.5	n/a	2.5

Description and scale of key monetised costs by 'main affected groups'

IT systems used in the calculation of APR will need to be changed. Estimates by industry varied widely depending on the complexity of their IT systems. Using these estimates the total costs to credit and charge providers ranges from negligible to £20 million. Despite a degree of industry uncertainty, the balance of evidence suggests impact towards the lower end of the estimated range. There is a low risk that implementation costs could be towards the higher end of the estimated range.

Other key non-monetised costs by 'main affected groups'

The limited scope and impact of the changes to the calculation of APR to the industry means that there are no non-monetised costs to providers of personal loans. There could be a small impact on hire purchase/finance lease providers but there was no consensus from providers so on balance this cost is zero to negligible. Once the change has been made there should be no significant on-going costs.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	optional	Optional	Optional
High	optional	Optional	Optional
Best Estimate			

Description and scale of key monetised benefits by 'main affected groups'

Not monetised

Other key non-monetised benefits by 'main affected groups'

The 2011 Directive improves the comparability across credit types, particularly for charge cards, this may increase the relative share of consumer spending on charge cards. Currently spending on charge cards is around a quarter of the total spending on credit cards and charge cards.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The drafting of the 2011 Directive is, in places, open to varying interpretations. If we use copy-out, we are passing the uncertainty onto the users of the legislation. If we use elaboration, we risk mis-transposing the Directive.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OIOO?	Measure qualifies as
Costs: 0.29	No	NA
Benefits: NA		
Net: -0.29		

Evidence Base (for summary sheets)

Background

1. One aim of the EC Consumer Credit Directive (2008/48/EC) "2008 Directive" was to foster integration of the consumer credit markets, along with a higher level of consumer protection, with a particular focus on transparency and consumer rights. The 2008 Directive introduced, amongst other things, a set of rules and assumptions for the calculation of APR for consumer credit products such as credit cards.
2. The objective was to facilitate the comparison of different credit products both within and between Member States. This was expected to lead to benefits to credit businesses in enabling them to calculate the APR in a consistent way across products and show more accurate representative charges. For consumers, expected benefits included easier identification of cheaper or more suitable loans. In turn, this could spur business to provide better and more suitable products.

Problem under consideration

3. However, the APR assumptions set out in the 2008 Directive, rather than harmonising the method of calculation, unfortunately resulted in some different interpretations of the APR calculations across the EU, which also affects certain consumer credit agreements regulated in the UK by the Consumer Credit Act 1974.

4. This impedes rather than supports consumer comparison of products. The 2011 Directive notes that:

"The experience gathered by Member States with the implementation of Directive 2008/48/EC has shown that the assumptions set out in Part II of Annex I to that Directive do not suffice to calculate the annual percentage rate of charge in a uniform manner and moreover are not adapted any more to the commercial situation at the market. "

5. The EU has therefore issued the 2011 Directive to fine tune some of these assumptions to enable consistency of calculation and like for like comparison of interest rate when applied to relevant products. A particular problem to address for the UK is when the current EU formula (using the 2008 Directive assumptions) is applied to charge cards, (such as American Express). The resultant APR is usually unrepresentatively high partly because the 2008 Directive calculation requires the assumption that annual fees for charge cards are paid in the first month rather than being spread over the year.
6. In reality the outstanding balance on charge cards is repayable in full at the end of each month (rather than for ordinary credit cards the balance being outstanding for indefinite periods with only a partial repayment due at the end of each month). For example consider a charge card with a maximum amount of £1200 that can be drawn down by the borrower at any time, but requires repayment strictly within the month i.e. no revolving balance. The card has no interest rate but an annual fee of £300 is payable. Under the existing assumptions, it would be assumed that the total amount of credit is withdrawn immediately and in full, and no other draw downs are taken in to account; the resultant APR is 1355.2%. Under the new assumptions successive draw downs and repayments over the year are taken into account and the APR becomes 33.7%.

7. These very high interest rates for charge cards result from the timing and amount of repayments affecting the APR even though the total charge for credit is the same. In the example below, the initial loan is £1,000, the charge for credit is £200 and the loan term is 12 months. (In each case the point at which the loan is advanced is the same, the point at which the loan is fully discharged is the same and the total repayment of £1,200 is the same.)
- One payment of £1200 at end of 12 months APR =20.0%
 - Two equal payments of £600 at 6 months and 12 months APR = 27.8%
 - Three equal payments of £400 at 4 months,8 months and 12 months APR = 32.0%
8. This appears to be explained simply in terms of the APR decreasing the longer the customer has use of the credit before being required to repay it. This does not allow consumers a meaningful comparison of APRs across products. Particular beneficiaries of the changes in the assumptions underlying the APR calculation are the charge card companies (such as American Express), who can now use a more representative APR when advertising their products. This is not to give them any competitive advantage (as there is no intentional change to the interest or charges that consumers pay) but to remove the presentational disadvantage caused by the existing 2008 Directive assumptions.
9. **The new Annex to 2011 Directive covers:**
- a. new assumptions on the standards for the calculation of the APR for credit agreements without fixed duration (such as credit cards, store cards, loan hire purchase agreements) or repayable in full repeatedly (such as for charge cards where the credit is repayable in full at the end of every month.).
 - b. additional standards for the timing of the initial drawdown of credit and the timing of the payments to be made by the consumer.
10. It should be noted that the essential formula for the calculation of the APR has not changed. The formula is attached at Annex B. Additionally, most of the original APR assumptions remain unchanged, although we have noted a typographical error in the original transposition that we are now correcting. The new Directive (Annex A) replaces Part II of Annex 1 to the 2008 Directive and provides additional, more detailed, assumptions and some revised assumptions which are tailored to the particular features of specified types of open ended credit agreements as well as some fixed term agreements.
11. The new method of calculation is designed to help consumers compare products. In practice, after application of the new assumptions, providers of charge cards and similar products are likely legitimately to display lower representative APRs. The calculations will not affect the interest that customers are actually charged for their credit. For example, charge card users will not experience a reduction in interest charges as a result of the Directive. Rather, the pre-sale comparison of APRs will be more realistic.

Rationale for intervention

12. As the EU issues Directives in support of transparency of consumer credit information, the mandatory assumptions they prescribe for how to calculate APRs must ensure appropriate and consistent calculations across all relevant credit products and throughout the EU. This is not currently the case. Therefore both the EU and the UK Government have a rationale to alter the mandatory calculation assumptions to ensure they provide APRs properly representative of actual charges. This will make a solid contribution to support the EU's overall policy of consumer protection and, as a discrete element, contributing to overall harmonisation within the EU.

Policy objective

13. In this section we consider the general policy objective of the 2008 Directive and the policy objective specific to this IA (affecting the APR calculations for all consumer credit agreements and with a particular impact on charge cards).

The Objective of the 2008 Credit Agreement for Consumers

14. The full harmonisation nature of the 2008 Directive is aimed at creating a 'level playing field' for creditors (who should not have to adapt their products to different legislations when supplying products and services cross-border) and a climate of confidence for consumers, who enjoy the same levels of protection throughout the EU as in their own Member State.

APR Calculations Objective

15. The provision of harmonised APR on credit products should help consumers compare loans within and between Member States, giving lenders a level playing field, spurring competition between firms and helping consumers find the most cost effective loans to meet their needs. The primary impact of the additional APR assumptions is in relation to i) credit cards including charge cards and ii) open ended credit agreements including store cards. There will be a lesser impact on other types of consumer credit agreements. A key subsidiary objective, apart from enabling consumers to compare the terms between all forms of credit offered within the UK, is to enable a better comparison of the relative costs of APRs between charge cards and credit cards as well as between all comparable products throughout Europe.

Options

Option 1: Do nothing.

16. This is not possible as UK law must be aligned with the Directive. **All EU Member States are required to bring these provisions into force with effect from 1 January 2013.** Were we to disregard the Directive, we risk infraction for the UK.

Option 2: Alternative to Regulation

17. There is no alternative to amendment of the existing UK regulations which effected the original transposition of relevant parts of the 2008 Directive..

Option 3: Gold Plating

18. The requirements of the Directive are to introduce the new provisions with effect from 1 January 2013. Any deviation from this deadline this can only be considered where there are extraordinary circumstances or adverse consequences for the UK, as a failure to implement on the stated deadline would risk infraction proceedings being brought against the UK, and could lead to a wronged party bringing a claim for Francovich damages against the UK.
19. Early implementation is considered gold-plating, and Government policy is not to gold-plate unless there are exceptional circumstances. These conditions do not apply.
20. Although a few firms have enquired about the possibilities of transitional, early or late implementation, our legal advice is that there is no scope to accommodate any such arrangements, as the Directive does not provide for any transitional arrangements or early/late implementation.
21. However, industry's wish for flexibility is intended to be met by providing up to six months advance clarity of the precise terms of the regulations to enable necessary preparations to be made. For this reason, we are seeking to lay the regulations before Parliament on 29 June 2012 albeit they will not become effective until 1 January 2013.
22. Accordingly, no gold plating is proposed.

Option 4: Transpose the Directive (Preferred Option)

23. As BIS did not transpose Annex I part II of the 2008 Directive word-for-word, it will not be possible literally to "copy out" the 2011 Directive into domestic regulations. However, we will implement by using "copy-out" as far as possible, and minor "elaboration" only where required for the sake of clarity e.g. if necessary, to refer to existing UK legislation.
24. The Annex of the 2011 Directive replaces Part II of Annex of the 2008 Directive. Since it does not vary greatly from the 2008 Annex, its relatively straightforward technical provisions can fairly easily be transposed.
25. The main new provisions of the Annex to the 2011 Directive are:
 - Assumption (e) relates to open-end agreements (other than overdrafts). For credit cards, it assumes that the capital is to be repaid in equal monthly instalments over one year with interest and charges.
 - Assumption (f) relates to fixed duration agreements such as loans and hire-purchase. It applies only in cases where the date or amount of drawdown is unknown.
 - Assumption (g) is a fall back assumption for use in cases where assumptions (a) to (f) are not sufficient to calculate an APR. It sets out how the lender should treat interest and charges when all of the variables are unknown.
26. These technical changes, are relatively uncontroversial with the business community; lenders have been involved in finalising the assumptions and they are broadly content with the changes in principle, despite the necessary changes to UK legislation and consequential changes to their systems.

Micro Business Exemption

27. The Directive applies to all credit businesses - of whatever size - and this is consistent with the Directive's rationale for uniformity, transparency of consumer choice and open competition. Since this is EU Legislation rather than regulation originating in the UK, it is out of scope of the One In One Out rule. As such, the three year moratorium on regulation of micro businesses does not apply.

Support to Industry

28. To help support industry in understanding the implications and effects of these changes we are disseminating via Trade Associations as much explanatory material as possible. This clarification and two way engagement will continue before, during and after the effective implementation date.

29. We have attempted to minimise costs to business by planning a 6 month notice period from the date the regulations are laid to the date the amendments must be formally introduced. This gives lenders the opportunity to introduce changes as part of their regular systems updates. Although not all lenders have indicated that they can easily deliver the changes within six months, this is the maximum we can accommodate given the EU timeframe.

30. We also propose to produce the draft regulations as early as possible to allow the industry to examine and comment upon the drafting of the law, give lenders early notice of precisely how UK law will be amended, and enable them to start to prepare with confidence to introduce the changes by the agreed date.

Commission Guidelines on APR Assumptions

31. The European Commission is also issuing guidelines to clarify the application of the 2011 Directive in relation to the APR rules where the issues are not dealt with in the assumptions themselves. The guidelines are seen as a 'tool' to assist Member States in implementing the APR rules and will not be legally binding. The OFT played a key role in helping to draft the guidelines and UK lenders have had the opportunity to comment on earlier drafts.

32. We will examine the Commission's new guidelines once they have been finalised and consider whether it would be appropriate to make any corresponding amendments to the current BIS guidance.

Any Scope for Unintended Consequences

33. The only issue identified thus far is whether, in some circumstances, industry would seek to pass on their Directive implementation costs in increased charges to the customers. This could lead on the one hand to unintended consumer detriment of higher costs of borrowing in return for greater transparency. On the other hand, it could lead to a restriction of product choice on business and consumers as the large lender who mentioned the possible need to pass on these costs, implied that they might withdraw the affected products from the market rather than offer them at a higher price.

Consultation

34. This is a very narrowly focused set of provisions which comprises replacement of Part 11 of Annex A to the 2008 Directive – on one sheet of paper. It is out of the scope of

BRE's UK Regulatory policy and as such is excluded from the requirement for formal consultation. In any event, there is no discretion for Member States to change the Directive's provisions so it would have been raising false expectations to present the matter for formal consultation. However, we held extensive opening discussions with industry representatives and with the OFT, the industry regulator, in order to prepare business for the change and listen to their views.

Methodology for Informal Consultation

35. The impact on the industry was tested by sending out questionnaires via three trade associations; the British Bankers Association, Finance and Leasing Association and UK Cards Association. Those responses were discussed with the trade associations and the UK regulator for consumer credit and OFT. Follow up telephone conversations were held with many respondents, in order to clarify responses.
36. We also invited consumer representatives Citizens Advice and Consumers Association (Which) to comment, but as yet have received no response. It may be that the changes are not expected to have a significant enough impact (if any) on consumers to make it worth while to give these issues priority at this stage. We will continue to liaise with them and monitor any emerging thinking.

Monetised and non-monetised costs and benefits of each option (including administrative burden)

37. There has been a good response from large lenders with 4 of the 5 major high street lenders responding. There has been a very limited response from smaller parts of the industry. The low responses from smaller lenders we have been told by the relevant Trade Associations is likely to indicate uncertainty about the extent or nature of the impact or an informed assessment of low impact from the changes.
38. Of those that did respond there is some uncertainty and caution around the costs of implementing the amended Directive. Some estimates have been based on the costs of implementing the fuller APR assumptions in the 2008 Directive. The new assumptions make relatively minor changes to the Directive so, for those respondents, it is likely that the true costs will be towards the lower end of the estimated ranges.

Credit, charge and store cards

39. The Bank of England estimate the total gross lending on credit and charge cards in 2011 was £136 billion. The amendments should impact primarily on the APR calculations for charge cards in order to help consumers compare credit products. It will not in itself change the interest consumers are charged.

One off costs of implementation

40. There is some uncertainty and caution in the industry surrounding the one off costs of implementation. Of the four major high street banks that responded, two reported relatively high costs for implementing the Directive. However, two other major high street banks and, separately, the major supplier of charge cards in the UK stated that the cost would be negligible or zero. A number of smaller lenders also reported that the changes would not involve significant implementation costs.

41. The 2 banks that reported high cost of implementation stated that most of the cost involved reprogramming some of the IT systems used in the APR calculation and ensuring consistency in calculation across the different IT system used throughout the relevant banking group. Other costs such as altering marketing information and terms and conditions were included in these estimates.
42. In total the responses cover in excess of 50% of the credit and charge cards market. We used the cost estimates from each response and combined them with market share figures to provide estimates of cost for the market as a whole.
43. Given the dispersion in cost estimates we provide three cost scenarios
- **High cost** (where we use the costs and market shares from the two major high street banks that reported high cost estimates for implementation to represent the credit and charge card market.)
 - **Medium cost** (where we use all respondents' information on costs (both high and low) and market shares to estimate the cost to the credit and charge card market)
 - **Low cost** (where we use the two major high street banks and one charge card provider that reported the low/negligible cost estimates and apply to the credit and charge card market)
44. Due to the lack of consistency in the cost estimates from industry we made follow up calls to most respondents to explore why some banks reported high cost estimates and some negligible costs. These conversations lead us to believe that the low or medium cost scenarios are the most likely. This is because the two banks that quoted high costs did so on the basis of the implementation cost of the 2008 directive. However, this new directive is only an update to some assumptions. In addition many banks quoted negligible costs and we were advised by the relevant trade association that the lack of responses from their members was probably because they are not concerned about the new directive and its costs. Therefore we are estimating the low cost scenario but acknowledge there is a risk that the average cost of implementation may be higher once the full details of the changes are clearer.
- **High cost.** The two major high street banks that reported high costs estimated it would cost around £7 million to implement in total, these banks represented around a third of the industry. Dividing cost by market share (£7m/34%) would mean a cost of £200,000 for each 1 per cent of the market or a one-off cost for the credit and charge card market of £20 million.
 - **Medium cost.** The total costs reported by all respondents was £7.6 million, this represented over half of the market, and would equate to (£7.6m/50+%) a one-off cost to the credit and charge card industry of £14m.
 - **Low cost.** Uses the estimates of the two major banks and one charge card provider that reported low costs to represent the credit and charge market implies a low one-off cost to the industry. The two banks declined to provide monetary estimates of the cost, other than to suggest that the costs were low or negligible, because they viewed the change as insignificant to them in terms of cost and implementation. The charge card provider estimated the cost to be low in their view and possibly in a range of £63k to £126k. Using the upper estimate of £126k and applying it to their market share of 5% yields a one off industry cost of £2.5m.

Personal Loans, Hire Purchase/Finance Lease

45. The amendments to assumptions (f) and (g) affect fixed-duration agreements like personal loans and hire purchase agreements. Some parts of the industry offering

specialised personal loan products felt they would be impacted by the amendments, however, other providers felt there would be no impact on this part of their credit business. As an example, one large lender quoted one off costs of £0 – £0.5 million.

46. Firms offering hire purchase and finance lease agreements largely did not respond to the questionnaire. The relevant trade association is interpreting this as a combination of factors: low impact or perceived low impact on their members' business, and some degree of uncertainty about the nature of the changes and their precise application to some specialised products. There may also have been an element of reluctance to contribute to debate about a Directive the term of which they could not influence. Therefore it has not been possible to estimate their costs of implementing the Directive. When costs were mentioned by respondents to the questionnaire they listed changing IT systems as the major cost component arising across the whole range of products involved.

On-going costs

47. Changes to customer literature costs are included in the quoted implementation costs. Once the IT system and documentation changes have been made there are no significant on going costs. Reflecting new annual percentage rates of charge in loans documentation is no more expensive than quoting existing rates of charge. Industry did not mention ongoing costs and a follow up discussion with Trade Associations confirms the view that there are zero additional on-going costs.

Benefits to business

48. The primary benefits to business from these changes will be to allow a more level playing field for charge card providers. The changes are not likely to increase the overall levels of borrowing on credit and charge cards although consumers may increase the relative share of purchases made on charge cards. Currently, purchases on charge cards make up around a quarter of the total purchases made on credit cards and charge cards.

Benefits to consumers

49. The impact upon consumers should be beneficial as intended, or negligible at worst. The changes are most likely to be invisible to consumers with the exception of apparently much reduced charge card APRs which provide a more realistic comparison of the cost of credit across products (although these changes will not in themselves alter actual interest rates charged).
50. The improvements in comparability of APR calculations should however allow consumers to identify cheaper/more appropriate credit for them and so could lead to potential savings. Research conducted for the Credit Advertising Regulations in 2004 indicates that 84% of the population consider the APR an important factor in choosing which credit product to take, and from which lender.

Risks

51. One respondent felt that an interpretation of the amendments could be detrimental to certain consumer credit products that offered special introductory rates, often at zero percent. However, this is not the intended interpretation of the Directive and we will ensure this risk is mitigated in the copy out of regulations.


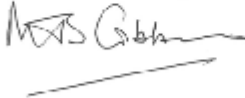
One in One Out

52. Out of scope as this is an EU Directive.

Annex A The new Directive assumptions (Part II of Annex I to 2011/90/EC)

The new Annex to the Directive showing the entire list of relevant provisions is attached in the separate PDF print-out.

RPC Opinion on next page

 Regulatory Policy Committee	OPINION	
Impact Assessment (IA)	EU Directive 2011/90/EU – Additional APR Assumptions	
Lead Department/Agency	Department for Business, Innovation and Skills	
Stage	Final	
Origin	European	
Date submitted to RPC	31/05/2012	
RPC Opinion date and reference	19/06/2012	RPC12-BIS-1360(2)
Overall Assessment	GREEN	
<p>The IA is fit for purpose. The issues raised in our previous Opinion (24/05/2012) have been adequately addressed.</p>		
<p>Identification of costs and benefits, and the impacts on small firms, public and third sector organisations, individuals and community groups and reflection of these in the choice of options</p> <p>The issues raised in our previous Opinion (24/05/2012) have been adequately addressed. In particular, the revised IA now provides a monetised best estimate of the costs of this proposal. It also clarifies that the additional costs of marketing and advertising are included in the main implementation costs.</p>		
<p>Have the necessary burden reductions required by One-in, One-out been identified and are they robust?</p> <p>As the measure is of European origin, without any evidence of going beyond the minimum requirements, it is out of scope of 'One-in, One-out'.</p>		
Signed		Michael Gibbons, Chairman

