EXPLANATORY MEMORANDUM TO

THE CONSUMER CREDIT (ADVERTISEMENTS) (AMENDMENT) REGULATIONS 2007

2007 No. 827

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

2. Description

This instrument makes minor amendments to the Consumer Credit (Advertisements) Regulations 2004 which impose requirements concerning the form and content of advertisements that relate to the provision of credit and the hiring of goods.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Background

The Consumer Credit Advertisements Regulations came into force on 31 October 2004. Their purpose was to simplify the existing rules governing the advertising of consumer credit by providing consumers with the essential information that they need to compare products and make informed purchasing decisions. Specifically, they set out the circumstances in which advertisers must quote a typical annual percentage rate (TAPR), other key financial indicators and appropriate warnings. This instrument amends the definition of the TAPR in regulation 1(2) of the 2004 Regulations and makes corresponding changes to regulation 8(2) which makes provision for adverts indicating a range of APRs.

5. Territorial Extent and Application

This instrument applies to the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 Since the Regulations have come into force, an issue has arisen as to whether the requirement in regulation 8 for advertisements to indicate a TAPR apply to adverts published by credit brokers, and by lenders acting as credit brokers. The amendments contained in this instrument are intended to ensure clarity and consistency in a key area of operation of the Regulations and to dispel any notion that the requirement to indicate a TAPR does not apply to credit brokers because they do not enter into agreements as such but merely facilitate agreements between borrowers and lenders.

7.2 The issue is not confined to professional brokers, but also lenders who, where they decline to grant loans themselves, effect introductions to other lenders or brokers. Therefore, brokers (and lenders who also act as brokers) are able to advertise deceptively low TAPRs, in the knowledge that they will refer many of the people who apply for their loans, to other lenders/brokers offering loans at much higher rates.

8. Impact

A Regulatory Impact Assessment is attached to this memorandum. There is no impact on the public sector.

9. Contact

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e-mail: iain.adlington@dti.gsi.gov.uk

Regulatory Impact Assessment

1. Title of proposal

To amend regulations 1(2) and 8(2) of the Consumer Credit (Advertisements) Regulations 2004 (SI 2004/1484).

Devolution: These changes will apply in the UK.

2. Purpose and intended effect of measure

(i) The objective

To make a technical amendment to the Regulations to close a loophole that is being exploited by an ever increasing number brokers (and lenders acting as brokers) to the detriment of consumers.

The current wording may be open to more than one possible interpretation and this amendment proposed in option 2 is intended to remove the existing ambiguity and make the wording more clearly aligned with the policy intention. In particular, it is designed to dispel any notion that the requirements relating to annual percentage rates (APRs) do not apply to advertisements published by credit brokers because they do not enter into agreements as such but merely facilitate agreements between borrowers and lenders.

The amendments will help to ensure that consumers will be able to compare the costs of loans so that they can make informed purchasing decisions. This will also encourage more competitive lending, and enable those brokers who are currently interpreting the Regulations in line with the policy intention to compete on a level playing field with those who are not.

(ii) The background

It was the intention of the Regulations to create a headline figure that would make comparing loans easier for consumers. The typical APR (TAPR) is intended to be a rate at or below which the advertiser reasonably expects that credit will be provided under at least 66% of agreements entered into as a result of the advertisement. Where triggered, the TAPR must be prominently displayed in an advertisement.

In practice, some brokers have relied on the possible ambiguity in the Regulations in order to advertise TAPRs at rates that very few respondents to the advertisement will actually receive. A consumer may be induced to respond because of a low TAPR but his application is likely to be rejected and he is then passed on to another lender with much higher APRs which are not reflected in the original advertisement.

The sector is divided between those brokers who follow the spirit and intention of the Regulations and those who do not. Some publish a TAPR which only a few applicants would qualify for in the knowledge that most applicants will only be able to receive loans at a much higher rate through their initial application with them. This creates distortion in the market which is detrimental to consumers since advertised TAPRs are neither realistic nor comparable.

It was the intention of the legislation that consumers should have access to better comparative information but this has not been reflected in the implementation.

(iii) Risk assessment

There is evidence that the current ambiguity in the Regulations is creating considerable consumer detriment arising from misleading advertising. It is also giving rise to significant distortions in the market, to the detriment of brokers seeking to comply with the spirit and intention of the Regulations.

3. Options

Option 1: Do nothing. This would mean continued consumer and business detriment. It is likely that more and more businesses will seek to follow the practice of using artificially low TAPRs thus misleading consumers and creating further distortion of the market.

Option 2: Make an amending statutory instrument that will correct the problem. The definition of 'typical APR' in regulation 1(2) of the Advertising Regulations would be amended as follows:

"The typical APR is an APR at or below which ~~an~~ the advertiser reasonably expects, at the date on which ~~an~~ the advertisement is published, that credit would be provided under at least 66% of the agreements ~~he will enter~~ which will be entered into as a result of the advertisement. In the case of an advertisement which falls within section 151(1) of the Act, "advertiser" means the person carrying on the business of credit brokerage."

Corresponding changes would be made to regulation 8(2) which makes provision for credit advertisements indicating a range of APRs.

4. Benefits

Option 1: None. Compliant companies may also be forced to amend their advertising in order to compete effectively or risk serious damage to their business, thus compounding existing consumer detriment and uncertainty as to the effect of the Regulations.

Option 2: The Regulations will be brought in line with the original policy intention. Brokers will have to advertise TAPRS which reflects the business that would be entered into as a result of the advertisement and it would be clear that the requirement applies to brokers' adverts. Consumers will be able to make more informed choices in the marketplace.

Business sectors affected

This will only affect lenders and brokers offering consumer credit products which are subject to the Consumer Credit Act advertising regime.

Issues of equity and fairness

This will increase the ability of consumers to make an informed choice when looking for loans.

5. Costs

(i) Compliance costs

Option 1: None.

Option 2: None above the cost of the original regulation as it was costed on the basis of 100% compliance. The amendment will ensure that all brokers (and lenders acting as brokers) apply the regulation as intended.

(ii) Other costs

None.

(iii) Costs for a typical business

None more than that of the original legislation.

6. Consultation with small business: the Small Firms' Impact Test

None apart from those considered in the RIA for the 2004 Advertisement Regulations (see attached).

7. Competition Assessment

This amendment will allow the OFT to enforce the Regulations in an environment where the legislation is open to a single interpretation. This will mean that current distortions in the market will reduce and the OFT and its enforcement partners in local authority Trading Standards Services (TSS) will be able to intervene by taking action as appropriate against businesses that continue to be non-compliant. Such intervention (and the threat of such intervention) will encourage all brokers in the sector to comply with the true intention of the Regulations, leading to a level playing field for businesses and a more competitive market in which consumers can make informed choices between competing products and suppliers.

8. Enforcement and sanctions

The OFT and TSS have responsibility for enforcing the Regulations but are currently constrained from doing so as the Regulations as drafted are open to more than one possible interpretation.

9. Monitoring and review

The legislation is subject to a two-year baseline review.

10. Consultation

(i) Within government

OFT.

(ii) Public consultation

We have received representations on this issue from the Finance Industry Standards Association (FISA) and the British Bankers Association (BBA).

11. Summary and recommendation

This is a straightforward change to the legislation that will close a potential loophole that has been exploited by some brokers, to the detriment of consumers and fair-dealing businesses.

By removing an ambiguity in the current legislation, the amendment will make it easier for firms to comply and remove a major cause of business uncertainty. It will thereby reduce burdens on businesses seeking to comply with the Regulations.

12. Declaration
I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed *Ian McCartney*

Minister for Trade, Investment and Foreign Affairs
Date *12th March 2007*

Contact point: Iain Adlington, Bay 428, 0207 215 3806.

Regulatory Impact Assessment

1. Title of proposal

The Consumer Credit (Advertisements) Regulations 2004

2. Purpose and intended effect of measure
(i) The objective
To ensure that adverts are easy for the consumer to understand, accurately and fairly describe the product advertised, and are not misleading. This, together with other reforms, will enable consumers to compare the costs of any product advertised with products from other lenders, and encourage more competitive lending.

Devolution: The changes will apply in the UK.

(ii) The background
Due to the rapid evolution of the credit industry, the current regulations[1] have resulted in a highly technical and complex regime, creating confusion for lenders, enforcers and consumers. 77% of the population find the language used in credit advertising confusing.[1] The complexity of credit products make it difficult for consumers to compare financial products with confidence and make informed purchasing decisions. In particular the price/quality trade-off that is used for most consumer goods is considerably more complex for credit products.
Similarly, while most lenders do their best to comply with the Regulations, they concede that it can be difficult to be sure that the Regulations are being satisfied - particularly when distinguishing between classes of advertisements. If certain information is given in an intermediate advertisement the lender will move into the full advertisement category, requiring additional information.
Many lenders who do their best to comply with the regulations are frustrated by what they see as blatant disregard for the law by others that goes unpunished. For these reasons, the consumer credit industry has confirmed that it would welcome the introduction of simplified regulations in conjunction with a tougher enforcement regime.
The current regulations require adverts that quote an APR to give this prominence but are unclear about how the APR should be derived. This means that products advertised with the same headline rate may cost the consumer

[1] Consumer Credit (Advertisements) Regulations 1989 (SI 1989/1125

[1] Op Cit 18

different amounts for the same amount of credit. This prevents the consumer using the APR effectively to compare different products.

(iii) Risk assessment

An efficient market relies on consumers being able identify the cheapest product that meets their requirements. If consumers continue to make decisions based on imperfect information, this hinders competition, to the detriment of both borrowers and some lenders. The new regulations set out a clear framework for advertising which will provide transparency and comparability for consumers.

There are a number of areas of ambiguity requiring clarification – in particular the way in which the APR is calculated. The APR is a notional rate of interest designed to allow consumers to compare the costs of credit between different lenders before they sign any credit agreement. 84% of the population consider the APR an important factor in choosing which credit product to take, and from which lender. However, there is no consensus in the assumptions that underpin this calculation. This means that the APR is not directly comparable between lenders – despite that being the aim.

Lenders therefore have the incentive to maintain and exploit the information gap and may advertise a low APR which attracts consumers who later face post-purchase surprises when the hidden costs become clear.

3. Options

Option 1: Do nothing but keep the current regulatory content.

Option 2: Abolish the intermediate credit advert but otherwise retain the current regulations

Option 3: Simplify the advertising regulations while being more prescriptive about key financial information and the font size of APR. New provisions setting out how the APR should be calculated and on the use of typical examples will apply. The existing categories of Simple, Intermediate and Full credit advertisements will be replaced with a new, simplified hierarchy of advertisement forms.

Option 4: Get the industry to impose a voluntary code of practice based on the measures outlined in option 3. The typical sign-up rate to voluntary codes of conduct is 50%.

There is a small risk that under options 2 and 4 some lenders could take advantage of the combination of old and new regimes to "push the boundary" in their advertising – potentially making the situation even more confusing for borrowers who are aware that some improvements/recommendations have been made, while the old regime still applies in places.

Under option 3, the regulations encourage lenders to simplify their advertisements, while at the same time being more prescriptive and up-front about key financial information, rather than hiding the information in small-print. This should enable the market to function more effectively, with consumers making better-informed choices. To optimise these benefits, it is important that efforts are made to educate the borrower if the information is to be valued and utilised. There is also a risk associated with enforcing the new regulations – the regulators may find they are swamped by a surge in complaints over illegal adverts – and excessive delay in pursuing these could result in a loss of credibility for the regulator.

4. Benefits

Option 1: None.

Option 2: Would reduce some of the confusion caused by the current regulations by removing the incentive for firms to withhold information in order to remain in the intermediate category of advert. Lenders' compliance costs would be reduced by at least £1 million. Enforcement costs would also be lower. Consumers would benefit from a greater quality and quantity of information, although this policy option does not address the current problems associated with the full advertisements. For example, consumers would still be faced with potentially confusing advertisements and would not be able to compare products with the same headline APR.

Option 3: Under this option both consumers and lenders benefit from an APR calculated on one set of assumptions allowing both borrowers and lenders to confidently use the APR as a means of comparing products. By providing consumers with an effective means of comparing loans, the consumer could make savings in the region of £41 million a year as a result of identifying cheaper/more suitable loans for their circumstances.
The consumer will also benefit from the time saved comparing products, and less sophisticated borrowers may be encouraged to look at products offered by mainstream lenders rather than “back street” lenders. This should also assist in keeping the cost of credit down.
Reputable lenders - who are losing revenue because the current market imperfections are allowing less competitive lenders to exploit the information gap and mislead consumers through hidden pricing or incomplete information - will benefit from the new regulations.
Lenders will spend less time on compliance once the ambiguity of existing regulations is removed, legal certainty will improve with regulations that are easier to follow, and in-house sales and marketing staff will be able to develop a much clearer understanding of what the law requires.
Clearer regulations may encourage small firms, previously deterred by complex regulations, to start advertising.

Option 4: Could improve the comparability of products advertised by those lenders who sign up to such a code. However, this option would leave consumers exposed to misleading adverts and lenders exposed to unfair competition. The state of confusion under the current regulations would be maintained and those lenders who voluntarily signed up to the recommended code of conduct would be exposed to unfair competition from those who did not sign up. Even with a 50% sign up rate, the benefits derived from this option are likely to be less than 50% because the environment will remain very confusing and inequitable for both consumers and borrowers.

Business sectors affected
The impact would fall on those license holders who are lenders. These businesses provide credit of hundreds of billions (overall debt stands around £954 bn. (February 2004) according to the Bank of England). Those advertising by radio will face less restrictive regulations to take account of the difficulties in meeting the requirement concerning APRs.

Issues of equity and fairness
By increasing the level of transparency in advertising, fair competition will be facilitated between lenders, with reputable lenders no longer losing revenue to those lenders that exploit information gaps and mislead consumers. The information gap that currently exists means that lenders have an information advantage over consumers – they are able to produce confusing or even misleading adverts, while still complying with the technical aspects of the regulations. This increases the potential for unscrupulous lenders to exploit consumers. As the market becomes more transparent, it will function more effectively. Rogue traders will lose market share as consumers are able to make more informed choices.

5. Costs

Option 1: No additional costs to lenders, but consumers would continue to be exposed to misleading adverts and lenders to unfair competition.

Option 2: The abolition of the intermediate credit advert would force many lenders to comply with the full credit advert regulations. There would be costs in terms of additional management time, staff training and legal costs in insuring adverts comply with the full regulations. We estimate that these would total around £7.5 million. Consumers would still be exposed to confusing information within adverts and fair lenders would still lose revenue to those exploiting the information gap with hidden costs.

Option 3: We estimate that this change in regulation would have a transitional cost of around £40million. This consists of staff training, and management and legal costs in changing all existing advertising to comply with the new regulations[2]. However, in the long-run we estimate reduced compliance costs to lenders in the region of £1 million a year, as a result of clearer advertising regulations which are easier to interpret and are therefore less costly in terms of management time and legal costs.

Option 4: Businesses who signed up to the code would have to ensure compliance with both the voluntary code and existing regulations. Assuming a typical sign-up rate to voluntary codes of conduct of 50%, we estimate that the combined costs would be around £20 million to those signing up to the scheme, though they would also be losing revenue to lenders who continue to advertise their products in less transparent ways. Consumers would still be exposed to misleading and confusing information in the adverts of those lenders who did not sign up to the scheme.

ii) Other costs

We expect that this set of measures will have a negligible impact outside of the credit market. We do not envisage these changes impacting upon the size of the credit market, but rather, the composition of the market, with reputable lenders gaining market share.

We do not anticipate that these proposals will significantly reduce the volume or value of advertising, and therefore they will have little impact on businesses who sell advertising space.

(iii) Costs for a typical business

This regulation should have a minimal impact on the costs of larger lenders because these lenders are likely to have the necessary in-house legal staff to adapt swiftly to the new legal framework and can also recoup these costs more quickly. With an adequate transition period to allow in-house lawyers time to familiarise themselves with the new regulations their additional costs should be relatively small.

For SMEs who can make use of trade association resources the costs will be reduced. We acknowledge that transitional costs may therefore disproportionately fall on SMEs without access to trade association resources. However, we do not envisage that SMEs will find these one off costs unaffordable or that these costs will place them at any significant competitive disadvantage. This is particularly the case because the smallest lenders tend not to advertise.[3] Some may even be encouraged to advertise once the clearer regulations are implemented, reflecting the more competitive market in conjunction with reduced legal uncertainty.

Consultation with small business: the Small Firms' Impact Test

Throughout the period of the review we have engaged with key trade associations whose membership predominantly comprises small businesses. We have also met with the owners of small lending businesses from southern Scotland, north Wales, the north west of England, Swindon, Hull and London. In addition, we have obtained advice from businesses that lend extensively to small businesses in sectors such as construction, and from businesses that act as consultants to a variety of small businesses inside and outside of the lending community.

Our evidence is that those small lenders who do advertise tend not to vary the format of their adverts and therefore do not seek legal advice for their advertising. In addition we understand that the smallest lenders do not advertise at all and therefore are unaffected by these proposals.

In conclusion these reforms will not impose any additional or disproportionate burden on small businesses.

7. Competition Assessment

The impact of the proposals on the consumer credit market was assessed, and was found to be unlikely to raise concerns about competition. In fact, we consider the proposals to be generally pro-competitive as transparency, certainty, and fairness in the market increases. The market is characterised by a multitude of lending firms of different sizes and we do not envisage that the changes will impact disproportionately on any particular part of the sector, particularly given the proportion of small firms that actually advertise. Similarly, the changes are unlikely to affect the size of the credit market.

There are likely to be significant benefits as rogue traders are eradicated from the market and their market share is spread amongst the fair and honest lenders. Therefore, overall we expect these reforms to have a marginal impact at the very most on entry by small lenders.

8. Enforcement and sanctions

As already stated, the complex nature of the existing Regulations is a problem for enforcement agencies. We are keen to avoid this situation with the new Regulations, and are therefore consulting OFT, LACORS and the Advertising Standards Authority to ensure that they will work together towards more effective enforcement against advertisers who produce misleading advertisements for credit products.

9. Monitoring and review

We intend to review the success of the changes by assessing whether:

- credit advertisements are clear, fair and not misleading;
- whether consumers have a better understanding of credit advertisements and of APRs;
- better information has led to more consumers switching credit products;
- the costs to business of complying with advertising regulations have decreased;
- enforcement authorities are more successful in enforcing compliance with the advertising regulations.

We will measure the success of these changes by conducting annual MORI polls aimed at obtaining consumer views on whether the changes have achieved the desired result.

We intend to continue to engage with lenders as part of our stakeholder panel and will actively seek feedback from them on the issues referred to above. In addition, industry trade associations will be able to provide statistics at an industry level from which we will be able to ascertain whether we have achieved our original goals. We will be conducting a poll to this effect two years after these regulations come into force.

10. Consultation

(i) Within government

We have consulted the OFT, HM Treasury, the Cabinet Office, DCA, devolved administrations, Number 10, the Social Exclusion Unit, DWP and DfES.

(ii) Public consultation

This partial RIA accompanies public consultation on our proposals.

11. Summary and recommendation

We recommend option 3. It is believed that option 3 would promote competition, a fairer deal for consumers and businesses, and allow confidence in credit advertising and the market as a whole to grow. It tackles misleading advertising as well as increasing competition generally. This will benefit legitimate businesses at the expense of the less scrupulous ones who have taken advantage of the problems identified with the current regulations. The proposed information changes should make it possible for consumers to better understand the products on offer and make better choices as a result.

Overall, the proposed changes are a proportionate response to the information deficit issues raised in our earlier work and take account of the valid concerns raised by the stakeholders.

	Total cost per annum	***Total benefit per annum***
1	Nil	Nil
2	Estimated as £7.5 million for management time and legal costs of complying with full credit advertising regulations.	Would remove the incentive for firms to withhold information in order to remain in the intermediate category of advert. While consumers will have more information to hand, it will remain complex and confusing, with no reliable means of comparing loans. Therefore benefits will be limited.
3	Transitional cost of around £40 million. This consists of staff training, and management and legal costs in changing all existing advertising in order to comply with the new regulations Compliance costs will be reduced by at least £1 million annually.	Reduced costs of compliance of £1 million annually for businesses. Consumers benefit from clearer information and make savings in the region of £41 million a year as a result of identifying cheaper/more suitable loans for their circumstances
4	Assuming a take up of 50%, we estimate that costs would be around £20 million	The benefits derived from this option are likely to be less than 50%of option 3 because the environment will remain very confusing and inequitable for both consumers and borrowers.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs

.... Date...

Gerry Sutcliffe MP, the Parliamentary Under-Secretary of State for Employment Relations, Competition and Consumers, Department of Trade and Industry

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