

Summary: Intervention & Options

Department /Agency:

Department for Business,
Enterprise & Regulatory
Reform

Title:

Impact Assessment of the Consumer Credit Directive

Stage: Consultation

Version: 1.0

Date: 1 March 2009

Related Publications: Consumer Credit Directive, EU Journal:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>

Available to view or download at:

<http://www>.

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

Evidence suggests that cross-border purchase of financial services within the EU is low, due to a number of barriers for both suppliers and customers. There appears to be significant information problems on both sides of the transaction - for consumers, the quantity and quality of information they receive and how it is presented; for lenders, a lack of information on creditworthiness of customers or regulatory/legal frameworks in different countries.

The Consumer Credit Directive attempts to correct these information asymmetries to improve the functioning of the EU consumer credit market.

What are the policy objectives and the intended effects?

The Commission has three main objectives for the Directive: establishing the conditions for a genuine internal market; ensuring a high level of consumer protection, and improving the clarity of EC regulation by replacing the three existing Directives on consumer credit.

The Directive aims to create a single European market for consumer credit through establishing harmonised rules in core areas applicable to the credit market of Member States. It is hoped that this will bolster consumer confidence, both at national and cross-border levels, and stimulate cross-border trade.

What policy options have been considered? Please justify any preferred option.

There are a number of articles within the Directive, some of which allow for flexibility in their implementation, and some which do not. Each of the relevant articles has been grouped into one of the following 3 categories:

1. No impact, relative to the current UK regulatory regime
2. Change to the current regulatory regime, but no scope for flexibility in implementation
3. Change to the current regulatory regime, some flexibility in implementation

The analysis will focus on the latter two categories, particularly the last of these.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Directive will be reviewed in 2013 by the Commission.

Ministerial Sign-off For consultation stage Impact Assessments:

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 Minister:

.....Date:

Summary: Analysis & Evidence

Policy Option:	Description: Full implementation of Consumer Credit Directive
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Costs incurred by credit providers in complying with various articles (e.g. information provisions, assessment of creditworthiness) in terms of system changes.
	One-off (Transition)	Yrs	
	£ 34.7m-132.2m	10	
	Average Annual Cost (excluding one-off)		
£ 39.3m-47.7m		Total Cost (PV) £ 373m-543m	
Other key non-monetised costs by 'main affected groups' Lenders may incur additional costs (e.g. staff training) that are not quantified here; consumer credit customers may also incur costs, e.g. as a result of reduced credit availability.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Partial realisation of completing single market in financial services - benefits to consumers of increased competition/innovation, lower prices and wider choice; benefits to consumers (e.g. health/stress impact) and firms (e.g. less bad debt) of reduction in over-indebtedness.
	One-off	Yrs	
	£ 92m	10	
	Average Annual Benefit (excluding one-off)		
£ 164.5m-189.5m		Total Benefit (PV) £ 1.5-1.7 billion	
Other key non-monetised benefits by 'main affected groups' Consumer will benefit from standardised information on credit products, facilitating comparison across providers, including international suppliers.			

Key Assumptions/Sensitivities/Risks Consumers need to switch (or at least threaten to switch) in order to realise many of the potential gains from increased competition; international suppliers must enter the UK market in order for consumers to be able to switch (or threaten to switch) to them.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ 1-1.3 billion	NET BENEFIT (NPV Best estimate) £ 1.15 billion
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What is the geographic coverage of the policy/option?				UK	
On what date will the policy be implemented?				June 2010	
Which organisation(s) will enforce the policy?				OFT	
What is the total annual cost of enforcement for these organisations?				£ N/A	
Does enforcement comply with Hampton principles?				Yes/No	
Will implementation go beyond minimum EU requirements?				No	
What is the value of the proposed offsetting measure per year?				£ -	
What is the value of changes in greenhouse gas emissions?				£ -	
Will the proposal have a significant impact on competition?				Yes	
Annual cost (£-£) per organisation (excluding one-off)		Micro -	Small -	Medium -	Large -
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ -	Decrease of £ -	Net Impact	£ -

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Overview

The Consumer Credit Directive¹ was adopted by the European Parliament in January 2008, by the Council in April 2008 and was published in the European Journal in May 2008. The transposition deadline for the Directive to be transposed into national law is 11 June 2010.

In the 20-plus years since the adoption of the first Directive on consumer credit in 1987² – despite two subsequent amendments in 1990 and 1998 – the nature and usage of financial products have changed considerably. The aim of the original Directive was to harmonise consumer protection across the EU to enable consumers to carry out cross-border transactions with confidence. However, only basic standards of consumer protection were laid out in the original Directive and many Member States have enacted higher standards, leading to a diverse and over-complex regulatory environment across the EU. This is likely to inhibit the provision of credit across borders, and evidence seems to suggest that there has not been much increase in cross-border trade.

This new Directive aims to foster further integration of the consumer credit markets, along with a higher level of consumer protection, with a particular focus on transparency and consumer rights. The full harmonisation nature of the 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. It covers almost all types of consumer credit (the main exclusions being mortgages) from €200 to €75,000 and applies harmonised provisions while offering Member States flexibility on implementation.

It provides for a comprehensible set of information to be given to consumers in good time before the contract is concluded and also as part of the credit agreement. In order to enhance the comparability of different offers and to make the information better understandable, the pre-contractual information needs to be supplied in a standardised form (Standard European Consumer Credit Information), i.e. every creditor has to use this form when marketing a consumer credit in any Member State, and consumers will receive the Annual Percentage Rate of Charge (APR, a single figure, harmonised at EU level, representing the cost of the credit).

In addition, the Directive also provides two essential rights for consumers: they are allowed to withdraw from the credit agreement without giving any reason within a period of 14 days after the conclusion of the contract. They also will have the possibility to repay their credit early at any time, while the creditor can ask for a fair and objectively justified compensation.

Overall, the available evidence suggests that there is significant doubt that the Directive will achieve an appreciable increase in cross-border trade, as although it does address some of the main issues (i.e. those related to information), it does not address other key barriers (e.g. cultural and language differences).

¹ Directive 2008/48/EC, available at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>

² Directive 87/102/EEC, available at: [http://eur-](http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31987L0102)

[lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31987L0102&model=guichett](http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31987L0102&model=guichett)

However, even changes that only make a small contribution towards increasing the integration of EU financial markets could lead to significant benefits – the *Cecchini* Report³ estimated the potential benefits due to liberalisation of financial services to be 1.5% of EU GDP, which would amount to almost €190 billion⁴. A more recent study conducted in 2002 estimates that European financial market integration would result in EU real GDP being raised by 1.1% in the long run, private consumption up by 0.8% and total employment by 0.5%⁵. This would give a range of potential benefits of €140-190 billion.

Therefore, even realising only 1% of these potential benefits as a result of implementing the Directive would generate benefits to consumers across the EU of around €1.4-1.9 billion (£1.3-1.75 billion). If it is assumed that benefits are proportionate to share of the EU consumer credit market, then it might be expected that overall benefits to UK consumers would amount to approximately £370-500 million⁶.

Some aspects of the Directive should help to reduce the incidence of consumers over-committing themselves in terms of borrowing beyond their ability to repay, whether this is through a lack of information (addressed in articles 4, 5, 11, 19) or lack of understanding on the part of consumers (article 5.6). The benefits derived from this could be substantial – a report by Debt Free Direct⁷ found that stress related to debt problems caused 8.7 million lost working days in 2004, with more than 250,000 people absent for over a month, resulting in a cost to employers of £497m. If even 10% of these lost days can be avoided through reductions in indebtedness due to implementation of the Directive, this would result in an increase in productivity, with benefit both individuals and their employers of approximately £50m per year.

Whilst it is difficult to quantify some of the other costs associated with over-borrowing, such as financial distress and consequent impacts on ill health or relationship breakdown, a recent study by Legal Services Research Commission (LSRC)⁸ estimated costs associated with debt problems to be in excess of £1,000 per individual. On the basis of recent survey data⁹, which suggests that around 3.7m households consider their debts to be a 'heavy burden', if this number could be reduced by only 1% as a result of implementing this article, there could be potential one-off benefits to the economy of £37m.

In addition, there may be benefits to firms through ensuring that any borrower is creditworthy (article 8) and hence credit is affordable to the consumer. This could lead to a reduction in bad debts to lenders, which currently represent a significant cost to the economy – latest figures suggest write-offs related to unsecured debt of £6.3 billion over the last 12 months.¹⁰ If this figure could be reduced by even 1 per cent through the implementation of the Directive, this would lead to benefits of £63m per year.

³ Quoted in 'The Benefits of a Working European Retail Market for Financial Services', ZEW/IEP (2002)

⁴ Based on EU GDP for 2008 of €12.5 trillion (source: Eurostat)

⁵ 'Quantification of the Macro-Economic Impact of integration of the EU Financial Markets', London Economics (November 2002)

⁶ Assuming that UK accounts for around 28% of the value of the EU consumer credit market:

[http://www.wsbi.org/uploadedFiles/Publications_and_Research_\(ESBG_only\)/Statistics/08%20Consumer%20credit%20in%20the%20EU.xls](http://www.wsbi.org/uploadedFiles/Publications_and_Research_(ESBG_only)/Statistics/08%20Consumer%20credit%20in%20the%20EU.xls)

⁷ http://www.manchesteronline.co.uk/personalfinance/s/123/123594_debt_stress_takes_heavy_toll_on_work_place.html

⁸ <http://www.lsrc.org.uk/publications/Impact.pdf>

⁹ YouGov Debt Tracker, October 2008 – 15.5% of respondents consider their debts to be a 'heavy burden' (assuming approximately 25m households)

¹⁰ Write-offs on unsecured debt between Q3 2007-Q3 2008 (Source: Bank of England)

Nevertheless, an impact assessment commissioned by industry in 2007¹¹ suggests that the overall impact of the Directive will be negative, with the central modelling scenario based on the following impacts in relation to unsecured credit:

- an increase in cost of unsecured consumer credit of 0.7 percentage points
- a restriction in availability of unsecured consumer credit of 2.5%

In terms of macroeconomic impact, the following outcomes for the UK economy were forecast, within 2 years of implementation:

- a fall in consumer spending of around £1.4bn;
- a decline in GDP of around £850m, and
- restriction of credit availability for between 1m-1.7m consumers

We have recently commissioned an economic consultancy, Copenhagen Economics, to conduct a similar exercise on the impact of the Directive – this is due to report at the end of March 2009.

Background

The original proposal¹² for a new Consumer Credit Directive (CCD) was adopted by the Commission in 2002, intended to cover new forms of consumer credit and facilitate the internal market in this sector. However, this was subject to a significant number of amendments by the European Parliament (in particular altering the scope and level of harmonisation¹³), which adopted amendments in April 2004, with the Commission adopting an amended proposal in October 2004.¹⁴ BERR consulted on this proposal in February 2005.¹⁵

The Commission then published a second revised text in October 2005¹⁶, which led to a supplementary consultation in March 2006¹⁷ that included a partial regulatory impact assessment. The Government response to this consultation was published in November 2006.

Following political agreement in May 2007, the proposal was formally transmitted to the European Parliament in September 2007, where it was agreed in January 2008.

Interaction with other legislative provisions

There are significant overlaps with existing consumer credit legislation. The Consumer Credit Act 2006 regulates credit agreements (above £50) and contains equivalent provisions to almost all Articles of the Directive, as well as provisions on other matters that the Directive is not concerned with. As a result, the Directive will require amendments to the Act and subordinate legislation that flows from it.

The Directive's scope is narrower, both in terms of the matters covered and in the kind of credit agreements falling within its scope. Those agreements currently caught by UK consumer credit legislation which are not caught by the Directive are as follows:

- lending to small businesses

¹¹ <http://www.oxera.com/cmsDocuments/Oxera%20report%20on%20CCD%20April%202007.pdf>

¹² COM (2002) 443 final

¹³ Whereas the Commission had proposed total harmonisation, the European Parliament preferred 'optimum harmonisation' which in effect means that Member States would retain the right to go further than the standards laid down in the Directive. However, the rules on APR would be subject to full harmonisation in order to facilitate the internal market.

¹⁴ http://ec.europa.eu/consumers/cons_int/fin_serv/cons_directive/credit_cons_en.pdf

¹⁵ <http://www.berr.gov.uk/consultations/page14387.html>

¹⁶ See COM (2005) 483 final/2, Corrigendum published on November 23, 2005

¹⁷ <http://www.berr.gov.uk/consultations/page27458.html>

- loans below €200 (£160)
- loans above €75,000 (£60, 260¹⁸)
- second-charge mortgages
- hire purchase agreements
- interest-free credit repayable within three months with only insignificant charges
- modifying agreements which are the outcome of a court settlement or allow deferment of payment of an exiting debt free of charge
- pawnbroking

Although the Directive's scope is narrower than the Consumer Credit Act, we propose that where amendment to the Act is required as a result of the Directive, those changes should apply to all products currently regulated by the Act. The exception to this policy is in relation to second charge loans which have been the subject of a separate review, and where we are not proposing any legislative change while the outcome of the review is still to be determined.

There is also some read-across to other EC instruments. In particular, the Payments Services Directive (Directive 2007/ 64) is intended to create a single market for payment services and contains provisions on payment instruments, including credit cards. Although a few of these provisions are similar to the CCD to some extent, there is unlikely to be any significant impact for business, as the Government is taking the approach that – where there is a conflict between the PSD and consumer credit provisions – consumer credit legislation, either provided by the Act or the CCD, will take precedence.

There are also provisions in the Unfair Commercial Practices Directive (Directive 2005/29/EC) that read-across to CCD provisions on advertising. However, it is clear that these cannot override the more specific provisions in the CCD relating to advertisements, although there could still be circumstances where the more general UCPD provisions on misleading promotions could be relevant in respect of a credit advertisement.

The CCD will also impact on the Distance Marketing of Consumer Financial Services Directive (Directive 2002/65/EC). The CCD will require that further pre-contractual information is provided in the case of voice telephony communications that lead up to the conclusion of a credit agreement.

Scale and scope

According to the European Commission, the retail banking sector generated gross income of €250-275 billion in 2004, equivalent to around 2 percent of EU GDP. Consumer loans generated nearly 18% of gross retail income in the EU 25, the third most important source of income from consumer products after mortgages (30%) and current accounts (28%)¹⁹.

The UK, Germany, and France have the largest consumer credit markets in the EU and within the Euro area there is considerable variation in the degree of lending (see Chart 1 below). The total amount outstanding on loans to Euro-area households was €4,940 billion as of October 2008, of which €637 billion (13%) was accounted for by consumer credit²⁰. The total outstanding amount of consumer credit for the UK as of October 2008, which is not included in the Euro area figures, was £235 billion²¹.

¹⁸ Using exchange rate as set out in article 28 of the Directive (£1 = €0.80345)

¹⁹ SEC(2007)106, European Commission, Report on the retail banking sector inquiry, January 2007, p. 13, 18, 21

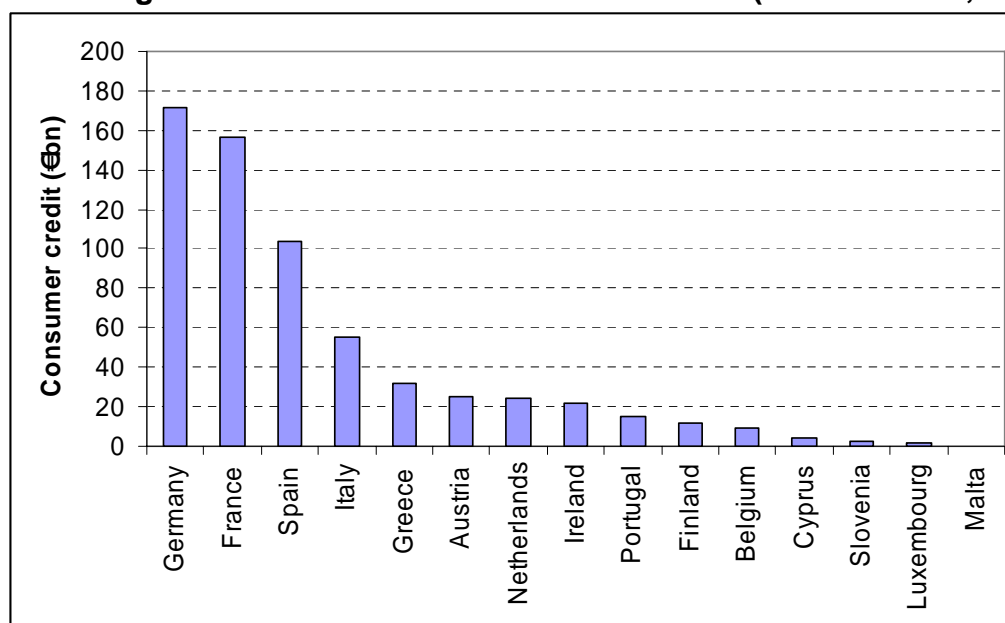
²⁰ Deutsche Bundesbank. *MFI balance sheets: outstanding amounts*. Retrieved from:

http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=outstanding_amounts&lang=en

²¹ Bank of England, Monetary and Financial Statistics (Bankstats), November 2008:

<http://www.bankofengland.co.uk/statistics/ms/2008/nov/ta5.6.xls>

Chart 1: Outstanding levels of consumer credit in Euro area (October 2008, €bn)



Source: Deutsche Bundesbank Statistics:

http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=outstanding_amounts&lang=en

Most lending to households in the EU continues to take place within domestic markets due to a number of factors on both the supply and the demand side, which are explored further below. Several countries with more highly-integrated markets (e.g. Benelux countries) display significantly more cross-border activity (see Table 1 below).

Table 1: Domestic and cross-border non-bank loans (Q3 2008)

	Loans to non-MFIs (€bn)	Domestic transactions (%)	Euro area transactions (%)	EU transactions (%)	Non-EU transactions (%)
Italy	1,786.0	97.2	1.9	0.4	0.5
Spain	1,960.1	96.8	1.3	0.8	1.1
Finland	162.7	96.4	0.9	1.4	1.3
Portugal	276.4	95.1	3.2	0.4	1.3
Greece	220.9	94.6	0.5	0.9	3.9
Slovenia	34.0	91.2	0.6	0.6	7.6
France	2,294.9	88.4	4.2	1.6	5.8
Netherlands	1,201.9	82.7	6.6	3.8	6.9
Germany	3,269.3	82.6	6.2	3.8	7.4
Cyprus	51.9	80.5	3.1	5.6	10.8
Austria	409.4	74.5	9.1	7.4	9.1
Ireland	509.1	73.9	8.9	7.2	10.0
Belgium	439.0	70.1	12.3	11.9	5.7
Luxembourg	218.1	33.7	37.4	9.4	19.5
Malta	25.1	27.5	9.6	8.4	54.6

Source: Deutsche Bundesbank Statistics:

http://www.bundesbank.de/statistik/statistik_eszb_neuesfenster_tabelle.php?stat=domestic_cross_border&lang=en

Levels of cross-border lending to non-monetary financial institutions (non-MFIs) differ significantly across Euro area countries, varying from 2.8% in Italy to 66.3% in Luxembourg. Latest figures for the Euro area lending (Q3 2008) show that 13.5% of all non –MFI lending was to other countries (5.2% within the Euro area, a further 2.9% to other EU Member States and 5.3% to non-EU countries). As this figure also includes lending to commercial sectors, cross-border lending to consumers will be less than this 13.5%. However, this figure is more than the

comparable figure from 5 years ago (Q3 2003), when only 10.3% of lending was conducted cross-border, indicating that there has been an increase of cross-border lending in the past 5 years (in both absolute and relative terms)²².

UK consumer credit market

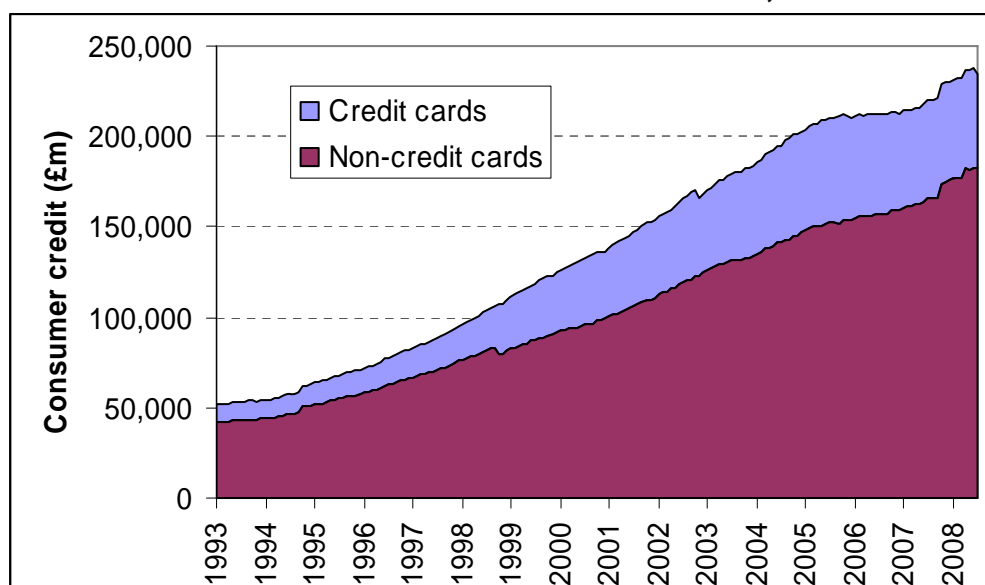
The UK consumer credit market is one of the most highly developed and sophisticated in the world, both in terms of the diverse range of institutions that provide credit and in terms of the different forms of agreement available. In volume terms, credit extended to consumers by UK credit institutions accounted for almost 30% of the total amount of consumer credit across the EU15.

Total UK consumer debt now stands at £1.45 trillion, of which the vast majority (£1.22 trillion) is accounted for by mortgage debt (which is not covered under the Directive). Although the precise number of consumer credit providers is unknown, it is estimated that the number of consumer credit licences in issue is in excess of 100,000. Of these, however, it is estimated that only 3,500-5,000 are active lenders. New products and practices are constantly evolving, and this presents a challenge to the lawmaker, who has to balance protection for the consumer against the need to avoid undue restrictions on entrepreneurial activity.

As of October 2008, the total amount of outstanding consumer credit was £235 billion, of which £53 billion was accounted for by credit cards and £182 billion by other types of consumer credit. Looking over long-term trends, it can be seen that total outstanding consumer credit has increased almost fivefold since 1993 – from around £50 billion to almost £250 billion, as can be seen in Chart 2 below.

The importance of credit cards has significantly increased during this time – in 1993, credit card lending accounted for less than 19% of all outstanding consumer credit; latest figures show that this proportion has now risen to almost 23%, though this has fallen from a high of over 28% at the end of 2000. In terms of levels, credit card lending increased from under £10 billion in 1993 to a peak of over £59 billion by the end of 2005, falling to around £53 billion today.

Chart 2: Growth in UK consumer credit levels, 1993-2008



Source: Bank of England

²² It should be noted that Euro area cross-border lending figures for Q3 2003 do not include data for Cyprus, Malta and Slovenia, as they had not yet acceded to the European Union.

Use of credit products has also become more commonplace in recent years – for example, survey data for 2002²³ found that only 7 per cent of respondents had four or more credit commitments, with an average of 2.1 credit commitments per person. Data for a survey conducted in October 2008²⁴ found that 13 per cent of respondents had four or more credit commitments, with the average number of credit commitments per person rising to 2.4.

Cross-border trade in financial services

In attempting to assess the impact of the Consumer Credit Directive on consumer credit, it is important to consider the effects on cross-border trade. This section looks at the extent of cross-border trade that already exists in financial services and consumer credit.

Demand side

A Eurobarometer survey in 2005²⁵ found that the vast majority of respondents (85%) indicated that they have never purchased financial services from firms located in another Member State. There was considerable variation across countries – in Luxembourg, 19% had opened a bank account with a firm located in another Member State and 8% had obtained a credit card cross-border; in Belgium and Austria, 11% had opened a bank account in another Member State.

This reluctance also seems to be reflected in future intentions – 75% of respondents across the EU25 stated that they did not intend to obtain any financial service from a firm located in another EU country. Likewise, this varied widely – from 87% in Greece to 55% in Slovakia.

Supply side

A report by Civic Consulting for the EU Parliament on the Consumer Credit Directive included a survey of national banking associations on the extent of cross-border trade in financial services.

There are a number of ways in which credit may be offered across borders - credit providers in one Member State may:

- start offering credit in another Member State by opening an office or setting up a network of branches in that Member State;
- enter into a joint venture with an existing local credit provider, or acquire, or merge with, a local credit provider; or
- start offering credit in another Member State by using their offices in their own Member State. The credit provider would then typically offer credit over the Internet and/or by phone.

This showed that only a very limited number of cross-border financial services transactions – less than 0.1% of total consumer credit transactions – currently take place as ‘direct cross-border transactions’.²⁶

The most significant distribution channel for creditors in other Member States is via branches and subsidiaries (including majority holdings in local banks), though this is still less than 1% across a range of products, according to the majority of respondents to the banking association survey. However, five banking associations (including the UK) estimated this percentage to be in excess of 10% - the Consumer Credit Association estimated that the percentage of members' business done through this route to be significantly higher than 10%, and stated that a very

²³ ‘Over-indebtedness in Britain’, Elaine Kempson (September 2002)

²⁴ YouGov Debt Tracker survey

²⁵ Special Eurobarometer 230: ‘Public Opinion in Europe on Financial Services’

²⁶ That is, a transaction between a creditor and consumer in two different EU Member States – i.e. the product is not sold through branches, subsidiaries, or majority holdings of a creditor in the country where the consumer is resident

large member of the association has over 1.5 million customers served through subsidiaries in other Member States.

Local establishment – whether through acquisition of an existing market participant or through a *de novo* enterprise – avoids the legal and institutional barriers that can prevent direct cross-border provision. It is therefore unsurprising that the overwhelming proportion of cross-border provision of retail financial services is through local establishment (confirmed by the survey findings above). This situation has consequences for the creation of a single market in consumer credit, as discussed further below.

The extent of EU fragmentation within the retail banking sector is highlighted by the fact that the average share of foreign branches and subsidiaries accounts for only about 15% of the Euro area banking market, though there are several banks which have been successful in establishing themselves in consumer credit markets in several MSs. The incidence of cross-border mergers and acquisitions in banking remains, according to the Commission, fairly low and there are very few players in retail banking that have a leading market share in two or more Member States, with foreign banks tending to have much stronger market positions in the new Member States than in the EU 15.

This indicates the existence of significant barriers for further integration of the financial retail market in large parts of the EU.

Barriers to trade for consumer credit

Following on from the section above, this section looks at whether there are barriers to intra-EU trade in consumer credit and, if so, the nature of these barriers in relation to both consumers and suppliers of credit.

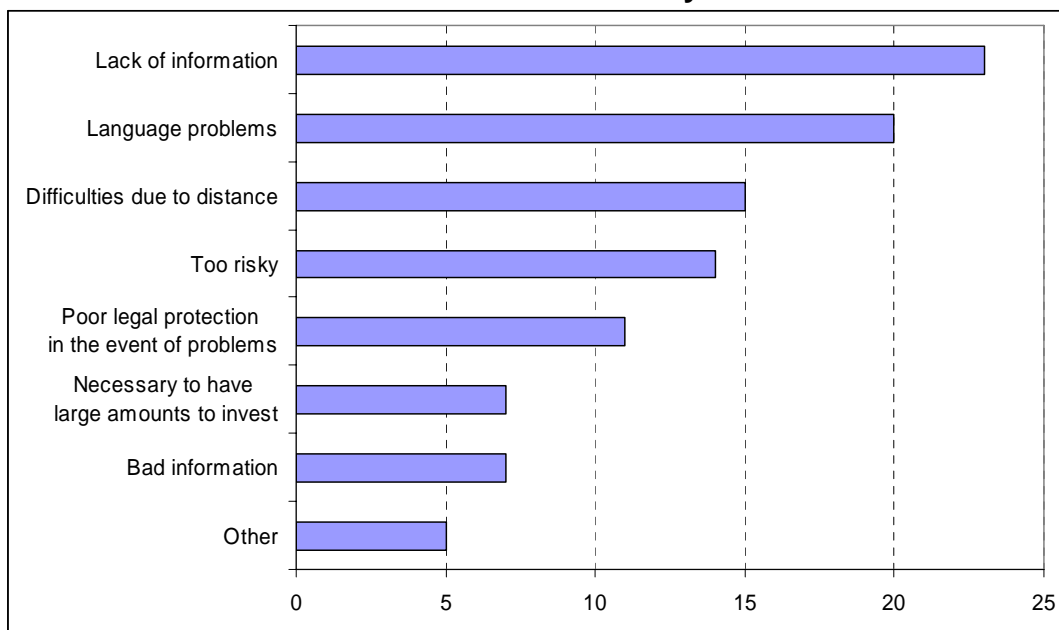
Demand side

According to the 2005 Eurobarometer survey²⁷, just over 30% of respondents state that there are no obstacles preventing them from using cross-border financial services.

However, in terms of barriers identified by consumers, lack of information and language problems were the two most popular reasons given (23 and 20 per cent respectively, as shown in Chart 3 below). Other barriers included: difficulties due to distance, too much risk, poor legal protection, high levels of capital for investment and bad information.

²⁷ Special Eurobarometer 230: 'Public Opinion in Europe on Financial Services'

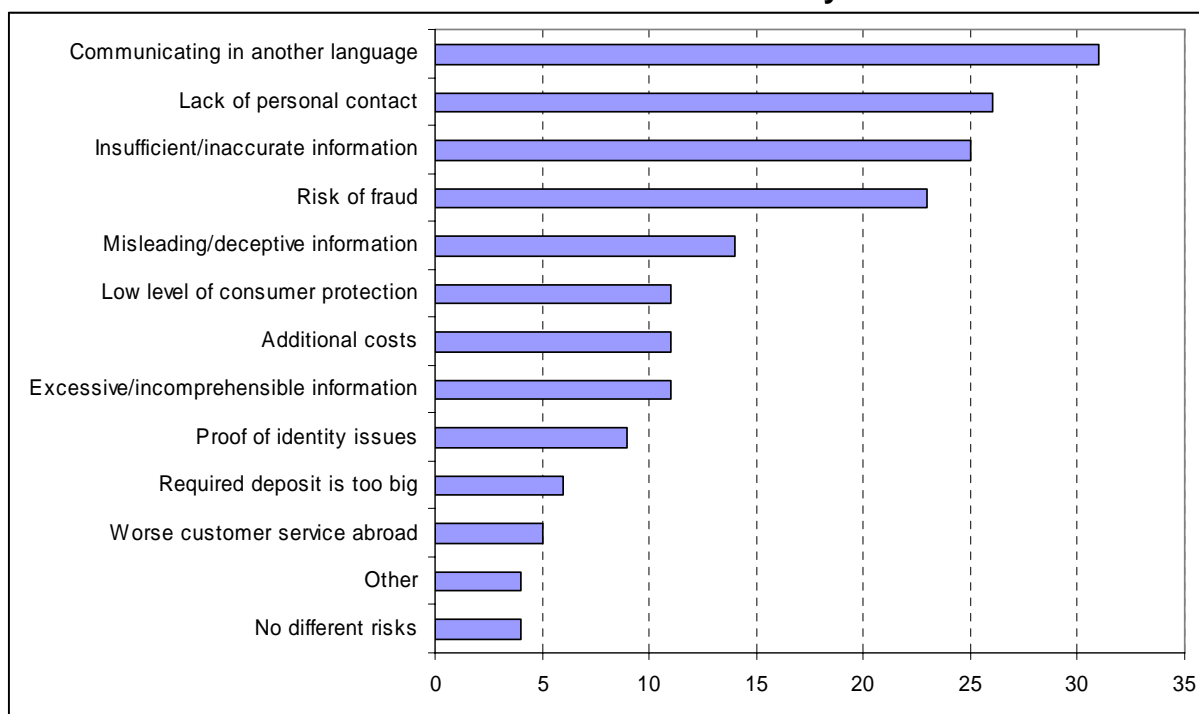
Chart 3: Obstacles preventing use of financial services elsewhere in the EU identified by consumers



Source: Special Eurobarometer 230: 'Public Opinion in Europe on Financial Services'

Respondents to a slightly more recent Eurobarometer survey again identified language and information issues – in various guises, be it too little, too much or not easily understandable – as two very important barriers to the purchase of financial services across borders (as shown in Chart 4 below). Lack of personal contact, risk of fraud and low levels of consumer protection were also given as important reasons for preventing cross-border purchase of financial services.

Chart 4: Obstacles preventing use of financial services elsewhere in the EU identified by consumers

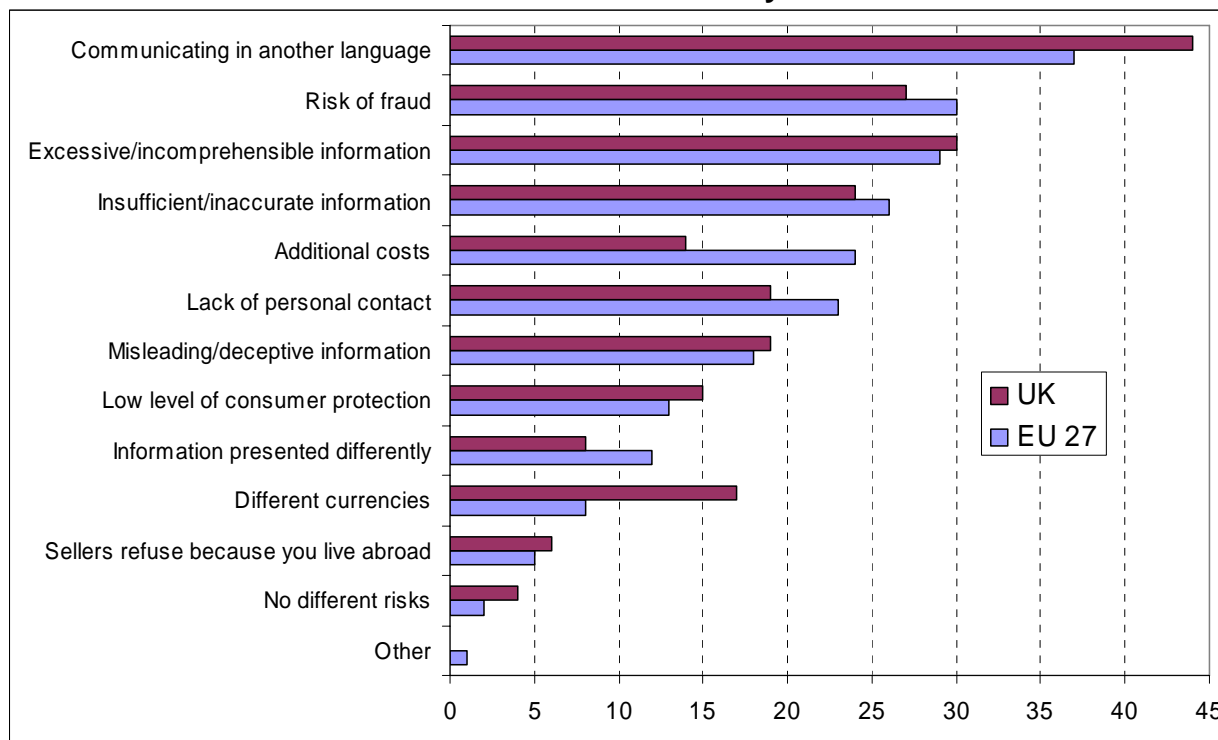


Source: Special Eurobarometer 232: 'Consumer Protection in the Internal Market'

This has since been added to and updated, with a Special Eurobarometer published in October 2008²⁸ asking about barriers to purchasing cross-border financial services (shown in Chart 5 below)

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Chart 5: Obstacles preventing use of financial services elsewhere in the EU identified by consumers



Source: Special Eurobarometer 298: 'Consumer Protection in the Internal Market'

As can be seen, issues around communicating in another language persist (particularly so for UK consumers), but information is still a persistent problem that appears in various guises – e.g. excessive or incomprehensible information, insufficient or inaccurate information, misleading or deceptive information and the different ways in which information is presented. It could be expected that the Directive will address many of these issues, particularly around information and standardisation of how it is presented.

There is some evidence that the number of these 'direct' transactions is rising and consumers are increasingly considering this option, partly due to migration that leads to consumers using financial services in both the country of origin and country of residence. The development of customers with increasingly international preferences is further supported by reports that, in a handful of cases, traders distributing point-of-sale credit had concluded agreements with customers from neighbouring EU countries. However, this required special permission from the bank and was not general policy to serve cross-border clients.

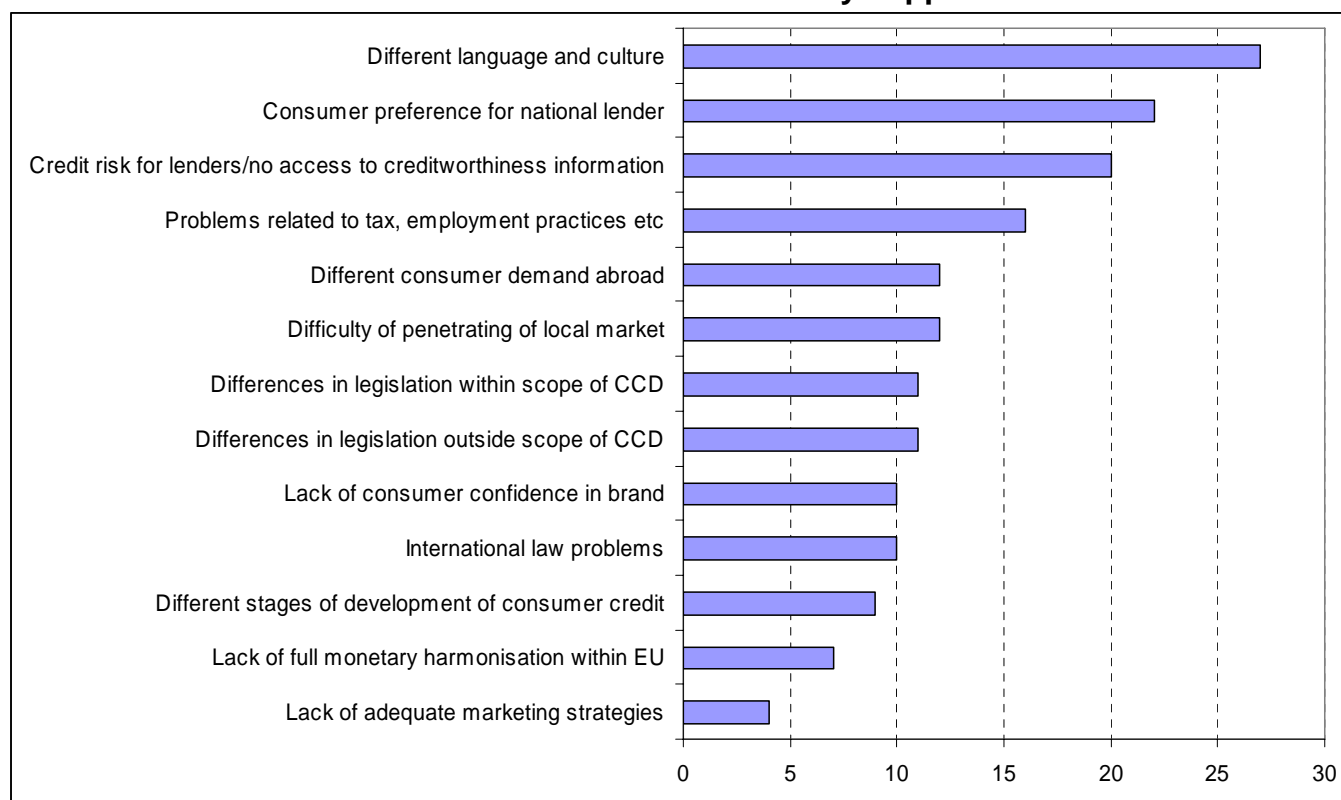
Supply side

Looking now at the perspective of lenders, the responses of national banking associations to the survey conducted by Civic Consulting indicate that differences in language and culture are the most important barrier to cross-border trade in financial services. Consumer preferences, credit risk and problems related to non-consumer credit legislation are also significant, as shown in Chart 6 below.

Interestingly, respondents felt that barriers arising from differences in legislation within scope of the CCD were just as prevalent as those arising from differences in legislation not covered by the CCD.

²⁸ http://ec.europa.eu/public_opinion/archives/ebs/ebs_298_en.pdf

Chart 6: Obstacles preventing use of financial services elsewhere in the EU identified by suppliers



Source: *Broad Economic Analysis of the impact of the proposed Consumer Credit Directive*, Civic Consulting

In their report on the impact of the CCD, Oxera found that the majority of credit providers they interviewed were unlikely to offer credit directly across borders. For most suppliers, their preferred method of entry into foreign markets was through a joint venture, merger/acquisition, opening their own local offices or setting up their own network of local branches.

A number of barriers to offering credit across borders were identified by Oxera, most of which are replicated above – lack of familiarity with (hence consumer confidence in) brand or reputation, ‘natural barriers’ (e.g. tailoring products to local consumer needs and attitudes), difficulty accessing distribution channels, customer risk assessment, differences in debt recovery procedures and differences in consumer credit regulations.

These findings, in part, reflect a key difference between the provision of credit products and other – in particular, non-financial – products that are bought and sold over the internet across borders, such as electronic appliances and other consumer products. For these products, the supplier does not need to know anything about its customers other than the delivery address. By contrast, in the case of the provision of credit products, in order to make its business commercially viable, it is crucial for credit providers to understand the risk profile of credit applicants in the new markets and the way in which debt can be recovered if they default.

Oxera made an assessment of these barriers to entry in their 2006 report on the impact of the CCD.

Barriers to entry may not prevent entry entirely, but can affect the way in which credit providers enter foreign markets. For example, lack of brand and reputation is one of the reasons why credit providers often enter foreign markets in the form of a joint venture or through acquisition of a local credit provider with an established brand and reputation. However, there are examples of credit providers successfully building up a brand and reputation in foreign markets – e.g. pan-European credit providers such as Cetelem and GE Consumer Finance.

Similarly, although access to distribution channels can inhibit entry, some banks have managed to enter foreign markets by offering their products over the internet rather than through traditional distribution channels (e.g. a Dutch bank, ING, has recently started offering mortgages in addition to savings accounts in a number of EU Member States).

Some of the barriers highlighted above relate to the core business expertise of credit providers – for example, the ability to assess the risk profile of credit applicants and to recover debt from defaulting customers.

Assessing the risk profiles of credit applicants and acquiring the necessary information to build internal credit scoring models is costly and is therefore normally only worth doing if the new market segment is entered into at a certain scale. An alternative route for entry into a foreign market would be to purchase a loan portfolio from existing credit providers. Similarly, developing a business strategy to recover debt from defaulting customers is costly and is often only commercially viable if done at a certain scale.

Benefits of a single EU market for consumer credit

One of the main objectives of the Directive is to contribute to the creation of a single European market for credit.

The theoretical concept underpinning the Directive is that, by harmonising credit regulation across EU Member States, providers would find it easier to offer credit across borders. The possibility to offer consumer credit throughout the EU, with access to almost 500m potential customers, should result in improved efficiencies and economies of scale for lenders and therefore deliver lower interest rates and greater credit availability, both in terms of the volume and variety of credit products.

For consumers, a single market for consumer credit would mean that they could be confident in purchasing credit from providers abroad, as they are assured that they benefit from the same degree of protection, irrespective of the origin of the credit product and comparison of products from different providers is facilitated through standardisation. Market integration should therefore lead to cheaper and more varied credit products, allowing consumers to manage their short- and medium-term mismatch of income and expenditures flexibly and at low cost.

This ultimately would lead to benefits from increased competition through widening consumer choice, lower prices resulting from competition and economies of scale and a greater variety of credit products that may increase further through enhanced incentives for innovation.

In reality, consumer credit liberalisation could have significant costs for consumers due to the inherent complexity of financial products, stemming from either a lack of consumer understanding, or from irrational decision making and resulting problems of over-indebtedness. This is not to say that market liberalisation will necessarily lead to such costs, but that ensuring consumers benefit requires vigorous measures for consumer protection. Effective consumer protection at a pan-European level can be expected to help overcome problems of customer trust in direct cross-border provision and hence directly enhance competition.

The potential benefits of integration of financial markets could be very significant - the 1988 *Cecchini Report*²⁹ estimated the potential benefits due to liberalisation of financial services to be 1.5% of EU GDP. A 2002 study estimates that European financial market integration would

²⁹ Quoted in 'The Benefits of a Working European Retail Market for Financial Services', ZEW/IEP (2002)

result in EU real GDP being raised by 1.1% in the long run, private consumption up by 0.8% and total employment by 0.5%³⁰.

However, the potential benefits associated with a single pan-European market in retail financial services cannot be realised through local establishment alone. In many cases of local establishment (for example, Santander's acquisition of Abbey), there is no impact on market structure and little indication of any economies of scale or scope – i.e. the competition and efficiency benefits of a single market are absent and any gains of the merger lie entirely in the cost reductions achieved through more effective management.

As argued by Deutsche Bank Research³¹: “Unlike domestic consolidation, where synergies can be reaped on the distribution side (closure of overlapping branch networks), the investment case for cross-border retail deals must be made on the production side: selling the same products to a broader market using a single platform for product development, transaction services, and product administration so as to achieve economies of scale.” In other words, local establishment only has a significant impact on economic efficiency if the barriers to direct cross-border provision are removed, allowing a single product to be delivered across a number of national markets.

Local establishment is only one of several distribution channels that can be used for delivery across national markets, and a channel which is likely to diminish in importance over time relative to telephone and the internet. Branches are not needed at all for the provision of some retail financial products and services, and it is in these cases – where competition from free-standing online and telephone-based providers is effective – that the potential competitive benefits of a single market in retail financial services are greatest. The removal of barriers to direct cross-border provision would then result in a significant increase in the number of potential and actual market entrants and a likely sharp reduction in cost and prices.

This is not to say that local establishment, without direct cross-border provision, does not have a role to play in the evolution towards a single market in retail financial services. Improved management practice, achieved through local establishment (via cross-border acquisition) can, even without removing the barriers to direct cross border provision, achieve some of the economic and efficiency benefits of a single market. A period of local presence may also be necessary in order to acquire the cultural and institutional understanding for the development of the eventual successful delivery of a single product across different national markets.

Will the Consumer Credit Directive achieve a single market for consumer credit?

Although from an economic point of view integration of the consumer credit market has considerable potential benefits for both consumers and lenders, stakeholders are rather pessimistic whether the CCD can be expected to achieve these in practice.

The survey of national banking and consumer associations by Civic Consulting found that:

- A large majority of national banking associations do not expect an increase of consumer confidence as a consequence of the proposed CCD, either for consumer credit agreements concluded nationally or cross-border. The majority of national consumer organisations that responded also have a negative view, but it should be noted that this is based on only a limited number of responses, with most operating in highly-developed consumer credit frameworks, such as the UK;

³⁰ 'Quantification of the Macro-Economic Impact of integration of the EU Financial Markets', London Economics (November 2002)

³¹ 'EU retail banking – Drivers for the emergence of cross-border business', EU monitor 34, Deutsche Bank (April 2006)

- The majority of banking and consumer associations do not expect an increase in the overall demand for consumer credit products resulting from the implementation of the CCD;
- Almost all national banking associations expect the range or variety and availability of credit products to either remain similar or to decrease with the implementation of the CCD;
- Most banking associations answering the survey do not expect an impact on competition, at either national or EU levels. However, a slight majority of individual banks that responded to the survey (albeit a non-representative sample, as this mainly covered large banks operating in many Member States) expected a fairly significant increase in competition in the cross-border consumer credit market. The majority of consumer organisations that had an opinion expected a fairly significant increase in national competition.

As part of the survey, banking associations were also asked whether they would expect to achieve any of the cost reductions and economies of scale set out above from selling consumer credit products in other EU Member States. The responses were split – 40% expected cost reductions/economies of scale, while 50% did not. Some responses flagged up differences in consumer demand/preferences across Member States, which might lead to a need for greater tailoring and personalisation of products, resulting in cost increases rather than decreases. The key to economies of scale seemed to be an ability to use existing contracts/methods across many countries, which was generally not felt to be possible currently. It therefore seemed that the realisation of cost synergies would be limited to funding, accounting and (hardware) data processing only.

These comments seem to suggest that economies of scale can only be expected if pan-European products can be developed and the legal framework allows for a high degree of standardisation of contracts and processes. Even then, the potential for cost reductions may be limited from creditors' points of view.

House of Lords committee report

The House of Lords European Union Committee Report³² agreed that there were potential benefits to both business and consumers of developing an internal market for consumer credit, but expressed concerns about the method for doing so. The CCD looks to promote cross-border credit through full harmonisation, facilitating the use of a single EU-wide credit agreement, about which the Committee remained unconvinced.

Further, the Committee found that barriers to a single consumer credit market were primarily due to other factors, such as language, culture and difficulties in penetrating a foreign market except by scale entry. In their view, the evidence suggested that full harmonisation was unlikely to displace the need for separate national credit agreements or facilitate internal cross-border market for other reasons. They felt that the most effective way of creating an internal market was to encourage greater convergence of market development and practice through other means, e.g. establishment/acquisition of branches and subsidiaries, borrowing of foreign market products/practices by local lenders and removal barriers at the local level (legal and administrative impediments; employment, conduct of business and taxation policies). Full harmonisation was felt to be more appropriate when a broadly similar range of products was available throughout the EU on competitive terms.

Oxera

In their report on the impact of the CCD, Oxera made an assessment of the barriers identified. Overall, they found that the impact of the CCD may be limited, as it removes only some of the differences in consumer credit regulation across countries.

³² 'Consumer Credit in the European Union: Harmonisation and Consumer Protection', House of Lords European Union Committee, 36th report of Session 2005-6 (July 2006)

Harmonisation of credit regulation may reduce some of the costs incurred by credit providers when entering foreign markets but, in terms of order of magnitude, these costs are likely to be small compared with the costs associated with other remaining barriers. For example, once a credit provider has decided to enter a foreign market, it incurs significant costs in developing credit scoring models and a strategy on debt recovery. This often means that it is worth having a local presence, which would also make it easier to hire local staff. The additional costs incurred by the credit provider in making sure that its business practices comply with local credit regulation are then likely to be small.

It was therefore felt that mergers, acquisitions and entering at scale by opening offices in foreign markets were likely to continue to be the main mechanisms through which the European market for consumer credit would develop. The Directive's contribution to the creation of a single European market for credit would therefore be limited.

Rationale for Government intervention

As identified by responses to the Eurobarometer surveys shown above, consumers feel that there is a significant problem regarding information in relation to consumer credit.

This informational problem has been identified as having many dimensions – for consumers, in terms of the quantity of information they receive, the quality of the information or how it is presented to them. However, the end result is the same – consumers feel that they have insufficient information about the products they are trying to buy. This can lead to consumers making choices based on inaccurate or incomplete information, which means that they may ultimately choose the 'wrong' product (or possibly choose not to buy such a product at all) and so will not be maximising their utility.

Information problems have also been identified by suppliers as barriers to the proper functioning of the consumer credit market – this could take the form of lack of access to information about the creditworthiness of potential customers or lack of information about regulatory or legal frameworks in different countries, which are both mentioned above. The result is that suppliers do not have as much information about their customers and how they are supposed to operate within particular countries as they might like. This can lead to credit providers making inaccurate assessments of their customers' credit risk and ability to repay a loan, meaning that some loans will be made that should not have been offered if the market was working correctly (i.e. under conditions of perfect information), introducing inefficiency.

With these market failures arising from information asymmetries on both sides of consumer credit transactions (demand and supply), there is scope for addressing these through government intervention.

The Directive does seek to address these issues. For example, by ensuring that certain information is presented to consumers in advertising (articles 4, 10, 11), standardising the way that certain financial information is calculated (article 19), standardising the information provided to consumers prior to making a contract (articles 5, 6), requiring that consumers adequately understand the terms of credit agreements they enter into (article 5.6) and ensuring that lenders are satisfied that customers are 'creditworthy' (article 8).

Detailed provisions

The Directive includes a number of articles covering different aspects of the consumer credit regime. Some of these articles involve changes to the current UK regulatory regime, while others do not – the latter of these are grouped together in a single category (category 1 below).

Where certain articles do require changes to be made (and are therefore likely to incur costs), these can be categorised into two types: those where the Directive contains provisions for leeway in implementation and those that do (categories 2 and 3 respectively).

The articles are grouped into the following categories:

Category 1 – no change to existing regulatory regime

- Database access – article 9
- Assignment of rights – article 17
- Regulation of creditors – article 20

Category 2 – changes to existing regime; no options available

- Information to be included in advertising – article 4
- Pre-contractual information – article 5
- Overdrafts, comprising:
 - Pre-contractual information relating to overdrafts – article 6
 - Obligations on overdrafts – article 12
- Borrowing rate information – article 11
- Open-ended credit agreements – article 13
- Right of withdrawal – article 14
- APR calculation – article 19
- Obligations of credit intermediaries – article 21

Category 3 – changes to existing regime; options available

- Scope – article 2
- Adequate explanations – article 5.6
- Obligation to assess creditworthiness – article 8
- Information included in credit agreements – article 10
- Linked transactions – article 15
- Early repayment – article 16

In so far as it is possible, estimates for the benefits and costs of all articles have been made. However, for the category 3 (where there is no scope for flexibility in implementation) it is not possible to identify discrete 'options' for implementation. These articles will therefore be covered but not subject to a comprehensive cost-benefit analysis.

The impact of each of these categories will be considered and assessed separately.

Summary: Analysis & Evidence

Policy Option: Implementation of category 1	Description: Implementation of the Consumer Credit Directive – articles for which there are no changes to existing UK regulatory framework (category 1)
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Implementation costs for lenders related to database access. Cost of additional time related to dealing with providing information to failed credit applicants. One-off cost associated with notification of customers whose debts have been transferred.
	One-off (Transition) Yrs	
	£ 1.6m 10	
	Average Annual Cost (excluding one-off)	
£ 0.9m-1.1m	Total Cost (PV)	£ 9.3m-11.1m
Other key non-monetised costs by 'main affected groups' Ongoing costs associated with 'new' customers, whose debts have been transferred.		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups'
	One-off Yrs	
	£ - 10	
	Average Annual Benefit (excluding one-off)	
£ -	Total Benefit (PV)	£ -
Other key non-monetised benefits by 'main affected groups' Consumers benefit from notification about transfer of debts. Also, potential benefits of investigating reasons for declined credit application (e.g. impaired credit record) and rectifying this, where applicable.		

Key Assumptions/Sensitivities/Risks Consumers need to switch (or at least threaten to switch) in order to realise many of the potential gains from increased competition; international suppliers must enter the UK market in order for consumers to be able to switch (or threaten to switch) to them.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ -9.3m to -11.1m	NET BENEFIT (NPV Best estimate) £ -10.2m
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		June 2010		
Which organisation(s) will enforce the policy?		To be confirmed		
What is the total annual cost of enforcement for these organisations?		£ -		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ -		
What is the value of changes in greenhouse gas emissions?		£ -		
Will the proposal have a significant impact on competition?		Yes		
Annual cost (£-£) per organisation (excluding one-off)	Micro -	Small -	Medium -	Large -
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ -	Decrease of £ -	Net Impact £ -

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Category 1 – no change to existing regulatory regime

Article 9 – Database access

In conjunction with the obligation on creditors under article 8 (creditworthiness) to undertake creditworthiness assessments, this article was established to ensure non-discriminatory access to credit reference agency (CRA) data across the EU for all EU creditors and to ensure that consumers were appropriately informed on a timely basis when their applications for credit had been declined as a result of the information obtained from the CRA.

It is the MS responsibility to ensure access for creditors from other MS, to CRA databases in that MS, to be used for creditworthiness assessments, on a non-discriminatory basis. Further, article 9 ensures that consumers who have their applications rejected as a result of a CRA search are informed immediately (consistent with the channel for application), and without charge, of the name and contact details of the CRA consulted.

Although there is no specific current requirement in UK legislation with respect to advising consumers as to why their application for credit has been declined, industry Codes of Conduct do cover this issue. For example, the BBA Code of Conduct indicates that where lenders are unable to provide the credit requested, "... we will explain the main reason why, if you ask us to..." and this will be provided in writing or electronically if requested.

There is a reasonable presumption that the term "databases" is meant to refer to CRA databases rather than any internal databases held by any large creditor, which was confirmed verbally at the CCD Transposition Workshop in November 2008.

Costs

Given that key industry bodies already set out in their codes of conduct the need to provide explanation to consumers when their request for credit has been declined, article 9 would not appear to constitute a new burden on lenders. Indeed such codes of conduct promote the need for this communication irrespective of the key factor being the consultation of the (CRA) database.

In terms of cross border-access into the UK, this will primarily be an issue for the UK CRAs who will need to provide non-discriminatory access to EU creditors (from outside the UK). To that end, it is understood that the UK CRAs – and indeed their European trade organisation ACCIS – are comfortable with the requirements imposed by the CCD.

If implementation results in a significant increase of consumers (who are declined credit applications) asking for details of particular CRA databases, this might increase the amount of time spent by lender's staff in processing credit applications, and hence costs. If it is assumed that each failed application would entail an additional 5 minutes time, the ongoing potential maximum cost to lenders associated with this could be between **£0.9m-£1.1m per year**³³.

³³ Survey data suggests that 22% of households did not apply for credit in the last 6 months – assuming around 25m UK households, this implies 5.5m credit applications per year. It has also been assumed that approval rates are between 75-80% (also based on survey data) and a wage rate for loan processing employees of £10 per hour.

Estimates provided by industry suggest that one-off implementation costs would be minimal – around £0.1m for a large lender. This would imply industry-wide implementation costs of around **£1m**.

Benefits

This article is unlikely to have a significant impact on consumer benefits, as it only formally ensures that customers have a right to ask for contact information for external databases and confers an obligation on lenders to provide it. Based on current industry practices, it seems that lenders already do this and so implementation of this article would not seem to provide an additional benefit for consumers.

In addition, it appears that not many consumers currently exercise the right to check their credit record. According to survey data from 2006³⁴, around one in twenty credit card holders have requested their credit report. A priori, it is difficult to know whether implementation of this article might increase this number or not.

Scope: It is intended to apply this requirement across all products currently regulated by the Consumer Credit Act.

Article 17 – Assignment of rights

This article covers the assignment of rights and the notification to consumers of changes in the ownership of their debt.

It states that:

- in the event of assignment to a third party of the creditor's rights under a credit agreement or the agreement itself, the consumer shall be entitled to plead against the assignee any defence which was available to him against the original creditor;
- In addition, the consumer shall be informed of the assignment referred to above, except where the original creditor, by agreement with the assignee, continues to service the credit vis-à-vis the consumer.

Current UK consumer credit legislation makes no reference to the concept of assignment of rights other than in the definitions of key terms as follows:

- Creditor - The person providing credit under a consumer credit agreement or the person to whom his rights and duties under the agreement have passed by assignment or operation of law, and in relation to a prospective consumer credit agreement, includes the prospective creditor.
- Debtor - The individual receiving credit under a consumer credit agreement or the person to whom his rights and duties under the agreement have passed by assignment or operation of law, and in relation to a prospective consumer credit agreement includes the prospective debtor.

The actual assignment or transfer of rights is a matter of general law principles. In the UK, the Law of Property Act 1925 requires firms to give written notice to their customers when they assign their rights in law to another party.

The OFT's Debt Collection Guidance lists 'not informing the debtor when their case has been passed on to a different debt collector' as an unfair practice.

In terms of informing consumers of assignment, the CCD does not make clear whether that duty lies with the assignee, the assignor or both. We therefore propose to require the assignor to

³⁴ http://www.apacs.org.uk/media_centre/press/06_07_08.html

communicate the assignment to the consumer, on the basis it would be reasonable to expect that the assignor owes this duty to the debtor.

Therefore, we do not believe that the position set out in article 17 is contrary to existing UK general law on assignment of rights and article 17 reflects what we consider is already the position in the UK.

Costs

From discussion with industry, it appears that the majority of what is covered under this article is already practiced by lenders. Therefore, it is assumed here that there will be minimal impact on industry.

Industry cost estimates varied, with one lender estimating one-off system change costs of £0.1m per lender, with another suggesting there would be either minor or no systems impact at all.

It may be expected that there may be additional ongoing costs associated with notification of customers for some organisations that purchase debt. Survey data suggests that only a very small proportion of those who are in structural arrears are aware of their debt being passed on to another company (just under 2% of all respondents, around 0.45m households), of which approximately one-third were notified of this change.

If the remaining two-thirds of these customers, whose debts have been sold on, were notified of the change – at a cost of up to £2 per notification³⁵ – this would imply a total cost across all debt-purchasing firms of approximately **£0.6m**. Since we can only observe the current stock of those for whom their debts have been transferred, this will be treated as a one-off cost. There may be additional ongoing costs associated with notification of new customers.

Benefits

There may be some additional benefits to consumers from receiving a notification that their debt has been sold on to another organisation, but these are very difficult to quantify.

Scope: It is intended to apply this regulation across all consumer credit-related agreements, both existing and new.

Article 20 – Regulation of creditors

This article requires that Member States ensure that creditors are supervised by a body or authority independent from financial institutions, or regulated.

Given that the UK already has a long-standing (and recently bolstered) framework for the licensing and supervision of those offering consumer credit, by the Office of Fair Trading, it is not expected that implementation will result in any change being needed. Therefore, no costs will be incurred by industry and no benefits will flow to consumers as a result.

³⁵ For the Consumer Credit Act 2006, it was estimated that the material costs of sending a paper statement to customers was around 30p (<http://www.berr.gov.uk/files/file38292.pdf>); this has been increased to reflect an element of the time associated with production of the notification

Summary: Analysis & Evidence

Policy Option: Implementation of category 2	Description: Implementation of the Consumer Credit Directive – articles for which there are no options in implementation (category 2)
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by ‘main affected groups’ Costs to firms through implementation – one-off system change costs and ongoing costs from production of SECCI.
	One-off (Transition) Yrs	
	£ 12.1m-61.6m 10	
	Average Annual Cost (excluding one-off)	
£ 11.3m-14.7m	Total Cost (PV)	£ 110m-188m
Other key non-monetised costs by ‘main affected groups’ Cost of consumer credit licence for additional affected businesses, depending on definition of ‘credit broker’ compared to ‘credit intermediary’ (article 21).		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by ‘main affected groups’ Benefits of reduction in mis-selling of financial products and reduced incidence of over-indebtedness (one-off), ongoing annual benefits – more suitable loans, switching to cheaper products as a result of improved information and reduction in overdraft charges.
	One-off Yrs	
	£ 92m 10	
	Average Annual Benefit (excluding one-off)	
£ 51.5m-76.5m	Total Benefit (PV)	£ 535m-750m
Other key non-monetised benefits by ‘main affected groups’ Time saved by consumers in comparing credit products; benefits to reputable firms through increased business.		

Key Assumptions/Sensitivities/Risks Consumers need to switch (or at least threaten to switch) in order to realise many of the potential gains from increased competition; international suppliers must enter the UK market in order for consumers to be able to switch (or threaten to switch) to them.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ 347m-640m	NET BENEFIT (NPV Best estimate) £ 494m
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		June 2010		
Which organisation(s) will enforce the policy?		To be confirmed		
What is the total annual cost of enforcement for these organisations?		£ -		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ -		
What is the value of changes in greenhouse gas emissions?		£ -		
Will the proposal have a significant impact on competition?		Yes		
Annual cost (£-£) per organisation (excluding one-off)	Micro -	Small -	Medium -	Large -
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ -	Decrease of £ -	Net Impact £ -

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Category 2 – changes to existing regime, no options available

Article 4 – Advertising information

This article concerns the standard information to be included in advertising for credit products and is intended to ensure that consumers are provided with sufficient information to enable them to compare different offers of credit. Article 4 is a maximum harmonisation provision, which means that Member States are not permitted to maintain or introduce national provisions other than those set out in the article. Specifically, the article requires that ‘standard information’ is to be provided where an indication of an interest rate or any figures relating to the cost of credit are included in an advertisement.

A standardised calculation can facilitate the comparison of different credit products, which can lead to benefits to consumers by identifying cheaper or more suitable loans for their circumstances. 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.

As evidenced by the survey data in the section above, insufficient, inaccurate or incomprehensible information is a key concern for consumers in purchasing cross-border financial services within the EU. Allied to this, problems around financial capability among the UK population means that improved standardisation of information across a range of financial products can only improve the ability of consumers to compare them – for example, one recent survey found that 13%, even for general insurance, one-third of consumers bought their policy without comparing it to even one other product.³⁶

The following items are to be included as part of the standard information at all times:

- Borrowing rate, whether fixed or variable, or both
- Charges included in the total cost of credit
- Total amount of credit
- APR

Other items may also be required where applicable:

- Duration of the credit agreement
- Cash price/advance payment for goods or services in case of credit, in the form of a deferred payment
- Total amount payable and amount of instalments

The standard information is to be given in a clear, concise and prominent way, by means of a representative example.

Costs

Compared to existing information requirements under the Consumer Credit (Advertising) Regulations 2004, the manner in which information is presented under article 4 is less prescriptive (and therefore less onerous) for lenders. However, it is likely that most lenders

³⁶ http://www.fsa.gov.uk/pubs/other/fincap_baseline.pdf

would refresh their advertising on a regular basis in any case and changes due to implementing elements of article would be absorbed into that budget – this would imply no additional costs.

There may be costs associated with replacing standard leaflets in branches, though lenders should have plenty of time to run down existing stock, which should minimise any potential recall and reprinting costs. Lastly, there may be costs associated with redesigning templates and/or forms for internet and online channels – again, it is likely that these would be absorbed into budgets for more routine updates.

From discussions with industry, it would seem that the standard information is already included with advertising for the vast majority of credit products – it is therefore expected that no additional products will be brought under the provisions of this article.

Cost estimates provided by industry vary from zero to £1.3m for one-off costs and ongoing annual costs of £70,000. However, for the reasons set out above, we believe that implementation would not significantly increase costs above that for budgets associated with regular updates to advertising.

Benefits

As part of the assessment for the Advertising Regulations 2004, it was estimated that providing consumers with an effective means of comparing loans could lead to savings of £41m per annum as a result of identifying cheaper/more suitable loans for their circumstances.³⁷ Although these benefits resulting from the implementation of those regulations have, in theory, been realised, it is possible that consumers may wish to take advantage of easier comparability for credit products across the EU.

According to a Eurobarometer survey, 31% of UK respondents would consider obtaining a financial service from a firm located in another Member State³⁸. Assuming that 15% of consumers already have made a cross-border purchase of financial services³⁹, this would imply an additional 16% willing to do so. If similar benefits could be achieved as for domestic switching, this would imply potential consumer benefits of around **£6.5m per year**.

Research conducted by the FSA in relation to information gathered by consumers regarding mortgages found that 77 per cent of customers gathered a range of information before making a decision, with 44 per cent studying leaflets of brochures from lenders they approached. FSA research also indicates that 42% of customers rely on product information and/or advice from friends, relatives and sales staff, which indicates the importance placed on advertising material by borrowers. If this information is misinterpreted, there is potential for significant costs to consumers – the extreme version of this could be mis-selling of financial products.

As an illustrative example, consider payment protection insurance (PPI) – the Financial Ombudsman Service has received 25,000 claims related to mis-selling of PPI, and with reports suggesting an average of £2,200 per claim⁴⁰, avoidance of this could lead to one-off consumer benefits of **£55m**. Although PPI falls outside the remit of the Directive, this is meant to be illustrative of potential benefits resulting from the reduction of mis-selling of financial products more generally.

Scope: It is left up to each Member State to decide for which products to require the inclusion of an APR in advertisements. The UK intends to maintain the existing coverage of the Consumer

³⁷ Advertising Regulations RIA, 2004

³⁸ Special Eurobarometer 230: 'Public Opinion in Europe on Financial Services'

³⁹ 85% of consumers indicate they have never purchased financial services from firms located in another Member State (source: Special Eurobarometer 230)

⁴⁰ <http://www.guardian.co.uk/money/2009/feb/22/ppi-banks-mis-selling>

Credit (Advertisements) Regulations, including the requirement to provide a representative APR (as opposed to a typical APR) in the same circumstances.

An issue related to article 19 (APR calculation) is relevant here, as advertisements where the amount of credit is unknown need to have the amount of credit that the representative example will be based on specified. Essentially, a similar amount of €1,500 could be used, or lenders could be given discretion for deciding the most appropriate amount for the calculation.

Keeping to the spirit of the Directive, it would seem to make sense to standardise information provided to consumers as much as possible, to facilitate comparison between products as much as possible. Allowing lenders to set differing thresholds, depending on the product offered, would seem to increase the scope for customer confusion. However, it is proposed to allow lenders to provide additional representative examples, based on an alternative amount of credit.

Article 5 – Pre-contractual and contractual information

Article 5 sets out pre-contractual information requirements for those consumers considering entering into credit agreements. It is very prescriptive, given that it mandates the use of a standardised form for providing pre-contractual information to customers, the Standard European Consumer Credit Information (SECCI) form. Part of article 5 (article 5.6) confers a duty on providers to provide 'adequate explanations' to consumers regarding credit agreements, but is considered separately, as there is more considerable variation in terms of the cost impact.

The information itself seems to be closely aligned with the UK's own pre-contractual information requirements, as set out in the Consumer Credit (Disclosure of Information) Regulations 2004. This was based on earlier rules governing the form and content of contractual information as set out in the Consumer Credit (Agreements) Regulations 1983, as amended in 2004. The Disclosure Regulations are prescriptive about the content of the information to be given, but not the ordering, whereas the Agreements Regulations are more prescriptive about the order of information, including the setting out of 'key information' boxes and headings.

Evidence from a recent Eurobarometer survey⁴¹ indicates that the vast majority of UK consumers would consider the introduction of a standardised information sheet in relation to financial services to be very helpful in comparing prices and offers – 53% considered this very useful, 34% fairly useful and only 7% considering it to be not useful.

Given that this is a maximum harmonisation Directive, it is not possible for a Member State to require creditors or credit intermediaries to provide more or less pre-contractual information than that specified in article 5. There is a little scope for variation in terms of the language used in the SECCI form and the precise way in which the required information will be presented. However, this variation will not be considered as discrete options, but is reflected in the range of costs set out below.

Although there may be some flexibility in terms of the discretion that Member States/lenders are allowed over the precise final wording used in SECCI, the cost impact of this is unlikely to be significant. Discretion over language could potentially create scope for customer confusion across products from different lenders, but much of the structure of the SECCI is not flexible (e.g. information presented in the same order, under the same headings/sections), which reduces the possibility of this.

⁴¹ http://ec.europa.eu/public_opinion/archives/ebs/ebs_298_en.pdf

Costs

Given that the list of information required under article 5 is similar in content to the list of information currently required under the 2004 disclosure regulations, the cost implications of introducing SECCI are likely to be quite low. There are front-end systems that will require changing to account for different products, for which a SECCI will have to be produced, and one-off costs primarily attributable to training requirements around new procedures to implement the requirements, as well as training for staff in order to explain the content of the new form. Industry estimates for these one-off costs vary from £0.1m-£1.05m for a large lender, which would imply industry-wide costs of **£1m-£10.9m**.

Ongoing costs may be incurred from the additional paper required from the production of SECCI and an element of ongoing staff time spent handling customer queries associated with SECCI. Industry estimates for these ongoing costs amount to £0.9m per year for a large lender, which would imply industry-wide costs of up to **£9m**. It has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, which would imply industry-wide ongoing costs of **£0.9m per year**.

Benefits

Research conducted for DTI for the Disclosure of information regulations in 2004⁴² indicated that 84% of consumers found language used in paperwork for credit agreements confusing. As a result of implementation, the standardised format of the SECCI should mean that consumers will be further advantaged in their ability to compare information across products, helping them to make informed decisions.

The provision of clear, comparable information – that is standardised across credit products throughout the EU – will raise consumer confidence in comparing and choosing credit products, through increased transparency of charges as well as terms and conditions. This should widen the potential choice set for consumers, resulting in keener competition between potential lenders and also reduce sub-optimal borrowing choices.

The provision of clearer information will allow consumers to (should they wish to) shop around and potentially achieve a better deal prior to entering into an agreement, including switching to cheaper products. For the Disclosure of Information Regulations in 2004, it was estimated that consumer savings from switching to cheaper products could be up to £153 million per year.

In a 2002 paper, the FSA estimated that credit card customers could save almost £140 per year by switching to the cheapest deal⁴³, based on an average credit card balance of £1,300 and a difference between average and cheapest credit card interest rates of 10.3%. If we update this figure for more modern statistics – average credit card balance of £1,800⁴⁴ and a difference in interest rates of around 11%⁴⁵ – this would suggest an average saving in repayments for a credit card customer of approximately £100. Assuming that there are currently 56.2m accounts⁴⁶ (of which approximately 68% are usually or always repaid in full each month⁴⁷), that switching is comparable to that for current accounts⁴⁸ and that those switching did not maximise the gains available to them⁴⁹, this would suggest average consumer savings of **£30m-£55m per year**.

⁴² 'Consumer awareness of credit issues', September 2003 (MORI)

⁴³ www.fsa.gov.uk/pubs/occpapers/OP19.pdf

⁴⁴ Average amount outstanding per active account = £1,824 in 2008 (based on BBA statistics)

⁴⁵ Average effective interest rate for credit cards = 17.9% (Bank of England, Jan 2009); cheapest credit card interest rate = 6.8% (Moneysupermarket.com, Mar 2009)

⁴⁶ Source: British Bankers' Association, as at January 2009

⁴⁷ http://www.apacs.org.uk/media_centre/documents/APACSPaymentMyths28.12.07.pdf

⁴⁸ 6% of customers switched in last 12 months (Source:

http://www.oft.gov.uk/shared_oftrreports/financial_products/oft1005d.pdf)

⁴⁹ Consumers appropriated 28-51% of maximum gains available to them

Scope: In respect of business lending (except for consolidation purposes), secured lending and for regulated agreements worth more than €75,000, it is proposed that pre-contractual information could be given either via the SECCI, or in the form currently required under the Disclosure regulations. A similar approach is proposed in respect of the provision of contractual information.

Articles 6 & 12 – Overdrafts

The Directive segments overdrafts for special regulatory treatment in terms of information provision, dependent upon the precise terms of repayment of the overdraft credit agreement. The Directive differentiates between overdrafts repayable on demand and within 3 months versus those repayable within one month. Discussion with stakeholders and creditors suggests that in the UK we only have overdrafts repayable on demand.

Article 6 (pre-contractual information on overdrafts) gives the option to Member States to require an APR figure to be included with the offer of an overdraft to customers. Since it is felt that an APR is not particularly representative of the costs to consumers for overdrafts, and an implied interest rate is not an important determinant in the choice of consumers to take out an overdraft, it is intended not to introduce this requirement. However, it is intended to require the inclusion of a figure for the Total Cost of Credit in contractual information relating to overdrafts.

Article 12 covers obligations on overdrafts, including ‘overrunning’ (i.e. tacitly-approved overdrafts) – under this article, borrowing rates will need to be shown in periodic statements that include overdraft interest amounts.

In broad terms, there are no significant changes imposed on UK creditors by the Directive.

Costs

Therefore, there will be some imposed changes (and hence costs) for business through notification of customers regarding their terms and conditions for overdrafts, but it is likely that most of these can be absorbed into regular customer communications (e.g. account statements). Since there is limited variation in the implementation of this article, no ‘options’ are considered here.

Industry estimates of costs associated with implementation for articles 6 and 12 are £0.2m-£1.6m for a large lender, which would imply industry-wide costs of **£2.1m-£16.7m**. As it has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, this would imply industry-wide ongoing costs of **£0.2m-£1.7m per year**.

Benefits

Since customer awareness of the terms and conditions of their overdrafts is likely to be increased, this may result in a reduction of overdraft-related fees (e.g. overdraft excess charges), which OFT recently estimated to be around £1.5 billion⁵⁰. Even if this were only reduced by 1%, this would amount to consumer savings of **£15m per year**.

Scope: It is intended to apply overdraft requirements across all products current regulated by the CCA, including business overdrafts

Article 11 – Borrowing rate information

(source: <http://ccpweb.mgt.uea.ac.uk/publicfiles/workingpapers/CCP07-6.pdf>)

⁵⁰ ‘Personal Current Accounts in the UK: An OFT market study’, July 2008

The Directive contains certain requirements dealing with the provision of information to a debtor once an agreement is entered into. The relevant provisions of the Directive are contained in article 11, which concerns the provision of information relating to changes in the borrowing rate.

Where applicable, the article states that consumers should be informed of any change in the borrowing rate before the change enters into force. The information shall state the amount of the payments to be made after the entry into force of the new borrowing rate and, if the number of frequency of the payments changes, particulars thereof.

Beyond the exact time period in which consumers should be informed of changes, there is very little scope for options in implementation of this article.

The Directive requires that notice of a change in the borrowing rate should be given before the change enters into force. There is no minimum specified period; existing UK legislation⁵¹ specifies that at least 7 days' notice must be given. This would seem to leave a choice between retaining the existing 7-day rule or allowing lenders to determine an appropriate time 'before' the change takes effect (e.g. to allow for regular statements to be used for this purpose).

Costs

There will be some limited costs to business of implementing this article through increased contact with customers about changes to their borrowing rates, but this is likely to be relatively infrequent. Further, notification of this information could be incorporated into more regular channels of communication with customers (e.g. statements). Therefore, we have assumed here that there are no additional costs associated with notification under article 11.

In relation to whether or not the time period should be specified as 7 days or not, it is likely that either proposal will be cost-neutral for lenders, given there is no substantive change in the requirement to provide information. However, a more prescriptive approach might impact adversely on the ability of lenders to use regular statements for this purpose, which suggests that it would be better to adopt a more general approach rather than the strict 7-day deadline.

Industry estimates of costs associated with implementation vary from zero to £0.6m per large lender. This would seem to suggest industry-wide costs of **£0-£6m**. It has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, which would imply industry-wide ongoing costs of up to **£0.6m per year**.

Benefits

As was calculated in relation to article 5 above, there could be significant benefits to consumers (£132m-£240m) if they were to take action as a result of receiving such information and move to products with lower interest rates. However, OFT research suggests that over 75% of credit card holders do not know what APR applies to their card.⁵²

There may also be benefits to consumers of being made aware of changes to their borrowing rates and how this impacts on any debt repayments, which might help them to improve the management of their borrowing and avoid the consequences of over-borrowing, such as financial distress and consequent impacts on ill health or relationship breakdown. Whilst it is difficult to quantify these costs, a recent study by LSRC estimated costs associated with debt problems to be in excess of £1,000 per individual⁵³.

⁵¹ Regulation 2 of the Consumer Credit (Notice of Variation of Agreements) Regulations 1977

⁵² http://www.oft.gov.uk/shared_ofr/reports/financial_products/oft709.pdf

⁵³ <http://www.lsrc.org.uk/publications/Impact.pdf>

On the basis of recent survey data⁵⁴, which suggests that around 3.7m households consider their debts to be a 'heavy burden', if this number could be reduced by only 1% as a result of implementing this article, there could be potential savings to the economy of **£37m**.

In terms of the time period for notifying customers of changes, there may be advantages in using the more general term 'before', given that 7 days may not give customers sufficient time to act. However, there is scope for lenders to interpret 'before' as being less than, rather than more than, 7 days.

Scope: It is intended to apply the provisions of article 11 to all credit agreements apart from 2nd-charge lending.

Article 13 – Open-ended credit agreements

This article concerns open-ended credit agreements – such as credit cards, store cards or payday loans – and the ability of consumers and creditors to terminate them. This varies for consumers (able to terminate at any time, with a maximum of one month's notice) and creditors (minimum of 2 months notice). Where creditors terminate the right to draw-down on an open-ended credit agreement, consumers must be informed in advance, where possible, or at the latest immediately thereafter.

UK legislation will need to be altered to reflect these changes – there will be a new, specific provision in UK law to give effect to the requirement that a consumer can terminate an open-end agreement at any time, unless the parties have agreed on a period of notice, that the consumer cannot be required to give more than one month's notice and that the creditor must give at least two months' notice.

There is no real flexibility with this article and it will therefore be transposed directly into UK law – as a result, there are therefore no options for implementation to consider.

Costs

In practice, there should be little cost impact on most lenders, given that there are similar provisions in the Banking Code regarding terminations. There may, however, be some impact on non-subscribers to the code.

Industry cost estimates of implementation related to article 13 range from £0.1m per lender to minimal or zero cost impact. Given the analysis above, it seems likely that the cost impact will be negligible.

Benefits

Similar to above, given that similar provisions already exist in the Banking Code, there are unlikely to be any significant impact on benefits to consumers. There may be some benefits accruing to those customers whose credit lines may currently be withdrawn with minimal or no notice that would receive some (advance) notification as a result of implementation.

⁵⁴ YouGov Debt Tracker, October 2008 – 15.5% of respondents consider their debts to be a 'heavy burden' (assuming approximately 25m households)

Article 14 – Right of withdrawal

This article covers the right of consumers to withdraw from credit agreements and sets out responsibilities regarding giving notice and returning money. The consumer will have the right to withdraw from a credit agreement within 14 days but not to return the goods in the case of a linked credit agreement. However, if the consumer wishes to return the goods and the supplier is willing to take them back, the legislation will not prevent this.

It is not proposed to define more closely when the 14-day period starts – when the contract is concluded may differ, depending on the type of credit agreement and it should be clear in the circumstances.

UK consumer credit law has provided for a right of withdrawal since 1974, but only in situations that involve some form of face-to-face contact and where credit agreements are not signed at premises of creditor or a linked party. This will therefore require changes to existing legislation. However, there is little scope for variation in how this is implemented, hence there are no options considered for this article.

Costs

Through informal consultation, one bank has assessed the cost impact of this article as 'neutral', while another stated that such action was already part of current policy, therefore there would be no effect. The extent to which this is true across the industry will determine the overall cost of implementation.

Based on estimates provided by industry, one-off costs associated with system changes vary between £0.2m-£0.8m for a large lender, which implies industry-wide one-off costs of **£2m-£8m**. Ongoing costs are estimated by industry to be around £0.05m, which implies industry-wide costs of **£0.5m per year**.

Benefits

As a result of implementation, consumers will have the right to withdraw from a credit agreement under a wider range of circumstances than possible under current UK law.

There may be additional benefits of reducing overall indebtedness if consumers use the right to withdraw in deciding not to proceed with loans they cannot afford, or to find loans that are more suitable for their circumstances. As set out in the section above, there are significant costs associated with the impact of people's lives related to debt – stress related to debt problems caused 8.7m lost working days in 2004, with a cost to employers of £497m⁵⁵. If only a fraction of these could be avoided, this would represent significant benefits to the overall economy.

However, there could also be a potentially negative impact for consumers if, as an unintended consequence of the implementation of this article, retailers might wait until the 14-day period has expired before allowing goods to be released, where credit agreements are used as a deferred payment for delivery of goods or services.

Scope: It is proposed to extend the right of withdrawal to credit agreements below €200, credit agreements above €75,000 for the purposes of debt consolidation, pawnbroking and all hire purchase and conditional sale agreements. It is undecided whether or not to extend this right to small business lending (up to £25,000).

Article 19 – APR calculation

⁵⁵http://www.manchesteronline.co.uk/personalfinance/s/123/123594_debt_stress_takes_heavy_toll_on_workplace.html

This article sets out the requirements on how the Annual Percentage Rate of Charge (APR) must be calculated for a number of different credit products across the EU. Approximately 84% of the UK population consider that APR is an important factor in terms of deciding both which credit products to buy and from which lender.⁵⁶

The methodology is the same as that followed in the UK; however, the assumptions provided where credit agreement terms have not been finalised appear to be less sophisticated than those currently used in the UK and do not appear to cater for as wide a range of situations. That said, these simpler assumptions appear to produce the same result in terms of calculated APR for the majority of cases.

Costs

When calculation of APR was standardised as part of the Advertising Regulations 2004, it was estimated that lenders would incur a one-off transitional cost of £40m (e.g. staff training, management and legal costs). However, the environment under which these changes were made is significantly different to the environment under which this article will be implemented.

Given that standardisation has already been achieved for APR calculation, the costs associated with a change to this standardisation should be an order of magnitude smaller. This would seem to be reflected in industry cost estimates – one-off system change costs of between £0.6m-£1.8m for a large lender. This implies industry-wide one-off costs of **£6m-£19m**. As per suggestions from industry stakeholders, if it assumed that ongoing costs represent around 10% of these one-off costs, this would imply industry-wide ongoing costs of **£0.6m-£1.9m per year**.

Benefits

Similar to the benefits calculated for article 4 above, there will be benefits for consumers in providing an effective means of comparing loans that could lead to savings as a result of identifying cheaper/more suitable loans for their circumstances.

Other benefits, which were unable to be quantified, include:

- Time saved comparing different credit products
- Benefits to reputable lenders through increased business, by stopping less competitive lenders exploiting information gaps and misleading customers through hidden pricing or incomplete information

Scope: It is intended to apply the new assumptions across all consumer credit agreements caught by the Consumer Credit Act.

Article 21 – Obligations of credit intermediaries

This article confers a requirement on credit intermediaries to disclose their ties with creditors, to agree with the customer, and disclose on paper, any fee and to communicate to the creditor any fee payable by the consumer for calculation of the APR.

The definition used in the Directive ('credit intermediary') is not used in the Consumer Credit Act 1974 (CCA); however, the term 'credit broker' is used. There are several differences between these two terms, including:

- credit brokerage does not require a fee to be paid, whereas a credit intermediary must charge a fee;
- credit brokerage not only applies in business to consumer transactions but also in business-to-business transactions below £25,000;

⁵⁶ Advertising Regulations RIA, 2004

- credit brokerage applies not only to introduction of persons desiring to obtain credit to persons supplying credit, but also to the introduction of persons desiring to obtain goods on hire to persons carrying on a hire business

There are currently no requirements in the CCA regarding the disclosure by credit brokers of ties with creditors, nor explicit requirements in the CCA for a credit broker to disclose any fee payable by the consumer for the broker's services and agree it on paper (or a durable medium). There is also no explicit requirement for the broker to inform the lender of any brokerage fee paid by the consumer.

In summary, it does not appear that any of the provisions in article 21 are currently explicit requirements in UK law, although it does appear that, to some extent, actions required by article 21 may already occur in practice. Explicit requirements would need to be introduced to fully implement the Directive.

The distinction between these two definitions is potentially relevant under article 21 in terms of the number of additional businesses that would fall within a changed definition. The two definitions will cover the same businesses to a certain extent, but it is unlikely that all businesses that could be considered 'credit intermediaries' under the Directive's definition would also be considered 'credit brokers' under the CCA definition. Indeed, evidence on OFT consumer credit licences suggests that there are around 3,100 licences attributed to 'brokers and intermediaries' and around 2,600 to solely 'credit brokers'.

The approach of relying on the existing definition of credit brokerage (whether unchanged or slightly extended) to cover the new requirements on credit intermediaries would create a homogeneous group to which the same requirements applied; this has advantages for consumers, business and the regulator. However, it is likely to mean that some businesses that are not currently credit brokers would fall within that definition and therefore be caught by all the requirements currently attached to credit brokers.

We have discounted the option of replacing our existing definition of credit brokerage with the Directive's definition of credit intermediary and applying the new definition to existing and new requirements. This option is not attractive as credit brokerage is used in several contexts in the CCA and has an entrenched meaning. To remove it would be difficult, could impact on non-CCD areas and could have unintended and undesirable consequences.

At this time, the UK is inclined to think that extending the CCA definition of credit brokerage so that it covers activities that fall within the definition of credit intermediary would be preferable, as long as this does not result in an excessive impact on business, either in terms of the number of additional businesses affected or the impact on individual businesses.

Costs

The costs to individual businesses of the new requirements are likely to relate primarily to having to change advertising and documentation intended for consumers to include the new disclosures. Other costs are likely to be insignificant. It is intended to take a non-prescriptive approach to implementing these requirements and providing flexibility for lenders, which should help to minimise costs.

As discussed above, the overall costs to business of implementation depends on the definition of the group to which the requirements apply.

If the CCA definition of 'credit broker' were extended to include credit intermediaries, there may be a cost to some businesses. If a business came within the definition of 'credit intermediary' but was not currently a 'credit broker', this would mean that they would have to comply with requirements for credit brokers, including licensing by the OFT.

The cost of a consumer credit licence from the OFT is £380-£735, depending on the type of business. To assess the monetary cost associated with implementation this figure would need to be multiplied by the number of additional affected businesses.

Other costs may include: staff time in filling in the OFT consumer credit licence application form, providing OFT with information and updates on business as necessary and cost of resources (time, training) for businesses to make themselves aware of the legal requirements surrounding being a credit broker.

Estimates provided by industry indicate that costs associated with implementation vary from zero to £0.1m for a large lender. On a conservative basis, this could imply additional industry-wide costs resulting from implementation of approximately **£1m**. It has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, which would imply industry-wide ongoing costs of **£0.1m per year**.

Benefits

Customers may benefit from greater transparency in conducting transactions through credit intermediaries that may lead to them shopping around and exerting greater competitive pressure, leading to lower fees. However, it is difficult to quantify this impact.

Scope: It is proposed that requirements under article 21 would apply to most agreements covered by the Consumer Credit Act but outside the scope of the Directive – loans below €200, loans above €75,000, hire purchase and conditional sale agreements, interest-free credit, credit repayable within 3 months with only insignificant charges, modifying agreement which allow deferment of payment of an existing debt free of charge, modifying agreements designed to avert court proceedings and lending to small businesses up to £25,000.

However, it is not expected that extending the scope in this way would increase costs in any material way.

Summary: Analysis & Evidence

Policy Option: Implementation of category 3	Description: Implementation of the Consumer Credit Directive – articles for which there are options in implementation (category 3)
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by ‘main affected groups’ System change costs associated with implementation of Directive applied to broader lending (under preferred option); implementation of credit agreement information (article 10); allowing for partial early repayment and potential liability under linked credit agreements (article 15).
	One-off (Transition)	Yrs	
	£ 11m-51m	10	
	Average Annual Cost (excluding one-off)		
£ 26.1m-30.1m			Total Cost (PV) £ 236m-310m
Other key non-monetised costs by ‘main affected groups’ Additional time to firms associated with assessment of creditworthiness (article 8) and verifying the extent of adequate explanations (article 5.6); product-specific costs incurred through implementation of article 2 – i.e. inclusion under the Directive. Costs to consumers through potential reduction in availability of credit.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by ‘main affected groups’ Benefits to economy due to reduction in working days lost due to debt-related stress and reduction in debt write-offs (bad debt).
	One-off	Yrs	
	£ -	10	
	Average Annual Benefit (excluding one-off)		
£ 113m			Total Benefit (PV) £ 970m
Other key non-monetised benefits by ‘main affected groups’ Extended protection to consumers for high-value purchases under linked credit agreements; reduction in repayments and savings through ability to make partial early repayments on debts.			

Key Assumptions/Sensitivities/Risks Consumers need to switch (or at least threaten to switch) in order to realise many of the potential gains from increased competition; international suppliers must enter the UK market in order for consumers to be able to switch (or threaten to switch) to them.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ 660m-734m	NET BENEFIT (NPV Best estimate) £ 697m
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What is the geographic coverage of the policy/option?				UK	
On what date will the policy be implemented?				June 2010	
Which organisation(s) will enforce the policy?				To be confirmed	
What is the total annual cost of enforcement for these organisations?				£ -	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				Yes	
What is the value of the proposed offsetting measure per year?				£ -	
What is the value of changes in greenhouse gas emissions?				£ -	
Will the proposal have a significant impact on competition?				Yes	
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		-	-	-	-

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)	
Increase of	£ -	Decrease of	£ -	Net Impact	£ -

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Category 3 – changes to existing regime; options available

Article 2 – Scope

The scope of the Directive does not match exactly the scope of existing UK consumer credit legislation. Certain consumer credit agreements fall outside the scope of the Directive, which also sets a threshold and ceiling, and the definition of "consumers" to which the provisions of the Directive apply is narrower than is the case in UK legislation. The list below sets out these in more detail those types of agreements that Member States have the opportunity to include on an article-by-article basis:

- Lending to small businesses
- Loans below €200
- Loans above €75,000
- 2nd-charge mortgages
- Hire purchase agreements
- Interest-free credit (repayable within 3 months with only insignificant charges)
- Agreements from court settlement
- Pawnbroking

In relation to these potential exclusions, three options are being considered:

1. Do not extend the scope of the Directive to include all other types of lending currently outside of scope (listed above) – i.e. maintain the same exclusions as above
2. Extend the scope of the Directive to include all other types of lending currently outside of scope (listed above)
3. Extend the scope of the Directive for certain types of lending and under certain circumstances where it is deemed appropriate

The costs and benefits of including these categories of lending are evaluated below:

Option 1 – maintain existing exclusions within Directive

By maintaining the existing exclusions above, there are neither additional costs nor benefits associated with this option. This means that the total cost of implementation is the sum of all estimated costs under the individual articles – that is, one-off costs of **£34.7m-£132.2m** and ongoing costs of **£39.3m-£47.7m per annum**.

Option 2 – extend scope of Directive include all types of lending

Information received from a major lender about the costs associated with mandating compliance with the Directive across all additional areas covered by the Consumer Credit Act implies that one-off costs would increase by approximately 75% and ongoing costs would increase by approximately 10%.

Taking into account the figures presented above, this would imply a one-off cost of **£60.7m-£231m** and an ongoing cost of **£43.2m-£52.5m per annum**.

Option 3 – extend Directive for certain types of lending, where it is deemed appropriate

Below is a summary of how we intend to treat the respective types of credit agreements falling outside the scope of the Directive:

Business lending (up to £25,000) is caught by UK consumer credit legislation. We propose to apply the amending provisions of the Directive to such business lending with the exception of:

- advertising requirements (not currently covered by UK legislation);
- mandatory use of the SECCI (although pre-contractual information would still have to be provided, either via the SECCI or the existing regime, set out in the Disclosure Regulations);
- the requirement to provide adequate explanations (as small business loans generally involve bilateral discussions between lender and borrower, in any case);
- the right of withdrawal;
- the requirement to provide amortisation tables on demand;
- and the requirements on notifying changes to interest rates (which will, in any case, be caught by the Payment Services Directive).

Loans below €200 should be subject to the full requirements of the Directive. We would, however, retain the existing 'light-touch' treatment for loans below £50 allowed in UK law;

Loans above €75,000 should be subject to the Directive's requirements. But, except where a loan is for consolidation purposes (and the consumer is therefore likely to be in the same position as consumers with smaller loans and very probably already in difficulty), we propose not applying the following provisions of the Directive:

- mandatory use of the SECCI (although pre-contractual information would still have to be provided, either via the SECCI or the existing regime, set out in the Disclosure Regulations);
- the requirement to provide adequate explanations (because in the case of a loan of this size (other than a consolidation loan) the borrower is likely to be relatively well-informed and, very likely, taking legal advice);
- the right of withdrawal;
- the requirement to provide amortisation tables on demand.

Modifying credit agreements – we do not propose to take advantage of the 'light-touch' provisions permitted in the Directive, as consumers who have already fallen into difficulties need full protection. However, we propose retaining the current UK distinction between agreements on the one hand (subject to full information requirements), and unilateral concessions by a lender on the other (currently not subject to requirements).

Pawnbroking agreements should be subject to the same consumer credit rules as other credit agreements, including the amending requirements of the Directive. However, there may be merit in rationalising pre-contractual information requirements, as differences in the way this sector works means that some of the requirements do not work well for pawnbroking.

Charge cards – the Directive allows us to retain the existing exemption from consumer credit regulation for charge cards, where they are used to pay for goods and services (provided that only insignificant charges are payable). Such cards are currently regulated in the UK, only insofar as they allow cash advances and which attract a charge (and are therefore akin to credit products). We are doing more work to consider whether the Directive's exemption at article 2.2 (f) will enable the UK to continue to exempt charge cards, as well as the possible interaction for this product with the Payment Services Directive.

2nd-charge mortgages should continue to be subject to existing CCA provisions because this sector is currently under review and it would not therefore make sense to impose changes at this stage. However, as with business lending and loans above €75,000, we believe it would make sense to allow lenders to provide pre-contractual information and contractual information in the manner required by the Directive, if they wish.

Interest-free credit repaid within 12 months – as permitted by the Directive, we propose to retain an existing exemption under UK law for this form of credit.

Hire purchase agreements – we believe that treating these agreements differently from other consumer credit products could lead to consumer detriment; in particular, confusion about which rights would apply. On this basis we propose to apply the Directive’s requirements to such agreements.

Table: Summary of potential inclusions for option 3

Potential inclusions	Articles												
	4	5	5.6	6/12	8	10	11	13	14	15	16	19	21
Small business lending (up to £25,000)		✓	TBC	✓	✓	✓	✓	✓	TBC	✓	✓	✓	✓
Loans below €200	✓	✓	✓	✓	✓	✓	✓	✓	✓**	✓	✓	✓	✓
Loans above €75,000 (for debt consolidation)	✓	✓	✓	N/A	✓	✓*	✓	✓	✓	✓	✓	✓	✓
Loans above €75,000 (for other purposes)	✓		TBC			✓*	✓	✓		✓	✓	✓	✓
Second-charge mortgages													
Hire purchase	✓	✓	✓	N/A	✓	✓	✓	✓	✓		✓	✓	✓
Interest-free credit***	✓	✓	✓	N/A	✓	✓	✓	✓				✓	✓
Agreements from court settlement	✓	✓		N/A		✓	✓	✓			✓	✓	✓
Pawnbroking	✓	TBC		N/A		✓		N/A	✓		✓	✓	✓

* – except requirement for amortisation tables on demand

** – applies to loans above £50

*** – subject to further consideration of charge cards

Industry cost estimates suggest the implementation of article 2 would incur additional costs of between £0.5m-£1.6m for a large lender, which implies one-off industry-wide costs of **£5m-£17m**. It has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, which would imply industry-wide ongoing costs of **£0.5m-£1.7m per year**.

It would be expected that there will be ongoing costs associated with implementation, through increased time taken to process applications, though it has been difficult to quantify these in the time available. We would welcome any estimates that respondents could provide.

Article 5.6 – Adequate explanations

Under this article, Member States have to include a requirement to provide ‘adequate explanations’ regarding the terms and conditions of credit products. However, the extent of such explanations (including the extent to which such explanations are ‘adequate’) and the circumstances under which they must be given is subject to the decisions of individual Member States.

There are no specific requirements in UK legislation for creditors to give adequate explanations about the credit on offer, although some lenders will provide something akin to this depending on the exact circumstances. Despite the existence of pre-contractual and contractual information, many consumers do not actually read the information they are given and some

consumers do not understand the significance of key aspects of agreements they are entering into. Against this background, implementation of article 5.6 provides an opportunity to enhance understanding in a way which could reduce the incidence of consumers entering into unsuitable agreements or taking on unsustainable levels of debt. In this sense the requirement to provide adequate explanations complements the requirement in article 8 (creditworthiness): adequate explanations will ensure that consumers can better determine whether or not a loan is affordable while the requirement to check creditworthiness will ensure that lenders reach their own view on whether or not a consumer is creditworthy.

As such, there are no discrete 'options' to consider in relation to this article, but we have endeavoured to provide sufficiently contrasting examples of how this might be implemented and the associated consequences that might result.

Minimum: The absolute minimum would be to make clear in implementing legislation that it is the consumer's responsibility to decide whether or not he or she has enough information on which to make an informed decision as to the suitability of a product. It would therefore be for the consumer to decide whether or not explanations were adequate and to ask questions (possibly prompted by a pro forma/script). In some cases, particularly in situations where the individual actually selling a credit product did not have detailed knowledge about it and was only acting in an ancillary capacity, the consumer would be directed to a hotline (probably the lender's) for further inquiries.

Maximum: At the other end of the scale, the lender would be responsible for making a reasonable judgement of the consumer's level of understanding of at least a number of basic elements common to all credit products together with specific features of particular relevance to the type of credit being offered. This would require the lender to test the consumer's understanding and might be achieved by questioning the consumer (again, possibly initially on the basis of a standard pro forma/script).

There is a range of potential tools that could be used in achieving this objective, such as:

A standard pro forma – either to be given to the consumer in writing in order to draw his/her attention to important issues which he/she should take into account in any assessment of a product's suitability, or to be used as a speaking note to be delivered orally where this would be more appropriate.

The advantage of a written pro forma would be that it would enable lenders to demonstrate compliance with the requirement to provide adequate explanations (a particular concern of the industry). On the other hand, it would entail the consumer receiving yet another piece of paper alongside the standard pre-contractual information form, which would already set out key features of the proposed product and, in some cases (e.g. point of sale retail credit), the consumer would also receive contractual information at the same time.

Clearly there is a danger that receiving three separate documents simultaneously might actually contribute to information overload and discourage consumers from reading anything. It might therefore be appropriate in face-to-face situations to require the lender to take the consumer through any standard pro forma.

A checklist for lenders to check consumer level of understanding – for example, an explanation of the meaning of an APR, interest and how interest can compound over time to increase the size of a debt.

Prescribed list of features specific to the particular credit product or products, which should be explained – for example, in the case of credit cards, the order in which repayments will be allocated, where this is relevant. This could also include the information which must now be provided to consumers in monthly statements by virtue of CCA 06: the

consequences of only making minimum monthly repayments, the consequences of failing to make the minimum payment and the implications of potential future interest changes (these could be illustrated by examples).

Examples of how a product would work in practice -- in the case of running account credit, and particularly credit cards, the lender could be required to provide examples of the total cost according to different repayment patterns. Such examples could include amount of instalments, how much is charged at different points during the life of the agreement, size of the debt at various points during the life of the agreement etc.

Where agreements are open-ended (again, particularly in the case of credit cards), lenders could be required to provide standardised examples (e.g. repaid in six months, one year, three years, five years) to assist consumers make comparisons between alternative offers. In all cases example should be relevant to the individual consumer – i.e. tailored to the details of the proposed product, including the credit ceiling if one has been agreed. Explanations should include examples of what happens when a consumer defaults.

‘Star rating’ of products – an area which has been the subject of previous consideration is some kind of star rating system for credit products. It is not always easy for consumers to compare the advantages and disadvantages of different credit products and a rating system might help them by providing an overview of the relative merits of products in the same way that energy efficiency ratings are applied to some electrical products.

This has been considered in relation to credit cards, but advice from OFT concluded that rating systems would be of limited value as they couldn't take into account the behaviour of consumers using credit cards. Because they are flexible tools which can be used in a variety of ways, a simple ranking system could prove misleading to a consumer unless he/she used the card in the exact same way as the ranking system. Similar drawbacks apply to other credit products.

OFT have recommended the establishment of a cards comparison website, which would allow consumers to enter their planned payment behaviour and derive product listings which ranked cards accordingly. FSA officials are currently seeking to identify solutions to legal obstacles to the establishments of such a comparison site. As indicated above, lenders could, however, be required to signpost consumers to a comparison website once this is set up.

The requirements of article 5.6 may present an opportunity to tackle the issues of consumer understanding in relation to consumer credit and – along with article 8 (creditworthiness) – over-indebtedness. To this end, as well as describing the broad range of possible options, set out below is an initial proposal on which comments are welcome, but please note that this is intended to illustrate only one possible approach, recognising that it may require significant modification, or that an alternative approach might be preferable.

In the consultation document, it is proposed that there should be a general duty for lenders (and, where appropriate, intermediaries) to provide sufficient explanation about the features of their credit products to enable consumers to make informed choices and to decide whether or not a credit product would be suited to their needs. This might take the form of minimum standards (information requirements) with which lenders would have to comply, according to the type and size of credit offered. These minimum information requirements would include a combination of explanation and examples covering features common to all credit products as well as features specific to the credit products proposed.

The information falls into four categories:

- *basic generic information,*

- *additional generic information,*
- *basic product related information and*
- *additional product-specific information.*

The first two categories (*generic information*) would be standard for all products and would cover default, the right of withdrawal, basic information on the meaning of the APR, how interest works and how interest and charges can increase the cost of borrowing over time. The third category (*basic product related information*) would explain the component costs of the specific product(s) offered and, where appropriate, how interest rates might change and the effect this could have.

The information in the fourth category (*additional product-specific information*) would vary according to the kind of product and would take account of consumer risk and known information imperfections. For example, in the case of credit cards, the additional product-specific information would cover the dangers of making only minimum monthly repayments, how 0% balance transfers work, the order in which repayments are allocated and, if appropriate, terms and conditions for credit card cheques.

Not all categories of information would be required in all cases: it would depend upon the type and size of the credit offered (summarised in the table below).

Types of credit	Types of information			
	Basic generic information*	Additional generic information	Basic product-related information*	Additional product-specific information
Prime fixed sum loans	✓	Loans >£500	✓	
Sub-prime fixed sum loans*	✓	Total amount owed >£100	✓	
Consolidation loans*	✓	✓		
Credit cards	✓	✓	✓	e.g. how 0% balance transfers work; dangers of making only minimum repayments; order of repayments
Store cards	✓	✓	✓	e.g. (where interest rate exceeds a given level) that this is an expensive form of credit and signpost to comparison website (if appropriate)
Home credit*	✓	Total amount owed >£100	✓	e.g. (where interest rate exceeds a given level) that this is an expensive form of credit and signpost to comparison website (if appropriate)
Payday loans and cheque-cashing*	✓	Total amount owed >£100	✓	e.g. (where interest rate exceeds a given level) that this is an expensive form of credit and signpost to comparison website (if appropriate); the dangers of rolling-over loans

* This information must be given orally if F2F or telephone interaction

* Types of loans commonly accessed by more vulnerable consumers

Bills of sale* (where this applies to credit products)	✓	✓	✓	e.g. the danger of losing the vehicle on which the loan is secured, how it would be possessed and the loss this could entail.
Linked credit (hire purchase and conditional sale)	✓	Loans >£100	✓	Only for loans >£100: e.g. Goods could be repossessed in case of default;
Pawnbroking			✓	e.g. pledge would be sold if not redeemed and how much the consumer would get back in this case.

In terms of assessing the costs and benefits of these proposals, clearly some of these requirements could prove to be particularly onerous in some settings – for example, in the case of store cards or linked credit provided at the point of sale, where the environment might not be conducive to explanation and detailed creditworthiness checks.

Excessively onerous requirements could make some forms of lending impracticable and could increase costs, making smaller loans less viable. This could harm consumers by increasing costs (which would almost certainly be passed on to consumers), reducing competition and reducing the overall availability of credit. Some sub-prime consumers might find it even more difficult to access affordable credit and might be pushed towards illegal lending.

It would be expected that there will be (potentially significant) ongoing costs associated with implementation, through increased time taken to process applications, though it has been difficult to quantify these in the time available. We would welcome any estimates that respondents could provide.

On the other hand, enhanced explanation could improve consumer understanding and help reduce irresponsible lending (and borrowing).

The benefits derived from this could be substantial – a report by Debt Free Direct⁵⁷ found that stress related to debt problems caused 8.7 million lost working days in 2004, with more than 250,000 people absent for over a month, resulting in a cost to employers of £497m per year. If even 10% of these lost days can be avoided through reductions in indebtedness due to implementation of the Directive, this would result in an increase in productivity, with benefit both individuals and their employers of approximately **£50m per year**.

Whilst it is difficult to quantify some of the other costs associated with over-borrowing, such as financial distress and consequent impacts on ill health or relationship breakdown, a recent study by LSRC⁵⁸ estimated costs associated with debt problems to be in excess of £1,000 per individual. On the basis of recent survey data⁵⁹, which suggests that around 3.7m households consider their debts to be a ‘heavy burden’, if this number could be reduced by only 1% as a result of implementing this article, there could be potential one-off benefits to the economy of £37m. This has already been accounted for in discussion under article 11.

In addition, there may be benefits to firms through ensuring that credit is affordable to the consumer. This could lead to a reduction in bad debts to lenders, which currently represent a significant cost to the economy – latest figures suggest write-offs related to unsecured debt of

* Types of loans commonly accessed by more vulnerable consumers

⁵⁷ http://www.manchesteronline.co.uk/personalfinance/s/123/123594_debt_stress_takes_heavy_toll_on_workplace.html

⁵⁸ <http://www.lsrc.org.uk/publications/Impact.pdf>

⁵⁹ YouGov Debt Tracker, October 2008 – 15.5% of respondents consider their debts to be a ‘heavy burden’ (assuming approximately 25m households)

£6.3 billion over the last 12 months.⁶⁰ If this figure could be reduced by even 1 per cent through the implementation of the Directive, this would lead to benefits of **£63m per year**.

Article 8 – Creditworthiness

This article mandates the introduction of a new requirement to check ‘creditworthiness’, but there is still some uncertainty around how to define the term – e.g. based on affordability, or likelihood of repaying.

There is no specific requirement in UK law to check consumers' creditworthiness. However, the OFT can consider whether or not a lender has lent irresponsibly in its consideration of fitness to hold a consumer credit licence and, clearly, checking creditworthiness adequately is an aspect of responsible lending. Many lenders do check consumers' creditworthiness, but they will generally do this in order to assess the risk of default rather than the wider question of the affordability of a loan and the impact it could have on a consumer's financial well-being. There is therefore a question as to whether, particularly in the light of the outcome of borrowing patterns over recent years, lenders should be given greater responsibility for gauging whether a loan is affordable before granting credit.

Consumer over-indebtedness is a serious problem and implementation of article 8 provides an opportunity to strengthen existing provisions on responsible lending in order to reduce the incidence of consumers taking on unsustainable levels of debt. As indicated above in the section on article 5.6 (Adequate Explanations), the requirement for lenders to check consumers' creditworthiness complements the requirement in the Directive for lenders to provide adequate explanations: among other things, article 5.6 will enable consumers to understand better whether or not they can afford a loan and to borrow responsibly; the requirement to check creditworthiness will help ensure that the lender lends responsibly.

There is a range of possible scenarios, broadly equivalent to a ‘light-touch’ (i.e. low burden on business, but lower levels of consumer protection) and ‘heavy-touch’ (i.e. high burden on business, but high levels of consumer protection).

Minimum: The absolute minimum would be simply to require the lender to assess the likelihood of the consumer repaying credit either at all or within a reasonable timescale, making clear that it is the consumer's responsibility to decide whether or not credit is affordable. The lender would not have to consider the wider impact of a loan on the consumer's overall financial well-being. To comply with the requirement the lender would simply have to demonstrate that he had completed certain prescribed activities.

Maximum: At the other end of the scale, the lender would be responsible for judging the impact which the grant of credit would be likely to have on a consumer's economic circumstances, examining affordability and making reasonable assumptions about future trends in order to avoid the grant of credit causing or contributing to a consumer's over-indebtedness. He would be required proactively to seek information about the consumer's wider economic circumstances, including assets or income and existing financial commitments. The lender's decision could be open to scrutiny.

In terms of specific actions that lenders might be required to take, this could include:

Checking a consumer's credit status with a credit reference agency – this is something which many lenders already do and it will not always be appropriate in every case. Where information from a credit reference agency would be appropriate it might be necessary to specify what kind of information should be sought: for example, negative data on its own may not be enough.

⁶⁰ Write-offs on unsecured debt between Q3 2007-Q3 2008 (Source: Bank of England)

Seeking specific information from the consumer about earnings, outgoings and disposable income – if the lender is to take a degree of responsibility for establishing whether or not a loan is affordable, some account of the consumer's assets/income and financial commitments will be necessary. Questioning in this area would also have the advantage of helping the consumer understand whether or not a loan was affordable. Depending on the type of loan it might be appropriate to go into a greater or lesser level of detail or to seek details on one or more of these factors.

Verifying the above information – it may not always be appropriate simply to take information provided by the consumer at face value – for example, it might be appropriate to request copies of a wage slips/bank statements and even to verify these where there is doubt about their authenticity. The lengths to which the lender might be expected to go to verify information would depend on the degree of responsibility imposed on him for ensuring that a loan was actually affordable.

Modelling repayment according to standard, prescribed repayment periods in order to avoid unrealistic assumptions – it may not always be appropriate to judge affordability on the basis of excessively long repayment periods. The cost of a relatively small loan could be disproportionately high if it is paid back at a high rate of interest over an extended period and it becomes questionable whether a loan is truly "affordable" if the consumer takes on an extended financial commitment which will impact negatively on his or her overall finances in return for relatively little benefit.

In the case of linked credit, for example, the term of the loan should not exceed the assumed life of the asset financed. In the case of credit cards, basing the assessment on whether or not a consumer can afford minimum monthly repayments may similarly provide a poor indicator of affordability.

A possible solution would be to prescribe maximum periods during which loans must be assumed to be repaid. We understand that this approach has been adopted in Switzerland, where it has to be assumed that borrowing on credit cards must be repaid within three years. A similar approach could be taken to running account credit products generally and in the case of fixed-sum loans, lenders could be prohibited from taking account of the possibility of extending the original term of the loan when assessing affordability.

Similarly to consideration of article 5.6 (adequate explanation), it is proposed that there should be a general duty for lenders (and, where appropriate, intermediaries) to base their lending decisions on a reasonable assessment of consumers' creditworthiness. There would then be additional minimum standards with which lenders would have to comply, according to the type and amount of credit offered.

As with adequate explanations, as well as describing the broad range of possible options, set out below is an initial proposal on which comments are welcomed, but this is intended to illustrate only one possible approach – it is recognised that this might need significant modification and an alternative approach might be preferable. As a guide, we are proposing three levels of creditworthiness-checking according to a combination of the size of the loan and the kind of credit offered (summarised in the table below):

1. *Level 1* – Lenders would either have to check a consumer's credit status by obtaining relevant data from a credit reference agency or take a reasonable view of the consumer's creditworthiness on the basis of information provided by the consumer concerning existing income and credit commitments;

2. *Level 2* – In addition to Level 1, lenders would be required proactively to seek evidence from consumers (except where information had already been obtained from a credit reference agency or other data source) sufficient to enable the lender to estimate the consumer's disposable income on the basis of total income and financial commitments. In the case of running account credit agreements, the lender would be required to base his assessment of affordability on a maximum repayment period of three years and lenders would be prohibited from relying on the possibility of extending the original term of the loan. The lender would also be required to make reasonable assumptions about future economic or other changes, particularly bearing in mind the possibility of interest rate increases
3. *Level 3* – In addition to Levels 1 and 2, lenders would be required to take appropriate steps to verify information provided by the consumer, taking a reasonable degree of responsibility for ensuring its accuracy. The lender would also take steps to be certain whether the consumer's financial or other relevant circumstances might change and to take account of relevant personal commitments. Finally, the lender would be required to ask the consumer to reveal any other information which might be relevant to a decision to lend.

Types of credit	Levels of checks			
	Base level	Level 1	Level 2	Level 3
Prime fixed sum loans	✓	✓	Loans >£500	Loans >£1000
Sub-prime fixed sum loans*	✓	✓	✓	
Consolidation loans*	✓	✓	✓	Agreed ceiling >£300
Credit cards	✓	✓	✓	Agreed ceiling >£500
Store cards	✓	✓	✓	Agreed ceiling >£500
Home credit*	✓	✓	✓	Agreed ceiling >£300
Payday loans and cheque-cashing*	✓	✓	✓	Loans >£300
Bills of sale*	✓	✓	✓	Loans >£300
Linked credit (hire purchase and conditional sale)	✓	✓	Loans >£500	Loans >£1000
Pawnbroking	Customer liability = pledged item	Customer liability = pledged item	Customer liability = pledged item	Customer liability = pledged item

In terms of assessing the costs and benefits of these proposals, clearly some of these requirements could prove to be particularly onerous in some settings – for example, in the case of store cards or linked credit provided at the point of sale, where the environment might not be conducive to explanation and detailed creditworthiness checks.

Excessively onerous requirements could make some forms of lending impracticable and could increase costs, making smaller loans less viable. This could harm consumers by increasing costs (which would almost certainly be passed on to consumers), reducing competition and reducing the overall availability of credit. Some sub-prime consumers might find it even more difficult to access affordable credit and might be pushed towards illegal lending.

It would be expected that there will be (potentially significant) ongoing costs associated with implementation, through increased time taken to process applications, though it has been difficult to quantify these in the time available. We would welcome any estimates that respondents could provide.

On the other hand, enhanced creditworthiness checking could improve consumer understanding and help reduce irresponsible lending (and borrowing).

As for article 5.6 (adequate explanations), the benefits derived from this could be substantial – to consumers, in terms of avoiding working days lost due to debt-related stress and reduction in over-indebtedness, and to firms in the reduction of debt write-offs.

Article 10 – Credit agreement information

Article 10 specifies the information that must be provided to the consumer at the contractual stage. The information listed in article 10 is very similar to that listed in article 5 (pre-contractual information).

In terms of contractual information that has to be provided with credit agreement, it is likely that – as a result of implementing article 10 – the amount of discretion that lenders have in determining its presentation will increase. This is because article 10 is far less prescriptive on the form and ordering of information as compared with the requirements in the relevant 1983 regulations.

In addition to setting out requirements on information to be included in a credit agreement, article 10.1 provides that all consumers should receive a copy of the agreement. As discussed in the chapter on article 10 in the consultation document, we have been considering various options as to how the existing Consumer Credit Act provisions (ss62-63) should be tailored to meet this requirement. These options are repeated below:

Option 1

Amend section 63 (duty to supply copy of executed agreement) so that consumer gets (a) notification of the date on which the agreement was executed and (b) confirmation that the agreement has not been changed rather than a copy of the executed agreement itself where they already have a copy of unexecuted agreement by virtue of section 62.

Option 2

Amend section 62 (duty to supply copy of unexecuted agreement) so that the consumer does not get a copy of the unexecuted agreement after signing the original and sending/handing it back. This would mean that in some cases after signing, the consumer may not have all the necessary information as to the agreement they have signed up to in the period leading up to the beginning of the 14 day right of withdrawal period.

Option 3

Repeal 62 and replace section 63(1) with obligation to provide a copy of the executed agreement except where the creditor has already provided before the agreement has been made a copy of the agreement or a draft agreement to comply with a request made under Article 5.1r). In that case, the creditor should be permitted to treat that copy (provided it remains unchanged from the executed agreement) as the copy of the executed agreement, by giving the borrower written notice that the agreement is made and that the lender is treating the copy already supplied as the copy of the executed agreement. Additionally the provision should require written notice to inform the borrower that during the cooling off period, the borrower has the right to be supplied on request and free of charge with a further copy of the executed agreement.

Costs

According to industry estimates, the cost for implementing article 10 varies between £0.3m and £2.3m for a large lender. This would imply an industry-wide implementation cost of **£3m-£24m**.

It has been suggested by industry stakeholders that ongoing costs represent around 10% of these one-off costs, which would imply industry-wide ongoing costs of **£0.3m-£2.4m per year**.

None of the above options would seem to impose an additional cost on lenders as compared with the current situation, given that in many cases the draft agreement can be expected to remain unchanged – therefore, no further copies of documents would be required under option 1 and 3. The same is so under option 2, although it is possible that in some situations the consumer would be left without a copy of the agreement for their retention in the period leading up to the agreement becoming executed. This can be an important safeguard to deter dishonest practice, such as where an unscrupulous lender increases the APR in the hope that the consumer does not notice.

Benefits

The principle benefit involved with all three options is a reduction in the need to provide additional copies of credit agreements. The options set out above are designed to minimise this possibility, to avoid unnecessary bureaucracy and information overload, while at the same time ensuring consumers have the necessary information at their disposal in order to decide whether to exercise their right to withdraw from the credit agreement.

Scope: It is proposed that this article will be applied to all agreements covered by the Consumer Credit Act but outside the scope of the Directive, with the exception of 2nd-charge mortgages.

Article 15 – Linked credit agreements

Under section 75 of the Consumer Credit Act 1974, the UK already has amongst the highest levels of consumer protection in Europe, in terms of the joint and several liability of both supplier and creditor. This means that consumers can raise any problems with either the supplier (of the goods/service bought through the credit agreement) or the creditor (the party with whom the customer has signed the credit agreement). In addition, customers can refuse further payment once goods have been delivered or service rendered and can also claim return of payments made, as well as damages if goods are not complete or not in conformity with the contract.

Article 15.1 provides that – where the consumer has exercised a right of withdrawal from a contract for the supply of goods and services, and that right is based on EU law – she is no longer bound by a linked credit agreement.

We consider that the UK is already in compliance with article 15.1 and no action is needed to implement it.

Article 15.2 contains protections for consumers where a transaction to purchase goods or services is financed by a linked credit agreement, as long as the amount of the credit agreement is not less than €200 and not more than €75,000. If there is a problem with the transaction, the consumer must first try to rectify this with the supplier; if she is unable to do so, she can pursue the creditor. Article 15.3 allows Member States to retain national rules covering joint and several liability, where these provide equivalent or higher levels of protection than article 15.2 – this means that we can maintain our existing regime under section 75.

However, in some respects section 75 offers greater consumer protection than article 15.2, but in other respects it offers less.

For example, section 75 currently covers purchases (rather than credit agreements) of more than £100 and more than £30,000. Therefore, it applies even if the consumer has paid most of the price in cash, as long as at least £101 has been paid by credit. Section 75 does fall short of the protection offered by article 15.2, in that it does not cover situations where the cash price of the item is less than £30,000 and the amount of the credit agreement is not more than €75,000.

We will therefore maintain section 75 but must cover the shortfall in protection in order to meet implementation of the Directive.

There are 2 options for covering this shortfall in protection:

1. Raise the ceiling in section 75 so that it applies where the cash price of the item purchased is not more than €75,000

This would offer additional consumer protection, although the number of agreements covered is likely to be relatively small. This option is potentially costly for creditors, since the consumer does not have to pursue the supplier first in the event of a problem and liability is not proportionate to the amount of the credit agreement (a small amount paid on credit gives liability for the whole amount of the purchase). However, we do not believe that raising the ceiling alone would guarantee coverage of credit agreements up to €75,000 and ensure we fully implement article 15.2.

2. Keep section 75 unchanged and apply the protections in article 15.2 to the shortfall (i.e. purchases where the cash price of the item is more than £30,000 and the amount of the credit agreement is not more than €75,000).

This would ensure that we fully implement article 15.2 while minimising the costs on business, hence it is our preferred option.

Costs

In relation to article 15.1, there will be no impact on costs for businesses, as no action is needed to implement it.

In relation to articles 15.2 and 15.3, there are potential costs for creditors in terms of how far they are liable for problems in respect of the supply of goods and services for higher-value purchases: whether they are liable for the purchase price or the amount of the credit agreement and whether or not the consumer must pursue the supplier first. This will vary according to the different options above.

As a representative example, assume a consumer buys a car costing £50,000, paying a deposit of £5,000 on a credit card and £45,000 in cash. Subsequently, she crashes the car.

- Under option 1, if the consumer is unable or unwilling to pursue the manufacturer for the cost of the car, the creditor is liable for the whole £50,000.
- Under option 2, the consumer would have to pursue the supplier first and the creditor is only liable for £5,000 (being the amount of the credit agreement), in the event the consumer did not receive satisfaction from the supplier.

Actual costs will occur only when there is a problem and the consumer pursues the creditor to resolve this.

According to one industry estimate, around 5 claims per month are made for purchases in excess of the current ceiling of £30,000 and significantly more would be made if the law covered purchases over £30,000. If those claims were all successful, assuming an average amount of £40,000, this would result in an increased potential annual liability of around £2.4m for a large lender. Across the whole industry, this could amount to around **£25m per year**.

In terms of implementation costs, industry estimates suggest that these would be negligible, ranging from zero to £0.1m for a large lender. It is more likely that the potential liability identified above is the more appropriate cost to consider.

Benefits

For article 15.1, there will be no additional benefit for consumers, as the UK has already fulfilled requirements under article 15.1.

For articles 15.2 and 15.3, both options will provide some additional benefit for consumers, as protection would be extended to higher-value purchases than is the case now. However, the overall benefit for consumers may be small, as the additional number of agreements covered is likely to be small.

Scope: There are no scope issues for article 15, as we are not proposing to apply article 15.2 to agreements outside the scope of the Directive.

Article 16 – Early repayment

Article 16 gives consumers the right to discharge her obligations under a credit agreement (fully or partially) at any time, and the right to a reduction in the total cost of credit corresponding to the interest and costs applicable to the remaining duration of the contract. It also gives lenders the right to compensation for the cost of early repayment provided that the early repayment falls within a period for which the borrowing rate is fixed, within certain limits.

The UK already has an early repayment regime, with the Early Settlement Regulations 2004 covering a wide range of situations in which agreements are terminated early (including cases of default), which is beyond those only where early settlement is requested by the consumer (as proposed under the Directive). However, there are two substantive differences:

- The current UK regime does not provide for partial early repayment, and
- The current UK regime does not make a distinction between variable and fixed-rate loans

In relation to **full** early repayment arrangements, we are proposing to retain this almost unchanged (including the option for creditors to recoup set-up costs and the administrative cost of early repayment). Therefore, the cost for creditors relating to this should be minimal and there is no additional benefit for consumers.

However, the UK does not already have provisions to cover **partial** early repayment, so we are also proposing to extend this regime to cover partial early repayment.

The article also provides a right for creditors to compensation for costs directly linked to early repayment where the borrowing rate is fixed. There are two options for Member States relating to this compensation:

1. Allow compensation only where total annual early repayments exceed €10,000
2. Allow higher compensation in 'exceptional circumstances', which are as yet undefined under the Directive

Such compensation is not currently a feature of the UK early settlement regime (introduced in 2004/5), which was considered to provide an appropriate and fair balance between consumers and creditors. We have no evidence that this is no longer the case and therefore wish to maintain the balance of the system as far as possible.

We are therefore retaining our current full early repayment regime. We have to allow for some additional compensation to creditors under article 16.2, but we do not consider that there is a good argument for disturbing the balance by allowing more than the minimum. Therefore, we propose to take up the first of these options.

Costs

The regime that covers full early repayment was introduced under the Early Settlement Regulations in 2004. It may be likely that the costs incurred by industry in extending these provisions to also cover partial early repayment may be of a similar order of magnitude⁶¹.

However, cost estimates provided by industry for implementing article 16 are significantly less than this – implementation costs of between £0.3m-£1m for a large lender, which implies industry-wide costs of **£3m-£10m**. On the basis that ongoing costs represent around 10% of these one-off costs – as suggested by industry stakeholders – this would imply industry-wide ongoing costs of **£0.3m-£1m per year**.

Benefits

There may be a benefit to consumers, as they will have increased opportunities to reduce their levels of indebtedness and may be able to pay off their debts earlier than otherwise, through partial early repayment of outstanding debts.

However, without better data on the proportion of credit agreements on which consumers would like to make partial early repayments, it is impossible to quantify this.

Scope: It is proposed that the right to repay early should be applied to the following agreements covered by the Consumer Credit Act but outside the scope of the Directive – loans below €200, loans above €75,000, hire purchase and conditional sale agreements, pawnbroking, loans above £25,000 to small business and modifying agreements as outcomes of court settlement.

⁶¹ One-off costs of £160m-£180m; ongoing costs of £2m per annum

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	No

Competition Assessment

Standardising information provision for consumer credit should facilitate comparison of credit products across suppliers throughout the EU. This should broaden the choice available to consumers, which in turn should increase competition amongst credit providers. This could result in lower prices and dynamic benefits through increased incentives for innovation.

A priori, it is difficult to assess the extent of this positive impact on competition, but implementation of the Directive is certainly not likely to result in any reduction in competition.

Small Firms Impact Test

It has not been possible to assess what proportion of UK consumer credit is accounted for by small and medium-sized firms. However, analysis for the Consumer Credit Legislative Reform Order in 2008 suggested that an approximation of the overall market structure for consumer credit was 14 large firm and roughly 150 small firms.

Without information on how cost structures vary for the different sizes of firm, it is difficult to say how the impact of implementing the Directive might differ according to the size of firm. On the one hand, it is likely that the costs associated with the provision of information requirements might be disproportionately higher for smaller firms, given that they would be expected to account for a lower level of activity related to consumer credit. However, on the other hand the cost impact may be not be so large for smaller firms, if trade associations produce a standardised form. In this way, economies of scale will mean that the costs to members of providing information can be mitigated.

Race Equality

After initial screening as to the potential impact of this policy/regulation on race equality, it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact, or both

Disability Equality

After initial screening as to the potential impact of this policy/regulation on disability equality, it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact, or both

Gender Equality

After initial screening as to the potential impact of this policy/regulation on gender equality, it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact, or both