COMMISSION OF THE EUROPEAN COMMUNITIES

Amended proposal for a Council Directive amending Directive 87/102/EEC
for the approximation of the laws, regulations and administrative
provisions of the Member States concerning consumer credit

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(presented by the Commission pursuant to the
third paragraph of Article 149 of the EEC Treaty)

Amended proposal for a Council Directive amending Directive 87/102/EEC for   2
the approximation of the laws, regulations and administrative provisions of the
Member States concerning consumer credit

The Council adopted Directive 87/102/EEC, concerning consumer credit,
on 22 December 1986.[1]

Following Parliament's Resolution[2] concerning the Commission's original
proposal[3] and Parliament's suggestions for amendment of it[4], the
Commission issued an amended proposal in 1984[5] which, as desired by
the European Parliament, provided for the establishing of a uniform
method of calculating the annual percentage rate of charge for credit.

The ninth recital and Article 5 of the Directive 87/102/EEC of 22 December
1986 duly anticipate the introduction of a Community method or methods
of calculating the annual percentage rate of charge for credit.

For the purposes of calculating the annual percentage rate of charge it
is necessary:

1. to use a mathematical formula;

2. to bring into account the various items of charge, including the
    interest.

The Commission has had many discussions with government experts from all
the Member States upon those two essential questions: mathematical
formula and items of charge. By the middle of 1988 there was no
consensus on the latter point, but the willingness on the part of most
Member States to require their lenders to use the present value method
recommended by Professor E S Kirschen, the Commission's consultant in
the matter, in his Report dated 19 October 1984, persuaded the Commission
to make a proposal[6] for a directive which was confined to the mathematical
aspects alone. The proposal engendered such lively discussion in Member
States that by March 1989 ten Member States had announced that they were
willing to adopt the method proposed by the Commission, and many Member
States were ready to treat at the same time the difficult problem of
which items of cost are to be brought into account for the purpose of
calculating the annual percentage rate of charge.

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1 OJ No L 42, 12.2.1987, p.48
2 OJ No C 242, 12.9.1983, p.10
3 OJ No C 80, 27.3.1979, p.4
4 OJ No C 68, 14.3.1983, p.91
5 OJ No C 183, 10.7.1984, p.4
6 OJ No C 155, 14.6.1988, p.10

Both the Economic and Social Committee[1] and Parliament[2] considered that the time was ripe to regulate not only the mathematical aspect but also the items of cost.

The Commission has accordingly amended its proposal published in June 1988. This amended proposal deals both with the mathematics and with the items of cost. The mathematical formula here proposed is the same as in June 1988.
The basic approach so far as the costs element is concerned is that all items of cost which the consumer must pay as a condition of obtaining the credit will have to be brought into account for the purpose of making the calculation, but that certain charges which sometimes arise - and may then have to be paid by the consumer - are to be excluded from the calculation. These items of charge are set out in detail in the proposed new Article 1a, paragraph 2(b).

Having identified the items of cost which have to be brought into account for the purpose of making the calculation, it will always be possible to calculate the true percentage rate of the cost of credit to the borrower (the "annual percentage rate of charge") provided that the two other essential factors are known, namely (1) the period of duration of the credit and (2) the interest rate. In cases where these essential factors are not known it will be necessary to make certain assumptions concerning them. These are set out in the proposed new Article 1a.

The Directive is based on Article 100a of the Treaty and aims at a high level of protection. It does not create special problems for less developed economies. There is, therefore, no need to propose provisions appropriate to their case.

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1 ECOSOC Opinion contained in OJ No. C 337 of 31.12.88, p.1

2 EP Report Doc. A2-418/88, 6.3.1989; EP Resolution of 15.3.1989
   (to be published in the OJ); EP Minutes of the Plenary Session,
   15.3.1989

COMMENTARY ON THE ARTICLES

Article 1 amends the definition of "annual percentage rate of charge" (hereinafter referred to as "APR"). The objective of the amendment is to establish that the APR is henceforth to be calculated in accordance with the Community's uniform method, and not "according to existing methods of the Member States" (which are the words used in the definition contained in Directive 87/102/EEC of 22 December 1986).

Article 1 also provides for the insertion into that Directive of a new Article, to be numbered Article 1a, which does the following things:

- it establishes a uniform method for the calculation of the APR;

- it determines which items of cost are to be brought into account for the purpose of making the APR calculation;

- it indicates in what manner the APR is to be calculated in the case of credits whose rate of interest, period of duration or repayment timetable is capable of being amended.

Article 1 further amends Directive 87/102/EEC by inserting into Article 4 (2) thereof three new subparagraphs each of which requires specific information to be furnished to the consumer borrower relating to:

- the amounts of money which he must pay in reimbursement of the credit and in payment of the interest and other charges;

- the items of cost which have not been included in calculating the APR but which the consumer may in certain circumstances be called upon to pay;

- specific conditions (other than those referable to the credit nature of the agreement) to which the granting of the credit is subject, such as, for example:

    (i) that the consumer must conclude a certain insurance or certain insurances, or

    (ii) that the consumer must achieve certain savings which are to be placed on a particular account, or

    (iii) that the consumer must be or become a member of a certain club, association or cooperative.   ./.

Article 1 also provides that the Annex to Directive 87/102/EEC is to be renumbered "Annex I"; and adds to that Directive two further Annexes which contain the mathematical formula for calculating the APR, together with a simple illustration of its application (Annex II), and three further examples of calculations in which that formula is used (Annex III).

Article 2 fixes the implementation date at 31 December 1992 and requires Member States to communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 3 addresses the Directive to the Member States.

C O M M I S S I O N

Amended proposal for a Council Directive amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit

ORIGINAL PROPOSAL	AMENDED PROPOSAL
THE COUNCIL OF THE EUROPEAN COMMUNITIES,	
Having regard to the Treaty establishing the European Economic Community, and in particular Article 100A thereof,	unchanged
Having regard to the proposal from the Commission,	unchanged
In cooperation with the European Parliament,	unchanged
Having regard to the opinion of the Economic and Social Committee,	unchanged
Whereas it is desirable, in order to promote the establishment and functioning of the internal market and to safeguard its consumers at a high level of protection, that, despite the differences in development of certain economies, one method of calculating the annual percentage rate of charge for credit should be used throughout the Community;	unchanged
Whereas Article 5 of Council Directive 87/102/EEC[1] anticipates the introduction of a Community method of calculating the annual percentage rate of charge for credit;	unchanged
Whereas it is desirable, as a first step towards the establishing of such a method, than an appropriate mathematical formula be laid down for the purpose of calculating the annual percentage rate of charge; whereas it is useful to adopt common rules concerning such a formula, although the cost items which will have to be taken into account in calculating the annual percentage rate of charge remain to be determined,	deleted

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(1) OJ No. L 42, 12.2.1987, p. 48

HAS ADOPTED THIS DIRECTIVE :

Article 1

Council Directive 87/102/EEC is hereby amended as follows :

1. In Article 1(2)(e), the definition of "annual percentage rate of charge" is replaced by the following :

   ' "annual percentage rate of charge" means the total cost of the credit to the consumer, expressed as an annual percentage of the amount of the credit granted and

   calculated in accordance with Article 1a of this Directive'

2. The following Article 1a is inserted :

   'Article 1a

   1. For the purpose of stating the annual percentage rate of charge for credit, the rate which equalizes the present values of the prospective or actual commitments of the lender and borrower shall be calculated in accordance with the method set out in Annex II.

2. The following Article 1a is inserted :

   'Article 1a

   1(a) The annual percentage rate of charge, which is the rate which equalizes, on an annual basis, the present values of all commitments (loans, repayments and charges), existing or future, entered into by the creditor and the borrower, shall be calculated in accordance with the mathema-formula set out in Annex II.

   (b) A simple illustration is given in Annex II. Further examples of calculations are given in Annex III.

2. The annual percentage rate of charge shall be calculated at the time of concluding an agreement for credit.

2(a) For the purpose of calculating the annual percentage rate of charge, the total cost of the credit to the consumer shall be ascertained by including every item of cost which the consumer must pay as a condition of obtaining the credit, including interest and all other charges.

(b) For the purpose aforesaid the following items shall not form part of the total cost of the credit to the consumer :

(i) charges payable by the consumer if he fails to comply with his obligation under the credit agreement;

(ii) charges which, in a transaction of purchase of goods or services, the consumer is obliged to pay irrespective of whether he purchases for cash or by means of the credit;

(iii) charges payable by the consumer for the transmission of money in reimbursement of the credit and in payment of the interest and other charges, if the creditor imposes upon the consumer special and onerous requirements in this respect. However, if the creditor is obligged to pay charges for receiving the consumer's payments

relating to the credit, these charges shall be included in the total cost of the credit to the consumer if the creditor recoups them from the consumer;

(iv) charges payable by the consumer for or related to services or benefits which are both incidental to the credit agreement and payable pursuant to an obligation existing before the consumer entered into the credit agreement (such as a subscription for membership of a club, association or cooperative);

(v) premiums for insurances or guarantees which do not have the objective of ensuring or securing payment to the creditor in the event of the death, sickness or unemployment of the consumer, of a sum equal in amount to that of the credit, with interest and other charges, or to parts thereof;

(vi) premiums for insurances or guarantees which, although their purpose is to ensure or to secure such payment, are nevertheless not paid pursuant to an obligation imposed upon the consumer by the creditor and accordingly cannot be regarded as being payable "as a condition of obtaining the credit";

(vii) premiums for the insurance of motor vehicles, unless the cover exceeds the statutory requirement of insurance for damage to third parties and the increased insurance is contracted by the consumer pursuant to an obligation imposed by the creditor and must accordingly be regarded as being payable "as a condition of obtaining the credit".

3(a) The annual percentage rate of charge shall be calculated as at the time of concluding the credit agreement; but this rule is without prejudice to the provisions of Article 3 relating to advertisements and offers.

(b) The calculation shall be made on the assumption that the credit agreement runs for its agreed period and that the creditor and the consumer perform their obligations thereunder in the manner and at the time of times agreed.

4. Where a credit agreement contains terms
   whereunder the rate of interest and the
   amount or rate of the other items of cost
   can be varied, the annual percentage rate
   of charge shall be calculated on the basis
   that the relevant rate or amount remains
   fixed at that applicable at the time of
   conclusion of the credit agreement.

5. Where the amount of an item or items of cost
   affecting the calculation of the annual
   percentage rate of charge has not been
   specified beyond doubt in the credit agree-
   ment, the annual percentage rate of charge
   shall be calculated on the basis of the
   following assumptions : :

   - if no credit limit is stated in the credit
     agreement, that the amount of credit
     granted is equal to an amount fixed by the
     relevant Member State, not exceeding the
     equivalent of two thousand ECUs;

   - if the credit agreement contains no fixed
     timetable for the making of payments by
     the consumer in reimbursement of the
     credit, with interest and other charges,
     that the duration of the credit agreement
     is one year;

   - unless otherwise specified, that the
     amount of the credit will be made
     available and that the payments in
     reimbursement of the credit, with interest
     and other charges, will be made at the
     earliest moment provided for in the
     credit agreement."

3. The use in a Member State of a method
   of calculation other than that shown
   in Annex II shall be allowed only if
   the resulting annual percentage rate
   of charge does not diverge by more
   than one tenth of one per cent from
   the rate of charge yielded by the
   method shown in the said Annex.

6. The use in a Member State of a method of
   calculation other than that shown in Annex II
   shall be allowed only if the resulting
   annual percentage rate of charge does not
   diverge by more than one tenth of one
   percentage point from the rate of charge
   yielded by the method shown in that Annex.

4. In the case of credit on current
   account, the method of calculation
   shown in Annex II shall be applied on
   the basis of the assumptions set out
   in Annex III.

Deleted

3. The following subparagraphs (c)(d) and (e) are inserted in Article 4(2) :

"(c) a statement of the amount in money, and the number and periodicity of the payments to be made by the consumer in reimbursement of the credit and in payment of the interest and other charges; and a statement of the total of those money amounts;

(d) a statement of the items of cost which have not been included in calculating the annual percentage rate of charge but which the consumer may nevertheless in certain circumstances have to pay for or in connection with the credit; and also a statement specifying those circumstances. Where the true amounts of these items, in money, are known they shall be stated; otherwise they shall be stated as estimates made as realistically as possible;

(e) a statement of the relevant conditions in cases where the credit is granted subject to conditions which are not specifically referable to the credit nature of the agreement, such as for example :

- that the consumer must conclude a certain insurance or certain insurances, or

- that the consumer must achieve certain savings which are to be placed on a particular account, or

- that the consumer must be or become of a certain club, association or cooperative."

3. Article 5 of the said Directive is repealed.

Deleted

4. The Annex becomes Annex I. Annexes II and III in the Annex to this Directive are added.

4. The Annex becomes Annex 1; and Annexes II and III contained in the Annex to this Directive are added.

Article 2

Member States shall take the necessary measures to comply with this Directive not later than 31 December 1992 and shall forthwith inform the Commission thereof. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 2

1. Unchanged

2. The provisions adopted pursuant to the first subparagraph shall make express reference to this Directive.

Article 3

This Directive is addressed to the Member States.

Article 3

Unchanged

ANNEX

Annex II

The basic equation

The general formula

The lender advances a sum S.

Borrower repays in n payments, numbered 1, 2, 3 ... t_k ... n.

These payments are not necessarily of equal amount, nor are the intervals between them necessarily of equal length. The dates to be considered are the date of the loan and the dates of the repayments.

Payment k is made t_k years after the date of the loan

(t_k being not necessarily a full number).

The effective annual rate is i.

The equation which equalizes the present values of the loan and repayments by the borrower is as follows:

$$S = \sum_{k=1}^{n} \frac{A_k}{(1+i)^{t_k}}$$

This enables i to be calculated provided <u>that the amount of each payment A_k is known.</u> (*)

Inversely, the amount of a repayment can be calculated in this way if one knows the amounts and dates of other repayments, and the effective annual rate i.

A simple illustration

S = 1 000 ECU

Two repayments: 1 and 2
 (n = 2)
of 600 ECU each.

The payments are of equal amount.

The payments are made at equal intervals, after one and two years, respectively

($t_1 = 1$ and $t_2 = 2$).

The effective annual rate is i.
The equation then appears as follows:

$$1\ 000 = \frac{600}{(1+i)} + \frac{600}{(1+i)^2}$$

The loan = the present value of the first payment plus the present value of the second payment.

This is a quadratic equation with i, which can be solved by algebra:
i = 0,1306623 ...

This can be rounded off to i = 13,1 or 13,07 % depending on whether the State, or usage permits a margin of tolerance of 1 or 2 decimal points.

If the payment at the end of the first year was reduced from 600 to 500 ECU, and if i was rounded off to 13,1 %, payment at the end of the second year would be 713,66 ECU (linear equation).

(*) The amendments to the original proposal are underlined.

Annex III

Adaptation of the method of calculation shown in Annex I to the case of running account credit

Where the annual percentage rate of charge is to be indicated in relation to an agreement for credit on a current account, the following assumptions shall be made :

(a) the rate of interest does not change;

(b) (i) if there is no fixed timetable for payment, the duration of the credit is one year;

   (ii) if there is a fixed timetable for payment, it is observed by the borrower;

(c) (i) if the agreement specifies a credit limit, the credit granted is equal to that limit;

   (ii) if no credit limit is stated in the agreement, the credit granted is equal to the amount fixed by the relevant Member State, not exceeding 200 ECU;

(d) unless otherwise specified, the credit is made available and the payments are made at the earliest moment provided for in the agreement."

AMENDED PROPOSAL

Annex III

Further examples of Calculations

First example

Sum loaned S = ECU 1 000.

It is repaid in a single payment of ECU 1 200 made 18 months, i.e. 1,5 years, after the date of the loan.

The equation becomes $1\ 000 = \dfrac{1\ 200}{(1+i)^{1,5}}$

$$\text{or } (1+i)^{1,5} = 1,2$$
$$1+i = 1,129243\ldots$$
$$i = 0,129243\ldots$$

This amount will be rounded off to 12,9% or 12,92% depending on whether the State or usage permits a margin of tolerance of 1 or 2 decimal points.

Second example

The sum agreed is S = ECU 1 000 but the creditor retains ECU 50 for enquiry and administrative expenses, so that the loan is in fact ECU 950; the repayment of ECU 1 200, as in the first example, is made 18 months after the date of the loan.

The equation becomes

$$950 = \frac{1\ 200}{(1+i)^{1,5}}$$

$$\text{or} \quad (1+i)^{1,5} = \frac{1200}{950} = 1,263157$$

$$1+i = 1,16851...$$

$$i = 0,16851...$$ rounded off to 16,9 or 16,85% depending on whether the State or usage permits a margin of tolerance of 1 or 2 decimal points.

Third example

The sum lent is ECU 1 000 and the amounts to be paid by the borrower are:

After three months (0,25 years)   ECU   272
After six months   (0,50 years)   ECU   272
After twelve months (1 year)   ECU   544

Total   ECU 1 088

The equation becomes:

$$1\ 000 = \frac{272}{(1+i)^{0,25}} + \frac{272}{(1+i)^{0,50}} + \frac{544}{1+i}$$

This equation allows i to be calculated by successive approximations, which can be programmed on a pocket computer.

The result is:

i = 0,1321 rounded off to 13,2 or 13,21%, depending on whether the State or usage permits a margin of tolerance of 1 or 2 decimal points.