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COMMISSION STAFF WORKING DOCUMENT

Guidelines on the application of Directive 2008/48/EC (Consumer Credit Directive) in relation to costs and the Annual Percentage Rate of charge

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GUIDELINES ON THE APPLICATION OF DIRECTIVE 2008/48/EC (CONSUMER CREDIT DIRECTIVE) IN RELATION TO COSTS AND THE ANNUAL PERCENTAGE RATE OF CHARGE

This document is a European Commission staff working document for information purposes. It does not represent an official position of the Commission on this issue, nor does it anticipate such a position.

Contents

1 INTRODUCTION

The aim of the Directive on Credit Agreements for Consumers (CCD)[1] is to facilitate the emergence of a well functioning internal market in consumer credit. This market should also offer a sufficient degree of consumer protection to ensure consumer confidence.

In order to meet the objective of ensuring that all consumers in the Union enjoy a high and equivalent level of protection of their interests and of creating a genuine internal market with regard to consumer credits, the CCD fully harmonises throughout the EU, *inter alia,* the following :

- the elements of the total cost of the credit to the consumer (Article 3(g));
- the methodology and assumptions used for calculating the Annual Percentage Rate of Charge (APR) (Article 19 and Annex I); and
- the obligations regarding disclosure of other relevant information to be provided to the consumer (Chapter II).

With regard to the information provided to the consumer, it should be noted that the Directive on Unfair Commercial Practices[2] (the "UCPD"), provides for general safeguards which complement the CCD information requirements.

Under the UCPD a commercial practice is considered unfair if it goes against the requirements of professional diligence and materially distorts the economic behaviour of the average consumer. This covers, in particular, misleading actions and omissions but also certain types of aggressive commercial practices.[3] The UCPD applies before, during and after a transaction has taken place, meaning at the advertising stage, the pre-contractual stage, the contractual stage and afterwards.[4]

Where there is a conflict between the provisions of the UCPD and other EU rules, such as the CCD, it follows from the *lex specialis* principle in Article 3(4) of the UCPD that

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[1] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133, 22 May 2008.

[2] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC and 2002/65 of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (Unfair Commercial Practices Directive), OJ L 149, 11 June 2005.

[3] Articles 5-9 of Directive 2005/29/EC.

[4] Article 3(1) of Directive 2005/29/EC.

the more specific rules, and in this case the rules included in the CCD, prevail. In the CCD, reference to the relationship between the UCPD and the CCD with regard to the information requirements at the advertising stage is made in Article 4(4) and Recital 18, which confirms the *lex specialis* principle.

In the areas and/or for aspects not covered by the CCD, the UCPD applies and completes the framework by filling in the gaps.

However, according to Article 3(9) of the UCPD, in relation to financial services as defined in Directive 2002/65/EC[5], and to immovable property, the UCPD establishes a minimum harmonisation only. This means, that Member States may go beyond the requirements of the UCPD and impose requirements that are more restrictive or prescriptive in the areas and/or for aspects not covered by the CCD.

Furthermore, Directive 2008/48/EC is without prejudice to Member States' ability to take appropriate measures to promote responsible practices, for example, by introducing and maintaining measures to promote financial literacy, launching public campaigns to raise awareness in this area, or dealing with over-indebtedness.

This Commission Staff Working Document has been prepared on the basis of work carried out by the Commission services informed by the knowledge on the transposition of the CCD by Member States. Its main purpose is to provide guidelines on the key concepts and provisions of the CCD, in particular with respect to the total cost of credit and the APR. The aim of the guidelines is to develop a common understanding of the provisions contained in the CCD and to facilitate a convergence of practices amongst Member States when implementing and applying the CCD to consumer credit agreements within the scope of the Directive, as set out in Article 2. In this way the Guidelines intend to contribute to the principal objective of the Directive, which is to enhance the functioning of the internal market for consumer credit also offering a sufficient degree of consumer protection. They take into account the results of a questionnaire sent to Member States in early 2011 on national practices when applying the APR rules to consumer credit and on difficulties encountered in the process of transposition.

The Guidelines should not prejudice any common understanding or convergence of practices with regard to other forms of credit, such as mortgage credit. Furthermore, the guidelines have no legal status and in the event of a dispute, the ultimate responsibility for the interpretation of the CCD lies with the European Court of Justice

The specific elements of the CCD which are addressed in this document include:

- The role of the APR (Section 2.1) as distinct from the borrowing rate (Section 2.2);

[5] Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services, OJ L 271, 09 October 2002

- The rules of disclosure of the APR and the stages for disclosure (Section 2.3);
- The role and design of the representative example (Section 2.5);
- Other information related to the cost of the credit and the characteristics of the credit product disclosed prior to the conclusion of a credit agreement (Section 2.6);
- Clarification of the elements to be included in the total cost of a credit and the APR (Section 3);
- The measurement of time intervals (Section 4.1.1); and
- Clarification on the use of assumptions in Part II of Annex I (as amended by Directive 2011/90/EU[6]) (Section 4.2).

2 THE APR

2.1 ROLE OF THE APR

The aim of the APR is to provide <u>a numerical and comparable representation of the cost of the credit to the consumer.</u>

Recital 19 highlights this role by stating that "*In order to enable consumers to make their decisions in full knowledge of the facts, they should receive adequate information, which the consumer may take away and consider, prior to the conclusion of the credit agreement, on the conditions and cost of the credit and on their obligations. To <u>ensure the fullest possible transparency and comparability of offers</u>, such information should, in particular, include the annual percentage rate of charge applicable to the credit, determined in the same way throughout the Community* […]."

To achieve comparability and to contribute to the creation of a single consumer credit market in the EU, the elements of the total cost of credit and the method and assumptions for calculating the APR should be uniformly defined throughout the EU.

2.2 APR VERSUS BORROWING RATE

The CCD defines the APR in Article 3(i) as "*the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit […]*". The explanation of the APR is provided in Article 19(1), which describes the APR as equating, on an annual basis, to "*the present value of all commitments (drawdowns, repayments and*

[6] Commission Directive 2011/90/EU of 14 November 2011 amending Part II of Annex I to Directive 2008/48/EC of the European Parliament and of the Council providing additional assumptions for the calculation of the annual percentage rate of charge, OJ L 296, 15 November 2011.

charges), future or existing, agreed by the creditor and the consumer". The CCD also stipulates that the APR must be calculated in accordance with the mathematical formula set out in Part I of Annex I.

It should be noted, however, that the payments to be made by the consumer might differ in nature. For example, payments could take the form of a repayment of the capital. They could also be interest charges, administrative charges, maintenance charges, charges for drawdowns or payments, costs of ancillary services, etc. Also the payments may be calculated by the creditor using different methods and variables. All these differences in methods to calculate payments are meaningless for the calculation of the APR. The mathematical formula allowing the APR to be calculated as the only unknown value in the equation can be applied only once the amounts and the dates of the payments to be made by consumer and drawdowns of the credit are known or specified according to the assumptions for the calculation of the APR set out in Article 19 and in Annex I.

The APR should not therefore be confused with the borrowing rate charged by the creditor or with the internal calculation the creditor makes in relation to calculating interest charges, for which the creditor may use different methods of calculation in accordance with applicable national law. These different methods could include, for instance, the use of simple interest or compound interest, or different compound frequencies (daily, weekly, monthly, etc.). As the CCD does not regulate the method used for calculating interest charges, Member States and/or creditors are able to determine the calculation method used for those charges.

In contrast, the method for calculating the APR and the assumptions to be used, where necessary, for this calculation are defined in the CCD. This is highlighted in Recital 19: "*To ensure the fullest possible transparency and comparability of offers, such information should, in particular, include the annual percentage rate of charge applicable to the credit, determined in the same way throughout the Community. […] As regards the borrowing rate, the frequency of instalments and the capitalisation of interest, creditors should use their conventional method of calculation for the consumer credit concerned.*"

Therefore, the CCD respects the diversity of methods used in practice for calculating interest charges, while imposing a unique method for calculating the APR. This unique method applies provided that it is possible to achieve the comparability of costs by means of such a single method of calculating the APR. However it should be noted that irrespective of how interest charges are calculated, the borrowing rate must be shown in advertising and other documentation as an annual rate (expressed on annual basis)

(Article 3(j)). This helps to ensure that the borrowing rate is more readily comparable to the APR[7] and to other credit offers.

2.3 THE DISCLOSURE OF THE APR

In the CCD the disclosure of the APR as well as the provision of other information is central to the objective of consumer protection. This requirement applies to all credit agreements within the scope of the CCD and at all three stages of the agreement: in advertising, at a pre-contractual and at a contractual stage.

The only variations to this rule are as described below[8]:

- Despite the exemption from the scope of the CCD of *overdraft facilities to be repaid within 1 month,* Article 6(5) of the CCD imposes the obligation to provide certain information which includes the APR, illustrated by means of a representative example at the pre-contractual stage.

- Under the light regime applicable to *overdraft facilities to be repaid on demand or within 3 months,* Member States may decide that the APR does not need to be provided at any stage of the process. Note however that the total cost of the credit must be included in the overdraft agreement by virtue of Article 10(5)(f), and this should be calculated by reference to the same assumptions as for the APR calculation.

- Under the light regime applicable to *credit agreements in the form of overrunning,* neither the APR nor a representative example is required to be provided. According to Article 2(4), only Articles 1 to 3, 18, 20 and 22 to 32 of the CCD are applicable to overrunning credits. As established in Article 18(1), an agreement to open a current account that would allow a consumer to overrun, must contain, in addition, the information referred to in Article 6(1)(e), that is, information on the borrowing rate and on other charges, which does not include the APR. Also, according to Article 18(2), if the overrunning becomes significant and lasts for more than 1 month, additional information should be provided, but it still does not include the APR.

It should be noted that the freedom of Member States to introduce or maintain requirements at a national level on the disclosure of the APR is however different for each case. Specifically:

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[7] Member States are free to determine whether or not to require that the borrowing rate be expressed as an effective annual rate (EAR), using the same rules as for APR calculation, so that it will always equate to the APR except in the case where there are non-interest charges.

[8] Note that the CCD refers to overrunning and overdraft facilities in current accounts.

- The exclusion from the scope of the CCD of *overdraft facilities to be repaid within 1 month* allows Member States to apply the provisions of the CCD to these credit agreements pursuant to Recital 10. It states that: "*this Directive should be without prejudice to the application by Member States, in accordance with Community law, of the provisions of this Directive to areas not covered by its scope. A Member State could thereby maintain or introduce national legislation corresponding to the provisions of this Directive or certain of its provisions on credit agreements outside the scope of this Directive*". Therefore, Member States could mandate the disclosure of the APR for these agreements at a national level.

- *Overdraft facilities to be repaid on demand or within 3 months* and *credit agreements in the form of overrunning* are light regime contracts, which means that only explicitly specified provisions of the CCD should apply to them, and not others. This is made clear in Recital 11, which specifies that: "*In the case of specific credit agreements to which only some provisions of this Directive are applicable, Member States should not be allowed to adopt national legislation implementing other provisions of this Directive.* For *overdraft facilities to be repaid on demand or within 3 months*, as stated above, the provisions applicable give Member States the freedom to decide if the APR is to be provided or not at any stage. However, in the case of overrunning credits, the provisions on the APR are not applicable, and hence Member States are not allowed to require creditors to disclose the APR as defined in the CCD at any stage. Also, it would be misleading to the consumer to use the term APR to refer to a measure of cost which is obtained differently. This, however, does not prevent Member States from obliging the disclosure of other ad-hoc measures of costs under the national law regulating the current account agreement, which is outside the scope of the CCD. However the information requirements in Article 18 of the CCD should be fulfilled with respect to information aspects covered by the CCD.

As for the requirement for the *disclosure of the APR once the credit is running*, it should be noted that the CCD does not require creditors to provide a new APR when there is a change in the borrowing rate or in charges forming part of the total cost of credit (see Articles 11 and 12(2)) or when the relevant contract terms change. In fact, the CCD is silent on the treatment of the APR where changes, which can affect the APR, occur in the terms of an existing contract. This does not prevent Member States therefore from regulating the treatment of changes in terms of an existing contract, in accordance with Union law[9]. Under the CCD, where the APR is to be disclosed, only the future or existing commitments (drawdowns, repayments, charges) should be taken into account

[9] E.g. Article 42(3) and Article 44 of Directive 2007/64/EC on payment services in the internal market.

in the calculation, in accordance with Article 19(1). This means that past commitments of the parties, if any, are excluded.

2.4 INSIGNIFICANT CHARGES

Article 2(2)(f) excludes from the scope of the CCD those "*credit agreements under the terms of which the credit has to be repaid within three months and only insignificant charges are payable*". As for the level and definition of such insignificant charges, the following shall be considered:

- The charges in question are those included in the total cost of credit, as defined in Article 3(g).

- The level of charges considered as insignificant can be specified by Member States in their national implementation law, for instance, by defining a lump sum or indicating that a certain percentage of the total amount of credit represents a ceiling above which charges have to be considered as significant. Member States may also simply retain the term "insignificant charges" in national law and thereby leave its interpretation to the judiciary.

- In the assessment of the level of charges considered as insignificant, relevant criteria might include the amount of the charge, either in absolute terms or relative to the amount of credit, the amount of the drawdown or the value and number of the transactions, and the comparison of the costs with the costs of other similar or competing products on the market.

2.5 REPRESENTATIVE EXAMPLE

When the APR is disclosed at the advertising or pre-contractual stage, the CCD indicates that it should be provided through a representative example, the purpose of which is to make the APR and the cost of the credit more understandable to the consumer. The relevant parts of the CCD include the following:

> Recital 19: *"As the annual percentage rate of charge can at this stage be indicated only through an example, such example should be representative. Therefore, it should correspond, for instance, to the average duration and total amount of credit granted for the type of credit agreement under consideration and, if applicable, to the goods purchased. When determining the representative example, the frequency of certain types of credit agreement in a specific market should also be taken into account […]".*
>
> Article 4(2): *"The standard information shall specify in a clear, concise and prominent way by means of representative example: […]"*
>
> Article 5(1)(g): *"[…] the annual percentage rate of charge and the total amount payable by the consumer, illustrated by means of a representative*

example mentioning all the assumptions used in order to calculate that rate; where the consumer has informed the creditor of one or more components of his preferred credit, such as the duration of the credit agreement and the total amount of credit, the creditor shall take those components into account […]".

It should be noted that throughout the CCD all references are made to the representative example (including the representative APR) in the singular and not representative examples in plural[10]. This reflects the fact that, for a given credit, <u>the representative example at each stage of the credit agreement is unique</u>.

The CCD defines the representative example in <u>advertising</u> in broad terms, only requiring that the example must be representative of the type of credit under consideration.

In any case, if it is a question of reflecting market conditions in general or trying to reflect the exact characteristics of the credit to be obtained by the consumer from the creditor, <u>a specific consumer credit should be chosen rather than the general market</u>. Otherwise, there might be significant differences between the information advertised and the information provided to the consumer at the pre-contractual stage and when the agreement is concluded. The risk of this happening is higher with regard to credits targeted at groups of consumers who are particularly vulnerable or with regard to low value or short term credits.

Therefore, in general, the creditor should determine the content of the representative example on the basis of <u>reasonable expectations regarding the offer</u>. At this stage the provisions of the UCPD complement the provision of the CCD: as part of the commercial communication of the creditor, the representative example should display clear and truthful information on the cost of the credit and, even if the information provided is factually correct, its overall presentation should not be likely to deceive the consumer and cause him to take a decision that he would not have taken otherwise (Article 6(1) of the UCPD).

In cases <u>where an element of the credit varies significantly and such a variation has a significant effect on the APR it may be appropriate to make use of the assumptions</u> for the calculation of the APR in Annex I in order to determine the specific value of such an

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[10] Article 6(1)(f), in reference to pre-contractual information for credit agreements under the light regime of Article 2 points 3, 5 and 6, states that the APR is illustrated by means of "representative examples". To determine whether this plural form is allowing more than one representative example in the case of the specific agreements covered by Art. 6 or it simply refers to the different types of contracts covered by Article 6, the objective of the CCD and its motivation provided in the recitals should be taken into account. Recital 19, in particular, refers to the "representative example" in singular and underlines the need to insure the comparability of different offers. This comparability would be very difficult to achieve in case of several representative examples. Therefore, the plural should be interpreted in the context of the different types of agreement regulated by Article 6.

element. An example of such a situation is where the amount of credit can vary considerably and there are costs which are independent from the amount of the credit. This should be read in conjunction with Article 7 of the UCPD concerning misleading omissions. In this context, Article 7(4) of the UCPD states that the price of the product or service offered should be indicated, or when the price cannot be reasonably calculated in advance, the manner in which the price is calculated is material information that needs to be communicated to the consumer in a clear, timely and unambiguous manner in invitations to purchase.

Other examples are agreements for credit cards and other revolving credit agreements. At the advertising stage, it may be appropriate for the representative example and the APR to be calculated on the basis of a EUR 1500 credit limit, in accordance with Assumption (h) of Annex I, on the grounds that this is representative of such agreements. However, if the advertiser knows that this is an unlikely scenario, e.g. because the creditor does not lend above a certain lower threshold, a lower amount should be considered instead.

In the case of personal loans and other fixed-sum credit agreements, it may be preferable for each creditor to base the representative example on an amount of credit which is representative of that creditor's own product range and expected customer base, as these may vary considerably among creditors. In order not to be misleading in the sense of Article 6(1) of the UCPD, the display of information, even if factually correct, should not deceive the consumer in relation to the price of the credits compared in a way that might cause him to take a transactional decision that he would not have taken otherwise.

At the pre-contractual stage, these difficulties are likely to be fewer, since at this stage the CCD requires adaptation of the representative example to the preferences and information (if any) provided by the consumer. Finally, at the contractual stage, no representative example exists because the APR refers to the specific credit agreement concluded by the consumer, and the unknown elements of the credit, if any, will be determined by the relevant assumptions[11].

2.6 CREDIT INFORMATION PRIOR TO THE CONCLUSION OF THE CREDIT AGREEMENT

Chapter II of the CCD sets out the requirements regarding the information to be provided to the consumer prior to the conclusion of the credit agreement. The chapter covers both the requirements with regard to information at the advertising stage (article 4) and at the pre-contractual stage (articles 5-7). The aim is to provide the consumer with the information needed to compare different offers and to make an informed decision as to whether or not to enter into the credit agreement.

[11] See Section 4.2 for a detailed explanation of the role of the assumptions.

Regarding specific items of this standardised information, it should be noted that:

- The total amount of credit, defined by Article 3(l), must be specified in all cases, either as an actual amount or as representative information (see Section 2.5). It should also specify the applicable currency of the total amount of credit. This is because this amount plays an important role in the determination of the APR whenever there are costs independent from the amount of the credit. It should be noted that, according to Article 3(l) the total amount of credit means the maximum amount or the total sums made available to the consumer. As such, the total amount of credit excludes those amounts for the payment of cost (e.g. administration costs) related to the credit. On the contrary these amounts are costs of the credit.[12]

- In open-end credit agreements the duration cannot be specified (as a number) because there is no fixed duration. However, since it is relevant to the consumer to know that the credit is open end (or with no fixed duration), this should be mentioned.

As regards the presentation of information provided to the consumer, the CCD sets out certain requirements:

- In advertising, the standard information in Article 4(2), illustrated by means of a representative example, should be presented in a clear, concise and prominent way. If the standard information is clear, it should not be difficult to find, nor should it be hidden among other information. It should describe the offer concisely, in other words, not by lengthy or rambling descriptions. Furthermore, it should be prominent, i.e. in text which is not too small or too difficult to read relative to other text in the advertisement. In particular, the standard information, including information on the representative example, should stand out in the advertising. It should also show clearly that the example is representative, allowing no risk of confusion with other information in the advertisement.[13]

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[12] For example, a creditor provides EUR 5000, but it is agreed with the consumer that costs (or one of the elements of costs) amounting to EUR 100 are financed out of this total, and not from other resources of the consumer. In this case, the consumer freely avails itself of 5000-100 = EUR 4900, being this amount the total amount of the credit as defined in Article 3(l). In the absence of other charges, the consumer will pay back EUR 5000 over the duration of the credit, comprising the costs of EUR 100 and the total amount of credit (actually made available to the consumer) of EUR 4900. If the total amount of the credit were assumed to be EUR 5000, the total amount payable by the consumer, (comprised of the total amount of the credit and the total cost of the credit, according to Article 3(h)), would had been 5000+100 = EUR 5100, which is not the case. Examples of costs which are sometimes financed with the credit include setting up costs, fees for authorization of the credit, for transmission of funds and single-premiums for credit insurance and PPI, among others.

[13] Other information which does not refer to features of the credit product or its costs, for example the identification or logo of the creditor may be more prominent provided that this does not undermine the clarity or prominence of the representative example.

- For pre-contractual information, the form in Annex II (Annex III for credit agreements referred to in Article 2(3), 2(5), or 2(6) , if this shorter form is provided) shall be used to display the standard information and, as stated in Article 5(1), final paragraph, "*any additional information which the creditor may provide to the consumer shall be given in a separate document*". This aims to guarantee the prominence, clarity and conciseness of the standard information as distinct from any other additional information.

It should be noted that the standard information requirements under Article 4 are subject to full harmonisation, which means that Member States are not allowed to maintain or introduce any other requirements in the national provisions relating to the items specified. For instance, they are not allowed to change the list and content of standard information and their leeway in relation to the requirement of additional information is limited to the matters not harmonised by the CCD. In this regard, the following should be noted:

Article 4 is without prejudice to the UCPD. This means that in addition to the information requirements mentioned in Article 4 of the CCD, all advertising materials should contain any material information that the consumer needs in order to be able to make an informed choice, as required by Articles 6 and 7 of the UCPD concerning misleading actions and omissions, provided that this would not contradict the CCD.

As an example, an advertisement which does not mention that a credit product is available at a specific price only during a limited period of time could be assessed under the provisions of the UCPD. Another example is when a creditor includes details of an introductory low rate without mentioning the 'go to' rate or the fact that an additional fee is payable. This could be challenged under UCPD. Also, Member States can use the UCPD to challenge the omission or inclusion of material information, provided that this challenge does not contradict the CCD. It should however, be clear that in this context, it is the responsibility of the advertiser (e.g. creditor) to ensure compliance of its commercial practices with the UCPD. The assessment of this compliance with the CCD and UCPD should be carried out, on a case-by-case basis, by the national authorities of the Member States which are primarily competent for investigating the conduct of individual companies in the light of EU legislation.

As to pre-contractual information, Article 5(6), (which corresponds to Recital 27), states that Member States shall ensure that creditors (or, where applicable, credit intermediaries), "*provide adequate explanations to the consumer, in order to place the consumer in a position enabling him to assess whether the proposed credit agreement is* *adapted to his needs and to his financial situation*[14]*, where appropriate by explaining the pre-contractual information to be provided in accordance with paragraph 1, the essential characteristics of the products proposed and the specific effects they may have on the consumer, including the consequences of default in payment by the consumer. Member States may adapt the manner by which and the extent to which such assistance is given, as well as by whom it is given, to the particular circumstances of the situation in which the credit agreement is offered, the person to whom it is offered and the type of credit offered.*"

For example, in the context of Article 5(6), Member States may require creditors to provide explanations to the consumers about the following, where relevant:

- Explanations of the exercise of any right to withdraw from the agreement including how and when this right may be exercised.
- Explanations of the particular features of the product which could distinguish it from other products and which may have consequences for the consumer, depending, for instance, on the use of the product by the consumer.
- Explanations of how the credit product operates and the effects that this might have on the cost of the credit. For example, by providing illustrative examples (not to be confused with the representative example), showing the cost of the credit on the basis of different patterns of drawdown and repayment.
- Explanations of the features of the agreement, which may operate in a manner that could have a significant adverse effect on the borrower. For example, fees calculated as a percentage of the highest amount of money drawn down during a given period, or different borrowing rates or charges applying in specific situations.
- Explanations of the consequences for the consumer of a failure to make payments under the agreement at the times required by the agreement. For example additional charges made for late or missed payments, increases in interest rates, impairment of credit status or legal action and associated costs.

Within the scope of Article 5 (6), Member States are allowed leeway to regulate these explanations in order to place the consumer in a position to make his own assessment as to whether the product is adapted to his needs and financial situation. The duty of

[14] Article 6, concerns pre-contractual information requirements for credit agreements that are subject to the light regime of Article 2(3), 2(5) or 2(6). It is silent about the provision of explanations to the consumer. The justification for this in Recital 23 is to avoid an excessive burden on creditors in relation to these agreements. However, if the circumstances of the market, the product or the consumers justify such explanations, the relevant explanations can be made obligatory.

creditors or credit intermediaries to provide adequate explanations is restricted to the provision of information and does not mean the provision of recommendations.

For example, Member States may require that the pre-contractual explanations are given in a certain way, to a certain extent, or orally/in writing, or by a specific representative of the creditor. Secondly, Member States may also clarify that the explanations regarding the particular circumstances in which the loan is being offered e.g. for a limited period or up to a certain monetary threshold etc, are emphasised. Member States may also customise the explanations to take account of the circumstances of the person receiving the loan, e.g. on his knowledge or experience as regards credits. Finally, Member States may clarify that the nature of the explanations depends on the type of credit being offered, e.g. distinguishing a term loan from a credit card facility, etc.

As these explanations are not part of the standard information, if they are provided in writing, they should be in a separate document which may be annexed to the Standard European Consumer Credit Information form. This is an identical situation as the case where the creditor may wish to give to the consumer any additional information. There should not be any risk of confusion between the standard information and any additional information.

Specific explanations could also be justified by the need to avoid unfair or misleading commercial practices in the national market, with regard to the characteristics of the market, the products offered, the consumers or the type of commercial communication in question.

It should be noted that additional information in advertising or pre-contractual information cannot, under any circumstances, contain alternative representative examples since the representative example is a core element of the standardised information needed to ensure the comparability of different offers by the consumer. As stated in Section 2.5. , for a given credit the representative example at each stage of the credit agreement is unique. If additional examples are included, they must be less prominent and there must be no risk of confusing them with the representative example.

3 THE TOTAL COST OF THE CREDIT

3.1 DEFINITION OF THE TOTAL COST OF CREDIT

In order to preserve the comparability and the informative content of the APR, the CCD aims to determine uniformly throughout the EU the cost elements to be included in the total cost of credit. Recital 43 states that "*In order to promote the establishment and functioning of the internal market and to ensure a high degree of protection for consumers throughout the Community, it is necessary to ensure the comparability of information relating to annual percentage rates of charge throughout the Community. […] This Directive should therefore clearly and comprehensively define the total cost of a credit to the consumer.*"

The definition of the total cost of credit is provided in Article 3(g) as follows: " *'total cost of the credit to the consumer' means all the costs, including interest, commissions, taxes and any other kind of fees which the consumer is required to pay in connection with the credit agreement and which are known to the creditor, except for notarial costs; costs in respect of ancillary services relating to the credit agreement, in particular insurance premiums, are also included if, in addition, the conclusion of a service contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed.*"

As to this definition, it should be noted that:

- The total cost of credit comprises all the range of costs that the consumer has to pay in order to access the credit or to use it,[15] which are known (or ascertainable[16]) by the creditor, except for notarial costs. These include, for example, interest charges, taxes and commissions arising from the credit agreement (as opposed to a service or goods tax, for example), credit intermediation fees payable by the consumer (see Article 21(c)), administrative fees (e.g. loan preparation or examination and authorisation of the credit), membership fees, costs for providing account statements or for postage.

- The exclusion of notarial costs refers only to those costs of a notarial nature, e.g. the fees a notary receives for the establishment of a legal act such as the notarial act.

- It should also be kept in mind that all eligible costs are to be accounted for regardless of whether they are payable to the creditor or a third party or whether they give access to financial or non-financial services (e.g. membership fees). In this context, taxes connected with the credit agreement and collected by a notary (for example on behalf of the government) should therefore be included in the total cost of the credit to the extent that they are known to the creditor.

- The total cost of credit is limited to the *costs* of credit, and does not include any offsetting *income or benefits*. These are not covered by Article 3(g). However, it is open to the creditor to disclose such income or benefits separately, subject to this not being misleading to the consumer.

- As for <u>ancillary services</u>, it should be noted that:

  - Ancillary services refer to services which are auxiliary or supplementary to the credit agreement, sometimes offered in the form of cross-selling

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[15] This does not include dormancy or inactivity fees, which are linked to non-use of the credit. Nevertheless, these fees must be disclosed as part of pre-contractual information under Articles 5(1)(i) and 6(1)(e) and contractual information under Article 10(2)(k).

[16] See Section 3.4 below.

products. Examples of these services include the opening of any kind of account, insurance contracts, concierge services or loyalty programs. Insurance contracts could include credit insurance, payment protection insurance, travel insurance, purchase insurance, motor insurance or other types of insurance[17], sureties or guarantees[18]. Also another type of ancillary service is an agreement that provides that capital constituted from payments made by the consumer would not result in an immediate corresponding amortisation of the amount of credit. This list is not exhaustive, because the CCD does not limit the types of ancillary services.

- Given that these ancillary services could be maintained for longer periods than the duration of the credit, their costs are included even if they are incurred after the repayment date of the credit, should the terms of the commitment described in the credit agreement oblige the consumer to maintain the services for such a longer period. If, on the contrary, the commitment to maintain these services finishes when the credit is repaid, only the costs due during the course of the credit agreement shall be included in the total cost of credit, together with any costs for withdrawing from the ancillary service at the termination of the credit agreement, if these costs exist and are known to the creditor. In the case where the duration of the ancillary service is shorter than the duration of the credit, the costs for this shorter period shall be taken into account.

- Article 3(g) introduces two situations which determine whether the cost of ancillary services should be included in the total cost of credit. The existence of either of these two situations implies the inclusion of these costs:

    - if the ancillary service is mandatory to obtain the credit or,

    - if the ancillary service is mandatory to obtain the credit on the terms and conditions marketed. The service could be necessary, for example, to obtain the marketed borrowing rate, charges or duration of the credit.

These apply even if the ancillary services that are required to obtain the credit agreement or the terms and conditions marketed do not relate directly to it or are not financial in nature.

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[17] Under the CCD, the inclusion of insurance costs is mandated irrespective of the purpose of the insurance. This is different from Directive 90/88/EEC, which excluded from the total cost of credit charges for insurance, or for guarantees not designed to ensure payment to the creditor in the event of death, invalidity, illness or unemployment.

[18] According to Article 2(2)(k) "*credit agreements upon the conclusion of which the consumer is requested to deposit an item as security in the creditor's safe-keeping and where the liability of the consumer is strictly limited to that pledged item*" are excluded from the scope of the CCD.

- Ancillary services can be considered as not mandatory where:
  - o the consumer is informed and can choose at any time during the credit agreement between products offered by the creditor including being able to keep the same credit facility but without any ancillary services (bundling),
  - o the consumer can withdraw from the ancillary services at any time and stop paying their costs without this withdrawal having any cost or any other effect on the terms of the credit.

  Nevertheless, if contracted as a result of the credit agreement, creditors should disclose the costs referred to in Articles 5(1)(i),6(1)(e) and Article 10(2)(k), unless these services are contracted separately from the credit agreement.

3.2 CALCULATION OF THE TOTAL COST OF CREDIT FOR THE PURPOSE OF CALCULATING THE APR

As stated before, the definition of the total cost of credit in Article 3(g) of the CCD covers all the costs that the consumer is required to pay in connection with the credit agreement, except for notarial costs. On an ex-post basis these costs can be determined based on the use of the credit by the consumer and in this sense, costs may vary from one consumer to another for the same credit agreement. However, the CCD requires the provision of cost information prior to such use of credit by the consumer (the APRC needs to be provided at the pre-contractual and the contractual stage). It is for this reason that, <u>for the calculation of the APR, the total cost of credit should be quantified on the basis of the representative example upon which the APR is based (at advertising and the pre-contractual stage) or the agreement concluded with the consumer (at the contractual stage) together with the assumptions used for the calculation of the APR</u>. These assumptions, containing further details about specific types of costs, are established in Article 19 and Annex I of the CCD.

According to Article 19(2)(1st paragraph) and 19(3) , for the purposes of the calculation of the APR, the total cost of credit will not include[19]:

- Fees for early repayment, for cancellation of the credit, and for changes in the contractual terms and conditions of the credit agreement, made at the consumer's request.
- Fees and charges incurred as a result of failure to comply with the terms of the agreement (e.g. late payment charges in the form of interest or penalties, charges

[19] Some of such charges may nevertheless be required to be disclosed to the consumer in pre-contractual information under Articles 5(1) and 6, and contractual information under Article 10.

for exceeding the credit limit, charges for returned payments, charges for collection of unpaid debts, charges for calls to pay amounts due or to fulfil other obligations, etc.).

- Charges other than the purchase price which, for purchases of goods or services, the consumer is obliged to pay whether the transaction is executed in cash or on credit, meaning that these are costs not paid in connection with the credit agreement (e.g. vehicle registration in the consumer's name for administrative records in the case of a loan to purchase a car).

As regards costs of a linked account and the expenses or fees for such an account, second paragraph of Article 19(2), states that:

- The total cost of credit will include the costs of maintaining an account recording both payment transactions and drawdowns[20] (including credit or debit accounts). Costs incurred for using a particular means of payment for payment transactions or drawdowns (e.g. cheques or cards) on that account are also included. In addition, any other costs relating to payment transactions on the account (e.g. fees for recording transactions, for the transfer of funds or for arranging a direct debit in connection with the credit) are also included. However if the opening of the account is optional and its costs "*have been clearly and separately shown in the credit agreement or in any other agreement concluded with the consumer*", such costs can be excluded from the total cost of credit. This means that even if the opening of the account is optional, should the consumer not be able to know the costs of the account because they have not been shown clearly or separately, then such costs should be **included** in the total cost of credit[21]. This requirement aims to prevent that creditors would hide costs and it encourages them to provide clear and complete information about their products.

- It should also be noted that although the wording of Article 19(2) seems to imply that only the costs of new accounts may be excluded from the calculation of the total cost of credit (under certain circumstances specified in Article 19(2)), the cost of a pre-existing account can also be excluded from the calculation of the total cost of credit, provided that maintaining such account is not a condition to obtain the credit or to obtain it according to the terms and conditions marketed. This is because under these circumstances the pre-existing account is neither a mandatory ancillary service nor its costs are costs *"which the consumer is*

[20] The payment transactions and drawdowns mentioned in this paragraph should be understood as those related to the credit.

[21] Note that the conditions in Article 19(2), second paragraph, imply that the costs relating to payment transactions can be excluded only if the account to which they are linked is also excluded on the basis that it meets the two conditions of optional opening and clear and separate presentation of costs.

required to pay in connection with the credit agreement". Accordingly, its costs are not included in the total cost of the credit as defined in Article 3(g).

Finally, when the assumption referred to in Article 19(4) and the additional assumptions in Annex I are used for the calculation of the APR, they shall be also used to determine the value of the total cost of credit because the APR is an expression of the total cost of credit (Article 3(i)). For example, if drawdowns involve costs, and the agreement gives the consumer freedom of drawdown, Assumption (a) of Annex I Part II will be necessary to determine such costs. As another example, if a credit agreement provides different ways of drawdown with different charges or borrowing rates, according to Assumption (c) of Annex I Part II, the costs would be those corresponding to the most common drawdown mechanism.

The quantification of the total cost of credit following these rules, which ensures consistency with the APR, does not narrow the definition of the total cost of credit. As an example, charges for cash advances under a credit agreement are costs connected to the credit, regardless of whether cash advances are the most common drawdown mechanism or not. This wide definition of the total cost of credit takes into consideration the objective of the CCD, which is to ensure a high level of protection to the consumer[22]. The obligation to disclose in pre-contractual information all the elements of the total cost of credit allows the consumer to take an informed credit decision.

3.3 PACKAGES OF PRODUCTS

Obtaining the total cost of credit (and the APR) in packages comprised of credit facilities and other products requires the application of the principles stated above (in Sections 3.1 and 3.2). For example, in a package including a bank account and a credit card, the costs of the account are excluded from the cost of the credit card (and from its APR), only if the costs of the account are shown separately and the consumer can access the credit card on the same terms without opening (or maintaining) the account which forms part of the package.

Further, it should be noted that in the case of packages of credit and non-credit products, the exclusion criteria might require a step-by-step analysis which yields the total cost of credit and the APR of each credit product[23]. For example, in a package comprised of a

[22] In case of doubt in respect of the correct interpretation of a given provision, both the objective of a given legal act and its motivation provided in the recitals should be taken into consideration.

[23] Each credit product should have its own APR. This is because several credit products cannot be treated as a unique credit and a unique APR would be difficult to interpret or determine, especially taking into account that the products might have different features (duration, drawdowns and repayments, etc.) and different assumptions could be required to calculate the APR.

credit card, an instalment loan and a bank account serving both the credit card and the loan:

i) the costs related to the account can be excluded from the cost of the loan if the double requirement relating to the account being optional and the separate nature of costs (Article 19(2)) holds true;

ii) such costs can be excluded from the cost of the card if the same conditions are fulfilled;

iii) if the costs of the account can be excluded from one credit product and not from the other, then it is possible to determine an APR for each credit product, one including the costs of the account and the other excluding them;

iv) if the costs of the account cannot be separated from the cost of the credit card nor from the cost of the loan, each of the credit products will include the costs of the account as a cost of the credit, hence the APR of each credit product will include the costs of the account.

3.4 KNOWLEDGE OF COST BY THE CREDITOR

Article 3(g) includes in the total cost of the credit, those costs which are known to the creditor. In relation to the creditor's knowledge of the costs, it is stated in Recital 20 that "*Creditors' actual knowledge of the costs should be assessed objectively, taking into account the requirements of professional diligence*"; in Recital 22 it is stated that "*The costs payable in respect of those ancillary services should be included in the total cost of the credit; alternatively, if the amount of such costs cannot be determined in advance, consumers should receive adequate information about the existence of costs at a pre-contractual stage. The creditor must be presumed to have knowledge of the costs of the ancillary services which he offers to the consumer himself, or on behalf of a third party, unless the price thereof depends on the specific characteristics or situation of the consumer*"; In addition, in Article 21(c) regarding the obligation on intermediaries relating to the agreement, it is stated that "*the fee, if any, payable by the consumer to the credit intermediary for his services is communicated to the creditor by the credit intermediary, for the purpose of calculation of the annual percentage rate of charge*".

In some cases the fact that a charge, or the cost of an ancillary service, would be imposed is known but the exact amount of costs over the period of the agreement is not known.

This situation does not refer to charges whose amount varies over time in a way which is unquantifiable or cannot be foreseen at the time of calculation of the APR, because in this case Article 19(4) or Assumption (j) would apply leading to the determination of such charges in advance.

The above could apply to the advertising or the pre-contractual stage, but not to the contractual stage. At the contractual stage, (unlike the situation in advertising and pre-contractual), most of the real costs of the agreement to be concluded with the consumer should be known to the creditor and so will be included in the calculation of the APR because either the creditor or the consumer will be able to avail of the necessary information. The creditor should make reasonable efforts to ascertain such costs, in line with the requirements of professional diligence, and should only exclude them from the APR calculation (and disclose separately to the consumer) if this is not practicable.

If estimated information is used, the consumer shall be made aware of this fact indicating that estimates are expected to be <u>representative of the type of agreement in question</u>[24]. At the pre-contractual stage, the consumer should also be provided with information of the nature of the assumptions used by the creditor[25].

If however it is not possible to ascertain the costs, or to estimate them with a reasonable degree of certainty in a specific situation, then they should not be included in the calculation of the total cost of credit (and consequently in the APR). In this case the creditor must inform the consumer of the existence of such costs at the advertising and pre-contractual stages (Articles 4(3) and 5(1)(k) and Recital 22). Should it still not be possible to ascertain costs at contractual stage despite the requirements of professional diligence, the consumer should be informed accordingly. For example, for credit products offered to foreign customers, it might be difficult to ascertain or estimate the amount of specific taxes at pre-contractual stages or when these taxes are payable after the conclusion of the credit agreement. Obligatory technical services in vehicle purchases are another example, as these services are provided by motor firms and may depend crucially on the firm and on the specific characteristics of the vehicle.

4 CALCULATION OF THE APR: ANNEX I

4.1 REMARKS

4.1.1 REMARK (C): MEASUREMENT OF TIME INTERVALS

Remark (c) establishes the method for the measurement of time periods for the calculation of the APR in the following terms: "*Intervals between dates used in the calculations shall be expressed in years or in fractions of a year. A year is presumed to have 365 days (or 366 days for leap years), 52 weeks or 12 equal months. An equal*

[24] For example, on the basis of the representative example (amount, duration, etc.) and the characteristics of the representative borrower (e.g. male aged 35).

[25] For example, in the case of an ancillary service, on the basis of the service the creditor sells on his behalf or on behalf of a third party, even when the consumer is free to choose the contracting party.

month is presumed to have 30,41666 days (i.e. 365/12) regardless of whether or not it is a leap year."

Application of this method is straightforward when the intervals between dates can be expressed as a whole number of weeks, months or years because in this case a single kind of fraction of the year is used[26]. However clarification is needed when the periods cannot be measured as a whole number of weeks, months and years (for example, when a repayment takes place in 1 month and 3 days).

In order to attain the objective of comparability of the APR by providing a uniform application of Remark (c) compatible with its wording, it shall be considered that:

Only when an interval between dates used in the calculation cannot be expressed as a whole number of years, months or weeks, the interval shall be expressed as a whole number of one of these periods in combination with a number of days. For the choice among years, months or weeks, consideration shall be given to the frequency of drawdowns and payments. When using days:

(i) Every day shall be counted, including weekends and holidays;

(ii) Equal periods and then days shall be counted backwards to the date of the initial drawdown; and

(iii) The length of a period of days shall be obtained excluding the first day and including the last day (simple subtraction of dates), and shall be expressed in years by dividing this period by the number of days (365 or 366 days) of the complete year counted backwards from the last day to the same day of the previous year.

This approach is largely similar to the existing convention used in bond markets in the Euro area, known as Actual/Actual AFB[27] or Actual/Actual (Euro) in international markets[28]. However, it departs significantly from other conventions such as 30/360 or actual/360, which are clearly incompatible with Remark (c) of the CCD.

The first paragraph of the explanation in italics above implies that:

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[26] This is coherent with the assertion in the explanatory memorandum of the initial Commission proposal for a revised Directive of 2002 [COM(2002) 443 final], where the text of Remark (c) appears. In pages 17-18 of this memorandum it is explained that "*The proposal is for complete standardisation in respect of rounding-off and what is understood by a year. Only the method for calculating fractions of a year has been retained*". When compared with the methods for the measurement of time established in Directive 98/7/EC, given as the calendar basis (according to which 1 year=365 days or 366 days for a leap year) and the standard year method (according to which 1 year=365 days or 365.25 days, or 52 weeks or 12 months of 365/12=30.411666 days), it is evident that there is an intention to abandon the calendar basis.

[27] AFB stands for the Association Française des Banques.

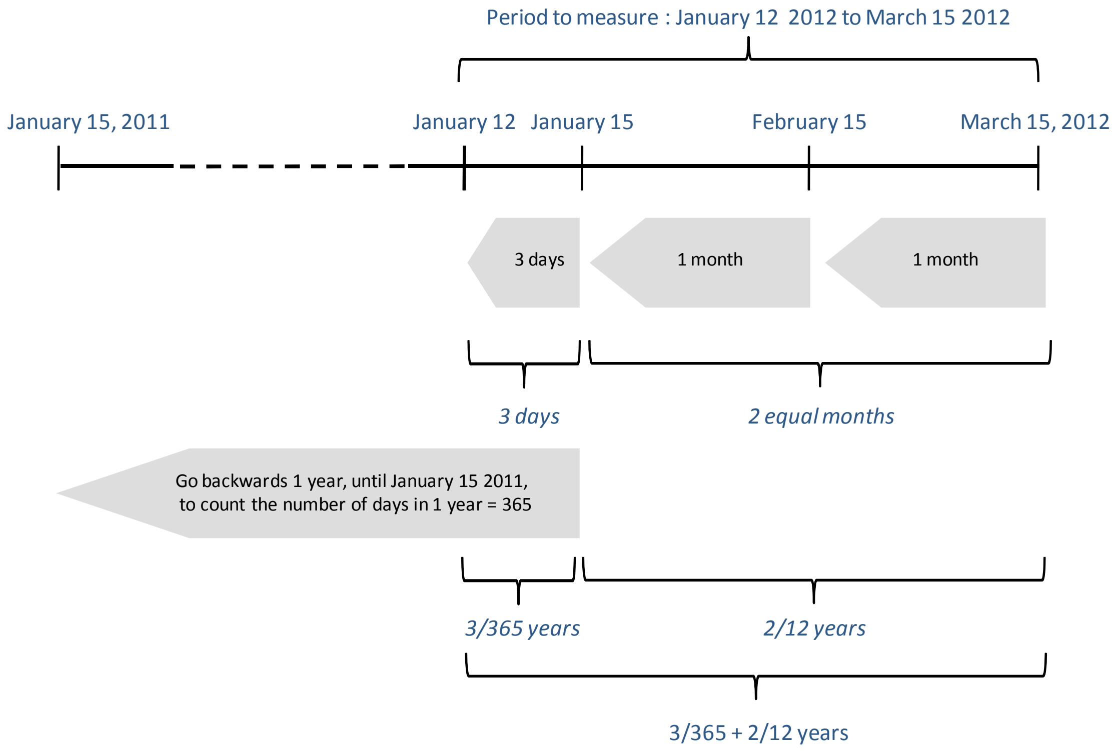
[28] This convention was supported by the European Commission and the European Monetary Institute before the introduction of the euro in 1999.

- No combination of years or fractions of years is allowed other than a combination of days and either years, equal months or weeks.
- If the interval can be expressed as a whole number of years, months or weeks, the interval shall not be expressed in days.
- The frequency of drawdowns and repayments shall be taken into account for the choice among years, months or weeks. For example, in the case of a single immediate drawdown and monthly repayments, regular periods of one month will be used; in the case of monthly drawdowns and yearly repayments, regular periods of one month will be used because they allow the expression of the time intervals of both drawdowns and repayments as a whole number of regular periods.

Points (ii) and (iii) above determine that time periods will be counted backwards. According to (ii), if an interval between dates is comprised of regular periods (years, months or weeks) and days, the period of days will appear at the beginning of the interval, i.e. after having taken account of the regular periods. According to (iii) above, to express a period of days in years, the period will be divided by the number of days of the year between the last calendar day of the period and the same day of the previous year.

For example, if months are used, the interval between January 12 2012 and March 15 2012 is given as 2 months (from March 15 2012 to January 15 2012) and 3 days (from January 15 2012 to January 12 2012). To express this interval in years, months are divided by 12 (the number of months in a year), and the period of 3 days from January 15 2012 to January 12 2012 is divided by the number of days of the year from January 15 2012 to January 15 2011, that is, by 365 days. Note that in this example the rule of simple subtraction of dates established in point (iii) above has been applied to obtain the result that, between January 15 2012 and January 12 2012, there are only 3 days, and not 4 days as would be obtained if both days (January 15 and January 12) were counted. Similarly, the period from January 15 2012 to January 15 2011 comprises 365 days and not 366 days (within this period, February 2011 has 28 days).

This example is illustrated in the following scheme:



If a credit agreement whose first drawdown is made at the conclusion of the agreement on January 12 2012 is considered and payments are to be made on the 15th day of each of the 3 succeeding months, from February to April, the intervals between the date of the first drawdown and the successive payments are:

- Payment on February 15 2012: 3/365+1/12 (1 month from February 15 2012 to January 15 2012 plus 3 days from January 15 2012 to January 12 2012 within a year from January 15 2012 to January 15 2011 with 365 days).
- Payment on March 15 2012: 3/365+2/12 (2 months from March 15 2012 to January 15 2012 plus 3 days from January 15 2012 to January 12 2012 within a year from January 15 2012 to January 15 2011 with 365 days; equivalently, it can be obtained adding 1 month to the interval of the previous payment to obtain March 15 2012).
- Payment on April 15 2012: 3/365+3/12 (add 1 month to the interval of the previous payment to obtain April 15 2012).

If the credit agreement were to be signed one year later, on January 12 2013, the intervals would be:

- Payment on February 15 2013: 3/366+1/12 (1 month from February 15 2013 to January 15 2013 plus 3 days from January 15 2013 to January 12 2013 within a year from January 15 2013 to January 15 2012 with 366 days).

- Payment on March 15 2013: 3/366+2/12 (add 1 month to the interval of the previous payment to obtain March 15 2013).

- Payment on April 15 2013: 3/366+3/12 (add 1 month to the interval of the previous payment to obtain April 15 2013).

If the credit agreement were to be signed on January 12 2012, foreseeing annual payments due on the 15th of February of each year from 2012 to 2014, the intervals would be:

- Payment on February 15 2012: 34/365 (34 days from February 15 2012 to January 12 2012 within a year from February 15 2012 to February 15 2011 with 365 days).

- Payment on February 15 2013: 34/365+1 (add 1 year to the interval of the previous payment to obtain February 15 2013).

- Payment on February 15 2014: 34/365+2 (add 1 year to the interval of the previous payment to obtain February 15 2014).

The treatment of leap years deserves special attention when the last day in February applies, because, as is usual, any reference to a day in February which does not exist (e.g. 31st) is considered to be a reference to the last day in February (28th, or 29th if a leap year) and any reference to a day which does exist is a reference to that date. To illustrate, consider the following examples:

- Agreement signed on 25/02/2013 with first payment on 28/03/2013: the interval is given as 1 month (from 28/**03**/2013 to 28/**02**/2013) plus 3 days (from **28**/02/2013 to **25**/02/2013) within a year (from 28/02/**2013** to 28/02/**2012)** with 366 days, that is, as 1/12+3/366 years. Note that counting backwards 1 year from 28/02/2013 implies going to the same date of the previous year because it exists, that is, to 28/02/2012 (and not to **29**/02/2012).

- Agreement signed on 26/02/2013 with first payment on 29/03/2013: the interval is given as 1 month (from **29**/**03**/2013 to **28**/**02**/2013, the last day of February; but not to 01/03/2013) plus 2 days (from **28**/02/2013 to **26**/02/2013) within a year (from 28/02/**2013** to 28/02/**2012**) with 366 days, that is, as 1/12+2/366.

- Agreement signed on 26/02/2012 with first payment on 29/03/2012: the interval is given as 1 month (from 29/**03**/2012 to 29/**02**/2012, because this date exists) plus 3 days (from **29**/02/2012 to **26**/02/2012) within a year (from **29**/**02**/2012 to **28**/**02**/2011, the last day of February; but not to 01/03/2011) with 366 days, that is, as 1/12+3/366.

The above explanation of Remark (c) has two main advantages. Firstly, the time intervals are independent of the exact date the agreement is signed. To illustrate this, consider a payment in 1 month and 1 day. Applying the rules we would obtain a period of 1/12 years plus 1 day, irrespective of the date the agreement is due to be signed – in fact, that date is usually unknown before the contract is signed. In the absence of the rules, creditors might use intervals from 29 to 32 days in the advertising and the pre-contractual stages, which might lead to significant differences in the APR. Later at the time the agreement is signed, the APR figure might be different from the one used in advertising and the pre-contractual information simply because the length of the interval changes. It is evident that such differences are not conducive to comparability of the APR among products and creditors. Moreover, it can be asserted that, strictly speaking, only regular periods are feasible in the advertising and the pre-contractual stages. For example, for a payment in 1 month, there is little justification in using 28, 29, 30 or 31 days instead of 1/12 years. And if 1/12 years is used, the period of 1 month and 1 day should be expressed as 1/12 years plus 1 day for coherence.

Secondly, the rules deal unambiguously with leap years. That is, in order to obtain the period of days expressed in years, the rules imply dividing by the number of days of the year between the first payment date and the same date of the previous year. For example, if the agreement is concluded on December 1 2012 and the first payment is on February 2 2013, application of the rules implies using 2/12 (from February 2 2013 to December 2 2012) plus 1/366 (1 day from December 2 2012 to December 1 2012, divided by the 366 days between December 2 2012 and December 2 2011). In the absence of rules, creditors might divide by 365 if they take the days in a normal year when the payment takes place (2013), or 366 if they take the days of the year 2012, or even, if they only use days, divide the days in 2012 by 366 and the days in 2013 by 365 days. Again, different solutions and different APRs might be obtained in the absence of explicit rules. These examples show that the rules are designed to obtain a uniform calculation of the APR throughout the EU.

Implicit in Remark (c) is that if certain time intervals are used in the APR formula, those intervals shall also be used to ascertain the amounts of interest and other charges used in the formula. For this reason, creditors shall use the method of measurement of time intervals described above to obtain the figures for the payments of charges. However, this is only applicable for the purposes of the calculation of the APR, and does not impact on the amounts actually charged by the creditor under the agreement, although if these are different, it may be necessary to explain the existence of this difference to avoid misleading the consumer. The application of this rule for the calculation of the APR implies that in the absence of non-interest charges, and assuming an identical method of calculation, the APR will equal the (effective) borrowing rate of the credit.

4.1.2 REMARK (D)

This remark states that "*The result of the calculation shall be expressed with an accuracy of at least one decimal place. If the figure at the following decimal place is greater than or equal to 5, the figure at that particular decimal place shall be increased by one*."

The remark establishes the required level of accuracy of the APR figure, i.e. to one decimal place (higher levels of accuracy, such as two decimal places, with the rounding off rule, can also be applied). As to the rounding, note that the figure to be increased by one is the one at the last decimal place. For example, if the APR is expressed with one decimal place, the figure at this (first) place is increased by one if the figure at the following (second) decimal place is greater than or equal to 5; if the APR is expressed with two decimal places, the figure at this (second) place is increased by one if the figure at the following (third) decimal place is greater than or equal to 5. Using a numerical example, for 3.055%, the APR with one decimal place is 3.1% and the APR with two decimal places is 3.06%; for 3.054%, the APR with one decimal place is 3.1% and the APR with two decimal places is 3.05%.

4.1.3 REMARK (E)

It should be noted that there is an error in Remark (e), second line: it should read "1 to n expressed in years" instead of "1 to k expressed in years".

4.2 ASSUMPTIONS FOR THE CALCULATION OF THE APR

The CCD includes a number of assumptions for the calculation of the APR. These assumptions are contained in Article 19(3) and 19(4), and in Part II of Annex I (as amended by Directive 2011/90/EU), which includes a set of ten additional assumptions.

The role of the assumptions for calculating the APR is to determine some of the elements to be included in the total cost of credit. This is required when these elements are not known or cannot be ascertained at the time the APR is calculated, or when they may vary, depending on how the credit agreement is operated.

The assumptions are intended to ensure that the APR is calculated in a consistent way to promote the comparability of different offers. Hence, the term 'Where necessary' at the beginning of Article 19(5) refers the creditor to the additional assumptions in the Annex only where those assumptions are necessary in relation to the specific agreement, e.g. where key features such as amount or duration of credit are uncertain. In general, though, the APR calculation will depend on the terms of the individual credit agreement, and the expression 'where necessary' should be understood in this context. In particular, Assumption (i) will apply only where other Assumptions in (a) to (h) of Annex I apply, since otherwise the terms of the contract (together with Assumption (j), as necessary) give sufficient certainty.

Articles 5(1)(g), 6(1)(f), 10(2)(g) and 10(5)(f) of the CCD imply that the APR is accompanied by an indication of the assumptions used in the calculation at the pre-contractual and contractual stages, which provides an element of transparency to the consumer and facilitates the understanding of the APR figure. The assumptions indicated will be those applicable to the credit in question, as set out in Article 19 and Part II of Annex I.

It should be highlighted that the CCD does not provide for the application of the assumptions to areas outside of the calculation of the APR (at advertising, pre-contractual and contractual stages). However, if they are used, their appropriateness should be assessed on a case by case basis. For example, for the calculation of the compensation to the creditor in the case of early repayment (Article 16) it would not be appropriate to apply borrowing rates to future payments based on the value of the agreed indicator when the agreement was concluded (Article 10(2)(f)). Rather, it should be based on the value of the indicator when early repayment actually takes place.

All references to the conclusion of the agreement are references to the date the agreement is executed. This is usually the date when the agreement is signed by the parties involved (and not when it comes to an end), unless otherwise specified.

4.2.1 ASSUMPTIONS (A) AND (B)

(a) If a credit agreement gives the consumer freedom of drawdown, the total amount of credit shall be deemed to be drawn down immediately and in full.

(b) If a credit agreement gives the consumer freedom of drawdown in general but imposes, amongst the different ways of drawdown, a limitation with regard to the amount of credit and period of time, the amount of credit shall be deemed to be drawn down on the earliest date provided for in the credit agreement and in accordance with those drawdown limits.

Assumptions (a) and (b) determine the scheme of drawdowns to be applied for the calculation of the APR when the credit agreement provides for freedom of drawdowns.

In accordance with Assumption (a), where a consumer may draw down credit at any time and for any amount, it shall be assumed that the whole amount of the credit is drawn down immediately at the date of conclusion of the agreement. If the agreement establishes limits with regard to the amounts of drawdown and periods of time among the different drawdown mechanisms, these drawdown limits are to be respected and, in accordance with Assumption (b), the amount of credit will be assumed to be drawn down on the earliest date (or dates) provided for in the agreement, using reasoning similar to Assumption (a).

One example of the application of Assumption (b), would be a revolving credit account which provides the consumer with freedom of drawdown but with the following limits in the first three months: during the first month no drawdown is possible, in the second month no more than one tenth of the amount of credit can be drawn down, in the third month drawdowns are possible up to a limit of 50% of the amount of the credit and from the fourth month no limitation exists. Assumption (b) implies that for the purpose of the calculation of the APR the following plan of drawdowns shall apply: a first drawdown at the beginning of the second month of 10% of the amount of the credit (this date is the earliest date of drawdown provided for in the agreement), a second drawdown of 40% at the beginning of the third month, and a final drawdown at the beginning of the fourth month of the remaining 50% of the credit.

Note that both Assumptions (a) and (b) apply solely to agreements providing freedom of drawdown (typically open-end agreements). They do not apply to agreements where the consumer has no discretion as to the date or amount of drawdown since they are decided either by the creditor or as a result of external factors (such as the date of provision of services or delivery of goods). In such cases, Point (ii) of Assumption (f) may apply instead of (a) or (b) (see Section 4.2.5. below).

Finally, the concept of additional drawdowns on the basis of the amount of the credit repaid (an option available in revolving credit agreements), is not a factor in the calculation of the APR unless it applies by virtue of Assumption (e).

4.2.2 ASSUMPTION (C)

(c) If a credit agreement provides different ways of drawdown with different charges or borrowing rates, the total amount of credit shall be deemed to be drawn down at the highest charge and borrowing rate applied to the most common drawdown mechanism for this type of credit agreement.

This assumption deals with the existence of different forms of drawdown of the amount of the credit[29] with different charges and/or borrowing rates. This situation usually occurs in the case of credit cards agreements because they typically distinguish between transactions such as cash advances, payments for purchases, balance transfers and foreign currency transactions and impose different rates and/or charges for each drawdown mechanism. Given that the application of different rates or charges, depending on the drawdown mechanism used, implies a different APR, the choice of the most appropriate drawdown mechanism for the calculation of the APR is a relevant issue.

The CCD mandates the use of the most common drawdown mechanism, but does not say how it is determined. Hence, Member States may introduce provisions in this respect if they wish to guide creditors or they can leave the choice of the drawdown mechanism to each creditor. In the latter case, the CCD implies that the creditor should analyse the use of the different drawdown mechanisms by its customers for the type of credit product offered by him, (or likely to result from the advertising) and choose the most common drawdown mechanism based on reasonable expectations.

[29] This assumption refers to mechanisms of drawdown of the credit (e.g. cash advances), and not drawdowns of the balance in the consumer's account (e.g. cash deposits with debit entry).

The determination of the most common mechanism could, for example, be established on the basis of different criteria such as the frequency of use or the total value of transactions within a given period.

When the creditor is unable to identify the most common mechanism, and does not have a basis to reasonably determine such mechanism, a solution coherent with the assumption would be to choose the mechanism with the highest borrowing rate and charges.

4.2.3 ASSUMPTION (D)

(d) In the case of an overdraft facility, the total amount of credit shall be deemed to be drawn down in full and for the whole duration of the credit agreement. If the duration of the overdraft facility is not known, the annual percentage rate of charge shall be calculated on the assumption that the duration of the credit is 3 months.

This assumption establishes a special regime for overdrafts, according to which the total amount of the credit is presumed to be drawn down in full and to remain so for the duration of the agreement, which means that repayment of the credit only takes place at the end of the agreement.

If the overdraft facility has a fixed duration, and the credit must be repaid in full at the end (and is not available to be drawn down again), that fixed duration shall be taken into account. However in all other cases, the duration is assumed to be 3 months (even if it is known that the facility is likely to last longer). This differentiates the treatment of overdrafts from other open-end agreements (such as credit cards and lines of credit or other revolving credits), whose assumed duration is 1 year according to Assumption (e)[30].

4.2.4 ASSUMPTION (E)

(e) In the case of an open-end credit agreement, other than an overdraft facility, it shall be assumed that:

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[30] The functioning of overdraft facilities differs from other forms of credit in several features. On the one hand, in overdrafts, the credit facility is only used when the consumer exceeds the balance in his current account, while in credit cards and lines of credit the credit exists permanently, regardless of the balance in any linked account. Further differences between overdrafts and credit cards include the following: 1) when an overdraft is provided, the consumer's account can be overdrawn for different reasons, including transactions related to cash, payment instruments (e.g. debit cards) and credit instruments (repayments and payment of charges of loans, credit cards or other forms of credit); however, in credit cards only payments made with the card can constitute drawdowns of the credit; 2) the credit limit in a credit card does not have a one-to-one correspondence with the balance in the consumer's account; in fact, the type of card which might show this correspondence is a debit card, and not a credit card.

(i) the credit is provided for a period of 1 year starting from the date of the initial drawdown, and that the final payment made by the consumer clears the balance of capital, interest and other charge, if any;

(ii) the capital is repaid by the consumer in equal monthly payments, commencing 1 month after the date of the initial drawdown. However, in cases where the capital must be repaid only in full, in a single payment, within each payment period, successive drawdowns and repayments of the entire capital by the consumer shall be assumed to occur over the period of 1 year. Interest and other charges shall be applied in accordance with those drawdowns and repayments of capital and as provided for in the credit agreement.

For the purposes of this point, an open-end credit agreement is a credit agreement without fixed duration and includes credits which must be repaid in full within or after a period but, once repaid, become available to be drawn down again.

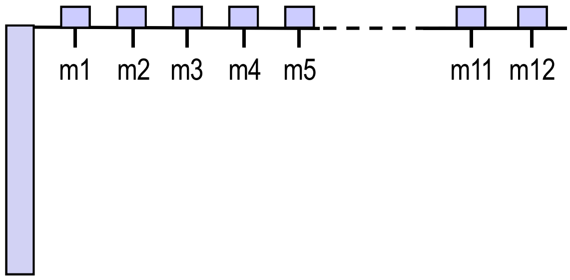
The method of calculation of the APR in open-end credit agreements is not straightforward, for a number of reasons. Firstly, these agreements do not have a fixed duration, which makes it difficult to calculate an APR. Secondly, these agreements typically take the form of revolving credit agreements, meaning that the credit may be used repeatedly as the borrower repays the sum used. The borrower can choose how much to draw down each month, and usually he can also choose how much to repay. As a result, none of the features, i.e. the duration, the drawdowns, the repayments or the amount due at each moment in time are known in advance, as they are dependent on how the borrower uses the credit. Examples of the cases of revolving credit agreements dealt with in this assumption include credit cards agreements, charge cards and lines of credit agreements, but not overdrafts.

Therefore, the calculation of the APR in open-end credit agreements requires the application of assumptions concerning the duration, drawdowns and repayments, with due consideration to the terms of the agreement and the aim of homogeneity which promotes the comparability of the APR among products.

As indicated in the final paragraph of Assumption (e), these agreements include cases where the credit must to be repaid in full within or after a period (meaning that there are maximum or a certain number of periods until full repayment) but, once repaid, the credit becomes available to be drawn down again. Therefore, such periods do not establish the duration of the agreement, because the credit revolves and can be used in successive new periods.

Point (i) of Assumption (e) establishes an applicable duration of 1 year for open-end agreements (other than overdrafts), implying that APRs are obtained on the basis of this duration. This is appropriate given that the agreements are open-ended and the APR is intended to provide an annual cost comparator. The 1-year period starts at the date of the initial drawdown, so that the final payment is assumed to be made one year after the initial drawdown (e.g. if the initial drawdown takes place on January 5th of a given year, the final payment is made on January 5th of the following year). This overrides the terms of the agreement, which otherwise typically require minimum repayments until the balance is repaid.

Point (ii) determines the scheme of repayment of the amount of the credit within the 1 year period. In general, such a scheme will consist of equal monthly repayments of capital,[31] starting one month after the date of the initial drawdown. This is illustrated in the figure below, which also assumes that the initial drawdown is for the total amount of the credit. This case illustrates a credit agreement with freedom of drawdown under Assumption (a). As can be seen, for months 1 to 12, an equal repayment of 1/12 of the amount of the credit is assumed, resulting in full repayment of the amount of the credit in 1 year.



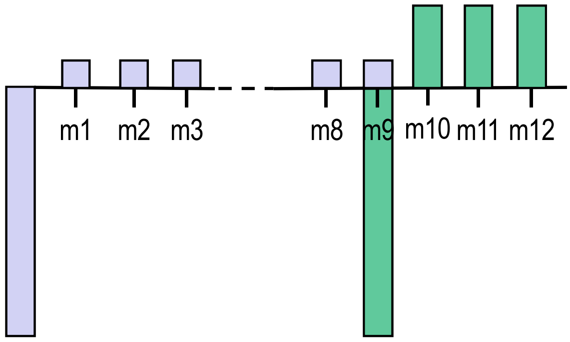
Compared to other schemes of repayments, such as minimum repayments or equal instalments comprised of capital and interest (or capital, interest and charges), this scheme of equal repayments of capital provides a relatively high level of APR compared with other options for the assumed duration of 1 year. Also, it is easy to understand for consumers, it does not encourage over-indebtedness, and facilitates the calculation of repayments and charges for the creditors[32].

If the credit agreement establishes recurrent periods until full repayment which are shorter than 1 year, after each of which the credit becomes available to draw down again, these periods will be respected by assuming equal monthly payments of capital within the period until full repayment and again within the remaining period until 1-year is reached. This case is illustrated in the following figure, which assumes a maximum period until full repayment of 9 months, followed by another full repayment in the remaining period of 3 months. Each of these periods begins with the drawdown of the total amount of the credit, and obviously, the repayment instalment of capital are lower

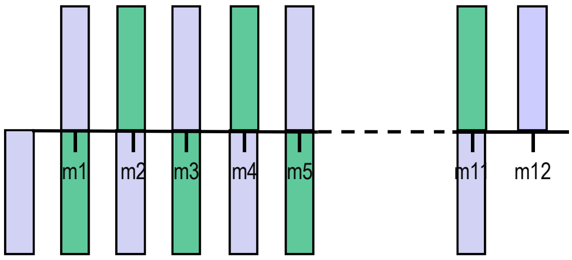
[31] The term ‘capital’ refers to the amount of credit drawn down, as distinct from interest and other charges payable on the credit.

[32] If the equal instalments were to comprise capital and interest, this would require an iterative process (‘trial and error’) to determine the amounts of repayments of capital which, taken together with interest payments (and any applicable charges), give rise to instalments of equal monthly value.

in the first period (the borrower has 9 months to make the payments) than they will be in the second (with only 3 months to make the repayments).



Finally, in cases such as charge cards, where the capital must be repaid only in full in respect of each payment period, but once repaid becomes available to be drawn down again in full, the assumption states that successive drawdowns and repayments of the entire capital will be assumed to occur over the period of one year. This is illustrated in the following figure, for the case of a credit agreement requiring repayments in full every month:



In relation to payments of interest and other charges, point (ii) of Assumption (e) states that the amount will be obtained from the terms of the agreement and the relevant scheme relating to drawdown(s) and repayment of capital. For example, in the case of credit cards, drawdown(s) will be determined by Assumption (a) or (b) and repayments by points (i) and (ii) of Assumption (e). In the case of charge cards, successive drawdowns and repayments in full are assumed, as above. Whenever this does not suffice for obtaining the amount and/or date of a payment of interest or other charges, Assumption (g) will apply. These payments, together with the repayments of capital, determine the sums to be paid by the consumer at each payment date. These sums are allocated firstly to paying interest and other charges and then capital (making them consistent with the way in which amortisation schedules are displayed).

4.2.5 ASSUMPTION (F)

(f) In the case of credit agreements other than overdrafts and open-end credits as referred to in the assumptions set out in points (d) and (e):

(i) if the date or amount of a repayment of capital to be made by the consumer cannot be ascertained, it shall be assumed that the repayment is made at the

earliest date provided for in the credit agreement and is for the lowest amount for which the credit agreement provides;

(ii) if the date of conclusion of the credit agreement is not known, the date of the initial drawdown shall be assumed to be the date which results in the shortest interval between that date and the date of the first payment to be made by the consumer.

An analysis of the situations described in this assumption makes clear that it applies only to credit agreements with a fixed duration other than overdraft facilities. It does not apply to open-end credit agreements. To illustrate this, and as seen above, Assumption (e) requires monthly and equal repayments of capital in open-end credit agreements (other than overdrafts). This means that minimum repayments or other repayment periods stipulated in Assumption (f) would be contradictory and are not allowed, thereby restricting the repayment rules of Assumption (f) to fixed duration credit agreements.

This assumption covers three different situations:

Case 1. The date of a repayment of capital is not known (and cannot be ascertained) from the agreement. In this case, the payment will be presumed to be made at the earliest date provided for in the agreement, thus leading to the highest possible APR. For example, if the agreement allows the consumer to choose the date of repayment provided that it is no later than a specified date, the repayment is deemed to be made the day immediately following the date of drawdown. If on the other hand payment is required to be made on or after a specified date, then it is assumed to be made on that date.

Case 2. The amount of a repayment of capital is not known (and cannot be ascertained) from the agreement. In this case, the repayment will be presumed to be the lowest amount for which the agreement provides. For example, if the agreement requires the consumer to make a minimum monthly payment equal to 10% of the outstanding balance of capital and interest, the amount of capital to be repaid will be obtained by deducting the amount of charges payable each month from this minimum payment. This gives the figure for the minimum amount of repayment of capital. This choice of lowest repayments is preferable to requiring highest repayments as this could imply full repayment of the credit in a very short period which would be unrealistic. In this case of minimum payments, the final repayment would not be the minimum, but would be the residual amount by virtue of Assumption (g). It should also be noted that when different schemes of repayments are available to the consumer, such as a minimum percentage of the amount of the credit, a minimum amount or equal instalments, only one of these schemes will be taken into account for the calculation of the APR. The choice of repayment scheme will be the one providing the lowest first repayment.

Case 3. The date the agreement is concluded is not known in advertising or at the pre-contractual stage and this has an effect on the length of the interval to the first payment to be made by the consumer. This idea also applies to situations where the date the agreement will be concluded is known but the date of the initial drawdown is not (as Assumptions (a) and (b) do not apply and the date of drawdown cannot otherwise be ascertained). An example of this situation could be a linked credit agreement with an unknown delivery date of the financed good or the provision of a service, where the credit drawdown takes place or begins on the date of delivery.[33]

Examples of such situations include:

- Credit agreements where payments are required to be made on specific dates (e.g. the first day of each month) irrespective of when the agreement is entered into;
- Credit agreements where the interval to the first payment depends on the date of the initial drawdown. For example, the agreement could stipulate that a drawdown occurring before or upon the 15th day of a month implies that payment is due on the first calendar day of the following month. If the drawdown occurs after the 15th day of a month, then payment is due the first calendar day of the second following month.

According to Assumption (f), when the date of the initial drawdown is not known, it shall be assumed to be the date which results in the shortest interval between that date and the date of the first payment by the consumer, thus leading to a highest possible APR.

For the first example above, i.e. payments on specific dates, this would mean that the date of the initial drawdown would be one day before the date of the first payment. For the second example, the shortest interval to the first repayment would be 14 days (assuming the shortest possible period, which is February 15th to March 1st in a non-leap year). This means that the initial drawdown would be assumed to occur on February 15th. These intervals of 1 day and 14 days, respectively, should be used at the advertising and pre-contractual stages for these agreements in order to obtain the interval to the first payment, provided that the terms of the agreement are coherent with such intervals[34]. The intervals for the next and following payments would be obtained by adding months to those first intervals, in accordance with Remark (c).

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[33] In this case, (f)(ii) refers to the date the good is delivered or service is provided rather than the date on which the agreement is entered into.

[34] When, for example, the duration of the credit is specified as exactly three years, payments are monthly, and the last payment clears the balance at the end of the third year, it is clear that the first payment is made one month after the date of the initial drawdown, and so Assumption (f) is not needed.

Similar reasoning would apply to the case where payment dates are unknown (case 1 above) because they depend on the dates when statements are received. In this situation, unless otherwise specified, it will be assumed that the statement is received by the consumer on the first day after the end of the billing period, and the payment is made on that same date. Therefore, if the billing period ends at the end of the month, it shall be assumed that the consumer receives the statement on the first day of the following month and pays immediately.

4.2.6 ASSUMPTION (G)

(g) Where the date or amount of a payment to be made by the consumer cannot be ascertained on the basis of the credit agreement or the assumptions set out in points (d), (e) or (f), it shall be assumed that the payment is made in accordance with the dates and conditions required by the creditor and, when these are unknown:

(i) interest charges are paid together with the repayments of capital;

(ii) a non-interest charge expressed as a single sum is paid at the date of the conclusion of the credit agreement;

(iii) non-interest charges expressed as several payments are paid at regular intervals, commencing with the date of the first repayment of capital, and if the amount of such payments is not known they shall be assumed to be equal amounts;

(iv) the final payment clears the balance of capital, interest and other charges, if any.

This assumption applies to all types of credit agreements, either open-end or non open-end (including overdraft facilities). Its purpose is to determine the date and/or amount of a payment of capital, interest or other charges where these are unknown and cannot be ascertained from the agreement, and where the previous assumptions do not provide a solution.

The need to determine these elements may arise when the credit agreement is silent about the date or amount of the payment. This could happen, for example, if the payment of a charge of EUR 10 was required but the date of payment was not mentioned. Payment dates or amounts could also be at the discretion of the creditor, such as when the agreement provides for the issue of monthly statements with the payment date specified, but leaves some discretion to the creditor as to when each statement will be issued.

The first paragraph of Assumption (g) specifies that the conditions required by the creditor will be respected before establishing any additional assumptions about dates or amounts. For the example regarding statements issued at the discretion of the creditor, if the billing period covers each calendar month and each monthly statement is issued on the 4th of the next month, specifying a due date falling on the 25th of that month, the consumer is assumed to make the payment on that date (even though it is not specified in the agreement itself). Similarly, a fee which falls due 14 days after the date of the statement is assumed to be paid at that date.

Points (i) and (iii) of the assumption are practical in nature and presume a regular payment of interest and other recurrent charges. The frequency of payment of interest charges is linked to the repayment of capital, given the interdependence of capital and interest charges. The amount of interest payable in each case will be the amount accrued up to the date of the repayment of capital, and this will be deemed to be paid together with the repayment of capital.

The frequency of payment of other, non-interest recurrent charges depends on the number of such charges. As to the amounts, if they are not known in the case of non-interest charges, equal payments are assumed. These may or may not correspond to the timing of repayments of capital, depending on the number of non-interest charges.

Point (ii) of the assumption, regarding single sum charges, leads to the highest possible APR.

Point (iv) ensures full repayment of the credit and all interest and non-interest charges at the end of the agreement. In the case of open-end agreements, other than overdraft facilities, this is also reflected in Assumption (e)(i) to ensure full repayment at the end of the assumed duration of one year.

4.2.7 ASSUMPTION (I)

(i) If different borrowing rates and charges are offered for a limited period or amount, the borrowing rate and the charges shall be deemed to be the highest rate for the whole duration of the credit agreement.

Assumption (i) applies where different borrowing rates and/or charges are offered for a limited period or in respect of different amounts of credit. These cases include products with reduced or even zero introductory interest rates, designed to attract customers, for example in the credit card market, or for small value credits, for example in overdraft facilities.

This assumption shall be applied when, at the date of the calculation of the APR, the relevant elements of the credit which determine the application and the effect on the APR of the different interest rates or charges are not known. For example, introductory rates or charges for a limited period shall not be taken into account for the calculation of the APR in open-end credit agreements, where the duration of the credit is not known at the date the APR is calculated or in cases where the amount of the credit is not known in advance. Another example could be the application of reduced rates or charges, which depend upon a specific pattern of drawdowns and/or repayments. A consumer may be offered a repayment schedule in the first three months or drawdowns within a certain period,[35] and if he is not bound by such patterns, the lower rates or charges shall not be taken into account for the calculation of the APR.

The aim, in all cases, is to consider, for the calculation of the APR, only those benefits which are certain and quantifiable at the time the APR is calculated, thus providing a realistic measure of the costs of the credit and of the APR. When these benefits are not certain or quantifiable, the APR shall be obtained under a worst case scenario. In this scenario, such benefits are to be disregarded and are not included in the APR calculation.

Assumption (i) refers to the "*whole duration of the credit agreement*". There may be cases where the agreement is open-ended but the credit is deemed to be repaid within a specified period, typically one year (by virtue of Assumption (e)). Regardless of this, a higher borrowing rate or charge will be used under Assumption (i) even if it is payable later than the assumed period of credit. For example, an annual fee may be waived in year 1 but becomes payable in year 2; if the amount of the fee in year 2 is known or can be ascertained, it must be used in the APR calculation.

4.2.8 ASSUMPTION (J)

(j) For consumer credit agreements for which a fixed borrowing rate is agreed in relation to the initial period, at the end of which a new borrowing rate is determined and subsequently periodically adjusted according to an agreed indicator, the calculation of the annual percentage rate shall be based on the assumption that, at the end of the fixed borrowing rate period, the borrowing rate is the same as at the time of calculating the annual percentage rate, based on the value of the agreed indicator at that time.

This assumption applies to those agreements where a fixed borrowing rate is agreed in relation to an initial period after which the borrowing rate is determined and subsequently adjusted according to an agreed indicator. This assumption determines the rate following the end of the initial fixed-rate period. Specifically, after this initial fixed-

[35] For example, a credit product which offers a zero borrowing rate for drawdowns in the first nine months. In this case, application of Assumption (a) of immediate drawdown in full would imply presentation to the consumer of a sharply lower cost of the credit (and the APR). It might be unrealistic for a consumer to obtain this if he does not, in practice, drawdown the full amount. A similar example would be a credit, which provides a waiver of its annual fee if the consumer withdraws a given amount of credit in the first three months. Again, application of Assumption (a) would imply a presentation of an extremely low cost of the credit (and the APR) which might not be obtained in reality by the consumer.

rate period the borrowing rate will be assumed to be determined by the value of the agreed indicator at the time of calculating the APR.

It should be noted that Assumption (j) may need to be applied in conjunction with Assumption (i) in cases where both are relevant.[36] In other words, if an introductory rate or charge is being disregarded under Assumption (i), on the basis that the benefit is not certain and quantifiable, then this assumption applies irrespective of whether the rate following the introductory period is specified in the agreement or is ascertainable using Assumption (j).

For example, in the case of an open-end credit agreement (such as a credit card agreement or overdraft facility), the benefit derived from a lower fixed or variable rate is not certain and quantifiable, and should therefore be disregarded in the APR calculation by virtue of Assumption (i). This is true irrespectively of whether the lower rate applies at the start of the agreement or subsequently.

To illustrate the simultaneous application of Assumptions (i) and (j) in the case of open-end credit agreements, consider the case where the borrowing rate is fixed at 1% for 2 years, and after that it reverts to the (variable) Euribor rate plus 1%. If at the time the APR is calculated the Euribor rate is 2.1%, applying (j) means that the borrowing rate after the first 2 years is assumed to be 3.1% (i.e. 2.1% + 1%) and to be fixed at that level for the remainder of the agreement. This is higher than the initial fixed rate, which is therefore disregarded under (i). This means that the borrowing rate is assumed to be 3.1% for the whole duration of the agreement. On the other hand, if the borrowing rate is fixed at 4% for 2 years, and then reverts to Euribor plus 1%, the highest borrowing rate is 4% (not 3.1%) and this is assumed to apply for the whole duration of the agreement.

There may also be cases involving non open-end agreements where Assumptions (i) and (j) apply simultaneously. For example, an agreement may have a fixed duration but the consumer may have freedom of drawdown and/or repayment (either completely or within limits), and so the amount of credit at any given time – and hence the amount to which the borrowing rate applies – is not ascertainable except by using assumptions in Annex I. In such a case, Assumption (i) should apply, even if Assumption (j) also applies.

On the other hand, if the amount and duration of credit are known then Assumption (j) can apply irrespectively of Assumption (i). For example, assume it is known that EUR 2000 will be drawn down on 1 January, and will be repaid in monthly intervals, in amounts determined by the contract, for a total of three years. The borrowing rate in the first year is 5%, in the second year it will be Euribor plus 1%, and in the third year Euribor plus 2%. Suppose that Euribor is 6% when the agreement is entered into. Applying Assumption (j), the rate in the second year will be 7% and in the third year it

[36] Note that neither of the assumptions excludes the application of the other.

will be 8%. All other elements of the APR calculation are however known and quantifiable, so there is no need to apply Assumption (i). In such a case, the lower rates in years 1 and 2 should be applied in the APR calculation.

In other words, if **only** Assumption (j) of Annex I is used, there is no need to apply (i) in addition, but if **any other** assumption from Annex I is used (e.g. because the amount or duration of credit is unknown or if it varies), then this triggers Assumption (i) in addition.

As to the interrelations between Assumption (j) and Article 19(4), it should be noted that Assumption (j) does not constitute an exception to the assumption in Article 19(4); rather, these assumptions complement each other.

Article 19(4) provides for the treatment of borrowing rates and charges that may vary in ways that are unquantifiable at the time of the calculation of the APR. In such cases, the rates and charges are assumed to remain fixed in relation to their initial level until the end of the agreement. Assumption (j) refers to those agreements where a fixed borrowing rate is agreed in relation to an initial period, after which the borrowing rate is variable (specifically, periodically adjusted according to an agreed indicator). This Assumption (j) shows that the solution provided by Article 19(4) should be applied to the variable rate period (where charges vary and are unquantifiable at the time of the calculation of the APR). This means that the fixed rate applies for the initial period, followed by the variable rate for the remaining duration of the agreement as determined by the value of the indicator at the time the APR is calculated.

Article 19(4) also provides a solution in cases where the change of the rate is only a possibility (e.g. when the agreement stipulates that after the initial period of a fixed borrowing rate, a new fixed rate may be agreed instead of proceeding with a variable borrowing rate). In contrast, Assumption (j) applies only when it is <u>known</u> that the rate will change.

There may be cases where it is known in advance that the rate will change and the extent of the change is ascertainable using Assumption (j), but the timing of the change is not known and cannot be ascertained (e.g. the change occurs at the discretion of the creditor or is dependent upon external circumstances). In such cases, Assumption (j) is applied to determine the new rate, and Assumption (i) is then applied to ensure that the highest rate and charges apply for the whole duration of the agreement.