

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(88) 201 final - SYN 132

Brussels, 2 May 1988

Proposal for a

COUNCIL DIRECTIVE

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

(presented by the Commission)

EXPLANATORY MEMORANDUM

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

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

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

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

1. to use a mathematical formula;
2. to bring into account the various items of charge, including the interest.

The Commission has had many discussions with government experts from all the Member States upon those two essential questions : mathematical formula and items of charge. There is at present no consensus on the latter point. As regards the mathematics, however, it appears that most Member States are now willing to take the necessary steps to require their lenders to use the actuarial method recommended by Professor E.S. Kirschen, the Commission's consultant in the matter, in his Report dated 19 October 1984, which has been

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

(2) See in OJ No C 68, 14.3.1983, p. 91 the suggestions made by Parliament for amendment of the Commission's original proposal published in OJ No C 80, 27.3.1979, p. 4; also Parliament's Resolution concerning that proposal, OJ No C 242, 12.9.1983, p. 10.

(3) OJ No C 183, 10.7.1984, p. 4.

widely distributed and discussed.

The present proposal deals only with the mathematical aspect of the calculation.

In so doing, it proceeds as follows :

1. Article 1 substitutes a new definition of "annual percentage rate of charge" for that contained in Article 1(2)(e) of Council Directive 87/102/EEC ("the principal Directive"). The new definition is as follows:

"annual percentage rate of charge" means the total cost of the credit to the consumer, expressed as an annual percentage of the amount of the credit granted and calculated in accordance with Article 1A of this Directive".

2. Article 1 inserts into the text of the principal Directive a new Article, numbered Article 1A, which reads as follows :

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

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

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

4. In the case of credit on running account, the method of calculation shown in Annex II shall be applied on the basis of the assumptions mentioned in Annex III."

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3. Annex I of the principal Directive contains a list of "essential" terms of contract as mentioned in Article 4(3) of that Directive.

Article 1 of the present proposal not only adds a new Article 1A to the principal Directive; it also adds two further annexes to that Directive. The first of these new Annexes (Annex II of the principal Directive) indicates the mathematical method which is to be used in calculating the annual percentage rate of charge.

4. By virtue of paragraph 3 of Article 1(2) of the present proposal the use in a Member State of a method of calculation other than that one will be allowed only if the resulting percentage rate of charge does not diverge by more than one tenth of one per cent from the rate of charge yielded by the said method.

5. Article 1 of the present proposal adds a further Annex (Annex III) to the principal Directive. This Annex indicates the assumptions which are to be made for the purpose of calculating the annual percentage rate of charge for credit in the case of a running account.

6. The present proposal revokes Article 5 of the principal Directive, which contains interim provisions concerning the disclosure of the total cost of credit to the consumer.

7. The present proposal provides for implementation not later than 31 December 1992.

The Directive is based on Article 100A of the Treaty and aims at a high level of protection. It does not create special problems for less developed economies.

There is, therefore, no need to propose provisions appropriate to their case.

II

(Preparatory Acts)

COMMISSION

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

COM(88) 201 final — SYN 132

*(Submitted by the Commission on 18 May 1988)**(88/C 155/06)*

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

HAS ADOPTED THIS DIRECTIVE:

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100A thereof,

Having regard to the proposal from the Commission,

In cooperation with the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas it is desirable, in order to promote the establishment and functioning of the internal market and to safeguard its consumers at a high level of protection, that, despite the differences in development of certain economies, one method of calculating the annual percentage rate of charge for credit should be used throughout the Community;

Whereas Article 5 of Council Directive 87/102/EEC (*) anticipates the introduction of a Community method of calculating the annual percentage rate of charge for credit;

Whereas it is desirable, as a first step towards the establishing of such a method, that an appropriate mathematical formula be laid down for the purpose of calculating the annual percentage rate of charge; whereas it is useful to adopt common rules concerning such a formula, although the cost items which will have to be taken into account in calculating the annual percentage rate of charge remain to be determined,

Article 1

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

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

'"annual percentage rate of charge" means the total cost of the credit to the consumer, expressed as an annual percentage of the amount of the credit granted and calculated in accordance with Article 1a of this Directive.'

2. The following Article 1a is inserted:

Article 1a

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

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

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

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

3. Article 5 of the said Directive is repealed.

(*) OJ No L 42, 12. 2. 1987, p. 48.

4. The Annex becomes Annex I.

Annexes II and III in the Annex to this Directive are added.

Article 2

Member States shall take the necessary measures to comply with this Directive not later than 31 December 1992 and shall forthwith inform the Commission thereof.

Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 3

This Directive is addressed to the Member States.

ANNEX

ANNEX II

The method of calculation

The general formula

The lender advances a sum S .

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

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

Payment k is made t_k years after the date of the loan (t_k being not necessarily a full number).

The effective annual rate is i .

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

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

This enables i to be calculated provided the amounts of payments A_k are all known.

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

A simple illustration

$S = 1\,000$ ECU

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

The payments are of equal amount.

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

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

The effective annual rate is i .

The equation then appears as follows:

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

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

This is a quadratic equation with i , which can be solved by algebra:

$i = 0,1306623 \dots$

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

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

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

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

- (a) the rate of interest does not change;
 - (b) (i) if there is no fixed timetable for payment, the duration of the credit is one year;
(ii) if there is a fixed timetable for payment, it is observed by the borrower;
 - (c) (i) if the agreement specifies a credit limit, the credit granted is equal to that limit;
(ii) if no credit limit is stated in the agreement, the credit granted is equal to the amount fixed by the relevant Member State, not exceeding 200 ECU;
 - (d) unless otherwise specified, the credit is made available and the payments are made at the earliest moment provided for in the agreement.
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COMPETITIVENESS AND EMPLOYMENT IMPACT STATEMENT

PROPOSAL FOR A DIRECTIVE ON THE ANNUAL PERCENTAGE RATE OF CHARGE FOR CREDIT (1)

- I. What is the main reason for introducing the measure?
To institute a uniform method of calculation of the annual percentage rate of charge for credit.
- II. Features of the businesses in question. In particular:
- (a) Are there many SMEs? Yes
- (b) Have any mergers been noted in any regions which are:
- (i) eligible for regional aid in the Member States? NO
- (ii) eligible under the ERDF? No
- III. What direct obligations does this measure impose on businesses? When granting credit, to use the mathematical method specified in the proposal for a directive when calculating the rate of charge which the consumer-borrower will pay. There will be initial*
- IV. What indirect obligations are local authorities likely to impose on businesses?
None
- V. Are there any special measures in respect of SMEs? No
Please specify. No
- VI. What is the likely effect on:
- (a) the competitiveness of businesses? They will become more conscious of price competition
- (b) employment? Nil
- VII. Have both sides of industry been consulted? Yes
Please indicate their opinions. There is general agreement that the measure is sensible, realistic and totally appropriate both for, and in seeking to create, a single market.

(1) The exact title is : Proposal for a Directive to amend Council Directive 87/102/EEC of 22/12/1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.
Council Directive 87/102/EEC anticipates, expressly, the present proposal on APR calculation.

*inconvenience for lenders until they are familiar with the method. No costs are involved.