



OFFICE OF FAIR TRADING

DISCOUNTED APRs AND PPI

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OFT299

A guidance note outlining the Director General's views on the issue of credit advertisements which offer discounted APRs linked to payment protection insurance

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1 DISCOUNTED APRS AND PPI

- 1.1 The Office of Fair Trading has received complaints regarding credit advertisements which offer discounted APRs linked to payment protection insurance. It has been alleged that the APRs are not being calculated in accordance with the Consumer Credit (Total Charge for Credit) Regulations 1980 (SI 1980/51), and that the advertisements therefore contravene the Consumer Credit (Advertisements) Regulations 1989 (SI 1989/1125). Both sets of Regulations will be amended by the Consumer Credit (Total Charge for Credit, Agreements and Advertisements) (Amendment) Regulations 1999 (SI 1999/3177) which come into force on 14 April 2000.
- 1.2 The purpose of this note is to set out the Director General's views on the issue, pursuant to his licensing responsibilities under the Consumer Credit Act 1974 ("the Act") and following discussion with LACOTS.

Background

- 1.3 The Office is aware that a number of lenders operate arrangements whereby loans are offered with or without payment protection insurance (PPI) and – presumably to encourage borrowers to take out that additional protection – the lender offers a reduced interest rate where the borrower chooses to take out a loan with PPI.
- 1.4 We recognise that there are benefits to both the borrower and the lender where PPI is taken out, and that the decision on whether or not to take it out genuinely rests with the borrower in such cases. However, we are concerned about the disclosure of APRs in such arrangements. Some lenders appear to take the view that, because the borrower has the option of taking out a loan with PPI or one without, the cost of the PPI should not be included in the calculation of the total charge for credit and APR for the loan with PPI. We do not agree.

The Total Charge for Credit Regulations

- 1.5 Regulation 4 of SI 1980/51 provides that, except as provided in regulation 5, the total charge for credit in relation to an agreement includes "(a) the total of the interest on the credit which may be provided under the agreement and (b) other charges at any time payable under the transaction by or on behalf of the debtor or a relative of his whether to the creditor or any other person". Regulation 5(1)(i), as amended by SI 1985/1192, excludes from the total charge for credit "a premium under a contract of life insurance where the policy monies payable under the contract are, under the transaction, to be used for the repayment of the credit under the agreement or under any other personal credit agreement secured by a land mortgage forming part of the transaction or of the total charge for credit".
- 1.6 In the Office's view, regulation 5(1)(i) was intended to apply to endowment policies, and not to cases such as PPI where the policy only repays the credit in the event of the debtor's death. However, we recognise that the point is not entirely clear, and some lenders have argued that the cost of PPI should not be included in the total charge for credit where it has a life element.
- 1.7 The position will be put beyond doubt by SI 1999/3177. This amends regulation 4 of SI 1980/51 by adding, as regulation 4(c), that the total charge for credit includes "a premium under a contract of insurance, payable under the transaction by a debtor or a relative of his, where the making or maintenance of the contract of insurance is required by the creditor (i) as a condition of making the agreement and (ii) for the sole purpose of ensuring complete or partial repayment of the credit, and complete or partial payment to the creditor of such of those charges included in the total charge for credit as are payable to him under the transaction, in the event of the death, invalidity, illness or

unemployment of the debtor”. Furthermore, regulation 5(1)(i) of SI 1980/51 is amended to read “a premium under a contract of insurance other than a contract of insurance referred to in regulation 4(c) above”.

The Advertisements Regulations

- 1.8 Paragraph 7 of Parts II and III of Schedule 1 to SI 1989/1125 require the statement of “the APR in relation to any actual or prospective agreement”, and regulation 3 provides that where an advertisement refers to a class of transactions, there may be substituted for “the APR” representative information (ie a typical APR) together with an indication that the information is representative. “The APR” is defined in regulation 1(2) as the annual percentage rate of charge for credit determined in accordance with the Total Charge for Credit Regulations.
- 1.9 As can be seen from paragraphs 5-7 above, the question of whether a PPI premium forms part of the total charge for credit depends on whether the premium is payable under the transaction, and whether the PPI is required as a condition of making the agreement.
- 1.10 For a single agreement or class of agreements, where PPI is optional, we agree that the PPI is not payable under the transaction and does not form part of the total charge for credit. The borrower is not required to take out the PPI, and it is not a condition of making the credit agreement.
- 1.11 However, where a lender offers loans with or without PPI, and with an interest rate discount where PPI is taken out, there are in the Office’s view two **separate** agreements or classes of agreement, each of which falls to be considered separately for the purposes of the Regulations. The borrower remains free to decide whether or not to take out a loan with PPI – but the interest rate discount is available only if he does so. There is a clear link between the offer of PPI and the offer of credit on alternative terms and conditions (namely a lower rate of interest), and the fact that the terms and conditions of the credit offered are different in each case means that there are two different credit agreements. **Under the agreement with the lower rate of interest, the PPI is in effect mandatory, and its cost therefore falls to be included in the total charge for credit.**
- 1.12 This view is consistent with the intention behind APR, which is to provide borrowers with a comparator which they can use to distinguish the relative merits of alternative credit facilities. When faced with alternatives of a single credit agreement which can be taken up with or without PPI, it is both appropriate and possible for the borrower to consider separately the cost of the credit and the PPI. Where the trader ties these two elements together, this is no longer true, and a figure which takes into account the reduced interest cost of the credit without also reflecting the additional cost of the PPI does not provide a valid means of comparison. Section 20(1) of the Act makes clear that the total charge for credit should represent “the true cost to the debtor of the credit provided”, and section 20(2) provides that the amount payable under a linked transaction may be required to be included in the total charge for credit whether or not the creditor is a party to the transaction or derives benefit from it.
- 1.13 To take a hypothetical example, a lender offers loans where interest is charged at a nominal annual rate of 12%, and at a reduced rate of 10% where PPI is taken out. On a loan of £10,000 the lender advertises repayments of £222.44 and an APR of 12.6% without PPI, and repayments of £254.96 and an APR of 10.4% with PPI. The APR therefore apparently decreases for larger repayments. The PPI may be paid for by a single up-front premium where the lender advances the borrower an additional sum to finance this, or by monthly insurance premiums. In the former case, the lender has failed to disclose the cash price of the PPI (£2,000 in the example). In the latter case, the lender has failed to give both the amount of the monthly premium (£42.49) and the repayments due under the credit agreement (£212.47), and has provided only the combined sum. The absence of this additional information about the cost of the PPI might lead some consumers to purchase PPI in circumstances

where, had they been provided with clear information, they might have chosen not to. If the cost of the PPI were included in the calculation of the APR – as we believe that it should – then the resultant APR for the loan with PPI would be 19.7% rather than 10.4%.

Section 46 CCA

- 1.14 Section 46 of the Act provides that if a credit advertisement conveys information which in a material respect is false or misleading the advertiser commits an offence. Information stating or implying an intention on the advertiser's part which he has not got is false. Section 47 provides that, where an advertiser commits an offence under section 46, or under the Advertisements Regulations, a like offence is committed by the publisher of the advertisement, or the person who devised the advertisement, or the person who procured its publication.
- 1.15 In the Office's view, where a lender advertises loans with or without PPI, and with an interest rate discount where PPI is taken out, but does not include the cost of the PPI in the total charge for credit and hence the APR, this could be held to be misleading in a material respect, over and above any breach of the Regulations. We recognise that the question of breach depends, to some extent, on the interpretation of regulation 5(1)(i) of SI 1980/51, but as indicated above we believe that that particular issue will be put beyond doubt by SI 1999/3177 which comes into force on 14 April 2000. From that date we can see no justification for the practice of discounted APRs linked to PPI, where the cost of the PPI has not been included in the total charge for credit and APR.
- 1.16 **More generally, it should be made clear in advertisements and other promotional material whether or not PPI is optional, and the cost of the PPI. Borrowers should be given sufficient information to be able to compare the cost of loans with or without PPI.**

The DG's Licensing Responsibilities

- 1.17 In considering fitness to hold a consumer credit licence, the Director General is required by section 25(2) of the Act to have regard to any circumstances appearing to him to be relevant, and in particular, among other matters, whether the trader has contravened any provision made by or under the Act, or has engaged in business practices appearing to the Director General to be deceitful or oppressive or otherwise unfair or improper (whether unlawful or not). Under section 25(2), the fitness of a licensee can be brought into question by the actions of any of its employees, agents or associates (whether past or present), and section 25(3) defines 'associate' for these purposes as including a business associate.
- 1.18 Each case would fall to be considered on its merits, and the Director General would wish to take into account in particular whether there had been, or was liable to be, any detriment to consumers, and the likely extent of such detriment. If firms are in any doubt as to whether an advertisement would be likely to breach the Regulations and/or section 46 of the Act, or its publication regarded by the Office as an unfair business practice, they should consider taking legal advice on the point. Their trade association, or local trading standards department, may also be able to offer advice.