

Consumer Measures Committee

Comité des mesures en matière de consommation

Consultation on Cost of Credit Disclosure January 2005

Background

In September 1996, Federal, Provincial and Territorial Ministers Responsible for Consumer Affairs agreed to a package of proposals for the harmonization of cost of credit disclosure law throughout Canada. Ministers then tasked the Consumer Measures Committee (CMC) with developing a technical template, or Harmonization Agreement, expressing the harmonization proposals in sufficient detail to guide legal drafting and with conducting technical consultations with stakeholders. The Harmonization Agreement, dated June 1, 1998, is available on the internet.¹

After implementation of cost of credit disclosure provisions by the governments of Alberta and Canada, Alberta (joined by Québec and British Columbia) brought forward, in 2003, a dispute under Article 1704 (Request for Panel) of the Agreement on Internal Trade regarding the federal *Bank Act – Cost of Borrowing (Banks) Regulations*. An Article 1704 Panel heard the dispute in March 2004. The June 4, 2004, Report of the *Article 1704 Panel Concerning a Dispute by Alberta, Québec and British Columbia with Canada regarding the Federal Bank Act - Cost of Borrowing (Banks) Regulations* recommended that, *inter alia*, the Consumer Measures Committee (“CMC”):

... meet at the earliest opportunity to resolve concerns raised by the Parties with respect to the Harmonisation Agreement, specifically by developing

- clear guidelines on how APR (Annual Percentage Rate) is to be calculated and what, if any, additional waivers to the 2-day cooling off period are acceptable, such guidelines to be followed by all jurisdictions in drafting their cost of credit legislation.²

Pursuant to this recommendation, CMC established a working group -- co-chaired by Canada (represented by the Department of Finance) and Québec (Office de la protection du consommateur), with membership from British Columbia, Alberta, Saskatchewan, Manitoba, Newfoundland and Labrador and Industry Canada -- to prepare suggested options for the two components of the above panel recommendation: (1) calculation of APR in open credit other than credit cards, and (2) conditions for allowing consumers to waive the two-day cooling-off period for mortgage contracts.

¹ Consumer Measures Committee, *Agreement for harmonization of Cost of Credit Disclosure Laws in Canada – Drafting Template*, June 1, 1998, available at: [http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/vwapj/cmcccdl.pdf/\\$FILE/cmcccdl.pdf](http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/vwapj/cmcccdl.pdf/$FILE/cmcccdl.pdf).

² Report of the *Article 1704 Panel Concerning a Dispute by Alberta, Québec and British Columbia with Canada regarding the Federal Bank Act - Cost of Borrowing (Banks) Regulations*, June 4, 2004, available at: <http://www.intrasec.mb.ca/2004panel/en/panel.pdf>.

The purpose of this consultation document is to obtain your views on the listed proposed approaches for dealing with the two components the Panel's report cited above.³ The paper is therefore divided accordingly into two parts, each dealing with one component.

You are requested to submit your comments by March 1, 2005.

You may reply by regular mail, fax or email, using this form or by letter. Please send your submissions to:

**Maryanne Murphy
Consumer Measures Committee
c/o Office of Consumer Affairs,
Industry Canada
235 Queen Street,
Ottawa ON K1A 0H5
Fax: (613) 952-6927
Email: Murphy.Maryanne@ic.gc.ca**

³ This consultation document is not being distributed to stakeholders in Newfoundland and Labrador as this jurisdiction intends to implement the current provisions in the federal *Bank Act - Cost of Borrowing (Banks) Regulations* with respect to interest rate disclosure for open credit and waiver of the 2-day cooling-off period for mortgage contracts, which are not included in this document, as discussed in the "Current Approaches" sections on pages 3 and 7.

COMPONENT ONE:

Annual Percentage Rate disclosure for open credit other than credit cards

The Cost of Credit Disclosure Harmonization Agreement Template (the “Agreement”) calls for disclosure by credit grantors of the Annual Percentage Rate (APR), as defined in this box.⁴

$$R = [C/(T \times P_a)] \times 100, \text{ where}$$

“**C**” is the total cost of borrowing over the term of the loan expressed as an amount. Interest charges and the non-interest charges specified under “Charges Included in the APR”⁵ will be included in the cost of borrowing for the purpose of this calculation;

“**P_a**” is the average of the principal of the loan outstanding at the end of each of a series **a** of equal interest calculation periods as provided for in the loan contract, before applying any payment due. The principal is the amount advanced, exclusive of any element of the cost of borrowing;

“**R**” is the cost of borrowing over the term of the loan, expressed as a rate per annum on the principal (the APR);

“**T**” is the term of the loan in years.

At the same time, it is to be noted that the Agreement also requires, in initial disclosure statements, disclosure of an annual interest rate (that is to say, a basic rate exclusive of charges) and the charges that are to be included in the APR calculation. Currently, credit grantors must make assumptions to the calculation of the APR equation to determine the **P_a** and **T** factors. In accordance with the Panel’s recommendation, CMC wishes to adopt an appropriate assumption for **P_a** and **T**, where those expressions may be unknown before the contract is entered into. CMC proposes two options for clarifying **P_a** and **T**, on which it would like to hear your views.

Current Approaches

There are several approaches that are currently in use, or at the proposal stage, within Canadian jurisdictions. The federal *Cost of Borrowing (Banks) Regulation* does not require the disclosure of an APR for lines of credit; rather, federally regulated financial institutions are required to disclose to consumers the annual interest rate and list the nature and amount of all non-interest charges.⁶ Ontario proposes to align with the federal approach.⁷ Also, Newfoundland and Labrador’s proposed regulations are similar to the current federal approach. These approaches do not meet the APR requirement as set out in the Harmonized Agreement, and are not an option that can be given consideration, without varying from the Harmonization Agreement. That option therefore is not under consideration for this consultation. Alberta requires disclosure of an APR in open credit

⁴ Harmonization Agreement, *op. cit.*, pp. 5-6.

⁵ “Charges Included in the APR” are listed at Article 1.4 of the Agreement, *ibid.*, pp. 8-9.

⁶ *Cost of Borrowing (Banks) Regulations*, SOR/2001-101, s. 10.

⁷ For more information on Ontario’s regulation on credit agreements, see the Consumer Protection Act 2002 on <http://www.e-laws.gov.on.ca>.

other than credit cards. In accordance with the Agreement, Alberta does not specify what assumptions are to be used in the calculation,⁸ but Alberta does permit the credit grantor to base disclosure on an estimate or assumption where the information is not ascertainable by the credit grantor at the time of disclosure and the estimate or assumption is clearly identified as an estimate or assumption.⁹ Under proposed legislation, British Columbia requires an APR for open lines of credit; where there is no maturity date, the Term is assumed to be one year for the purposes of the APR calculation and Principal is assumed to equal the credit limit (the maximum amount the borrower can draw on the credit agreement).¹⁰ Québec has not yet implemented the Agreement; its current approach is to require disclosure of a credit rate, broadly similar in concept to the Agreement's APR, and a table of examples of the credit charges, which may vary according to the specifics of the contract. The Québec legislation does not specify what assumptions are to be used.¹¹ Saskatchewan's *Cost of Credit Disclosure Act, 2002* also requires the disclosure of an APR for open credit agreements. Proposed regulations under the Saskatchewan *Act* provide that where the total amount to be advanced is unknown, the APR is to be calculated using the credit limit existing at the time of the calculation. Where no term is specified, Saskatchewan's *Act* allows disclosure to be based on an assumed term, provided that it is clearly identified as an assumption.¹²

The proposed options

Before presenting the options, we would note that the rationale behind the development of harmonized cost of credit disclosure rules is to assist consumers to fairly compare costs of borrowing among competing products. Our efforts in developing the options were guided by criteria laid down in the Agreement on Internal Trade.¹³ **Given this rationale, and given the requirements of the Agreement on Internal Trade, we request that you use the criteria of *fairness, accuracy, comparability, simplicity and clarity* as the basis for your discussion about these options.**

In addition to your assessment of each of these approaches based upon the above criteria, please indicate your preferred approach of the two listed.

⁸ S. 10 of the template states that "A credit grantor may base a disclosure on an estimate or assumption where (a) the information is not ascertainable by the credit grantor at the time of disclosure, and (b) the estimate or assumption is reasonable and is clearly identified as an estimate or assumption." See Harmonization Agreement, *op.cit.*, p. 11.

⁹ See *Cost of Credit Disclosure Regulation*, s. 3.

¹⁰ *Disclosure of the Cost of Credit Regulation*, s. 8.

¹¹ *Consumer Protection Act*, Québec

¹² *Cost of Credit Disclosure Act, 2002*, s. 9.

¹³ Under Annex 807.1 of the AIT (text of Consumer-related Measures and Standards Chapter of the AIT available at: <http://strategis.ic.gc.ca/epic/internet/inait-aci.nsf/en/il00009e.html>), parties to the AIT are required to develop cost of credit legislation such that:

- A. Consumers must receive fair, accurate and comparable information about the cost of credit.
- B. The disclosure must be as clear and simple as possible, taking into account the inherent complexity of disclosure issues related to any form of credit.

1. *The Full Principal approach*

Under this approach, where the amount advanced or the repayment plan for open credit other than credit cards is unknown, the following assumptions are made:

P_a = the credit limit, and
T = 1 year.

It is assumed that the full amount of the credit limit is drawn down at the beginning of the year. Further, it is assumed that payment is made once, in full, at the end of the year. Thus, for a \$20,000 credit limit, $P_a = 20,000$ and $T = 1$ year. APR is then calculated using the Harmonization Agreement formula. (In effect, $C/P_a * 100$.) This approach is the approach most commonly used by lenders who must comply with the APR standard and who are free to choose assumptions. It is also the proposed legislative standard in British Columbia.

Please discuss this approach, based on the criteria of fairness, accuracy, comparability, simplicity and clarity.

2. *Declining Principal (fixed payment) Approach*

Under this approach,

P_a = the sum of all principal amounts outstanding at the beginning of each statement period divided by the total number of statement periods. The borrower is assumed to make payments of 3% of the credit limit on the due date and
T = the number of years it takes to pay off the principal based on monthly payments of 3% of the credit limit.

It is further assumed that the full credit limit is drawn down by the borrower upon approval of the line of credit, and that twelve monthly payments are made each year. Total costs of borrowing are summed. Applying the formula, $[\text{Total cost}/(T \text{ in years} * P_a)] * 100$ gives us the APR.

Under this approach, rather than assuming payments as a fraction of the outstanding balance (as per the terms and conditions of certain lines of credits), we assume payments as a fraction of the credit limit. This shortens the assumed repayment term, i.e. a borrower is assumed to pay off a loan more quickly than when calculating payments as a fraction of the balance. We propose the figure of 3% as our base payment, based on the

fact that it is a commonly used figure among open credit grantors in Canada (who often demand the larger of monthly minimum payments of 3% of a remaining balance, or a flat amount). However, we welcome views on whether this is an appropriate amount to assume under this approach.

Please discuss this approach, based on the criteria of fairness, accuracy, comparability, simplicity and clarity.

An appendix to the document also provides information on rules to be implemented in the United Kingdom with respect to consumer credit agreements. Section 15 is specific to running-account credit, and assumes a one-year term, and that twelve equal monthly payments are made.

COMPONENT TWO:

Conditions for waiving the 2-day cooling-off period in mortgage contracts

The Harmonization Agreement provides for a two-day notification period -- the period between disclosure and entering the contract. The Agreement allows for a waiver of this period following initial disclosure, only if the consumer receives legal advice as to the effect of the waiver. The relevant text is as follows:¹⁴

S. 13

(2) The credit grantor must provide the initial disclosure statement for a mortgage loan to the borrower at least 2 business days before the borrower enters into the credit agreement or makes any payment, excluding disbursement charges, whichever is earlier.

(3) The two-day period for receiving the disclosure statement may be waived by the borrower if the borrower obtains independent legal advice.

The rationale for including a cooling-off period is related to the fact that, in contrast to most other loan agreements, in mortgage contracts there is typically a significant monetary penalty that attaches to paying off the loan in advance of the timing set out in the contract. On the other hand, there is a rationale for permitting consumers to waive the cooling-off period without conditions; this allows consumers to enter into mortgage contracts without a loss of time and expense.

Current approaches

Federal regulations do not require consumers to seek independent legal advice to waive their right to a 2-day cooling off period. Newfoundland and Labrador's proposed regulations are similar to the current federal approach. Alberta and British Columbia, in current or proposed regulations, list a set of possible conditions, the fulfilment of any one of which may allow the consumer to waive the cooling-off period.

The proposed options

Jurisdictions may apply more than one possible condition. Therefore, in reviewing these options, it is important to note that they are not exclusive; you do not have to pick one favoured approach.

1. Independent legal advice approach

This option fulfils the requirements of s.13(3) of the Harmonized Agreement drafting template. Under this approach the consumer may waive the two-day cooling-off period if he or she has received "independent advice of the legal effect of the waiver, and a

¹⁴ Harmonization Agreement, *op. cit.*, p. 16.

statement to that effect, signed by the lawyer providing the advice, is attached to the waiver”. British Columbia and Alberta include this as a possible condition.

2. *Rescission period approach*

Under this approach, waiver of the two-day notification period can be made if the mortgage clearly includes a rescission provision granting the borrower the right to extricate from the mortgage within two days of the disclosure being made. This rescission provision must clearly indicate that rescission is at no cost to the borrower - in respect of the mortgage, any payments made by the borrower are refunded and any obligations placed on the borrower are rescinded in the event of rescission. This approach is currently found in Alberta’s *Fair Trading Act—Cost of Credit Disclosure Regulation*.

3. *Waiver dependent on consumer*

Under this approach, the independent legal advice condition for the waiver of the cooling off period would be required for mortgage consumers obtaining their first mortgage, but not for more experienced consumers obtaining their second (or later) mortgage.

4. *“Favourable prepayment terms” clause*

Currently found in Alberta’s regulation and British Columbia’s proposed regulation, this approach allows consumers to waive the advance notice period if there is no prepayment penalty -- that is to say, where the pre-payment rights are as favourable to the consumer as those rights found in non-mortgage loans.

Question

Keeping these options in mind, we would like you to tell us which, if any, of the above conditions should apply to allow consumers to waive a two-day cooling-off period.

- End of Document –

APPENDIX: United Kingdom Regulations

STATUTORY INSTRUMENTS

2004 No. 1482

CONSUMER CREDIT

The Consumer Credit (Agreements) (Amendment) Regulations 2004

Made 5th June 2004

Laid before Parliament 9th June 2004

Coming into force 31st May 2005

The Secretary of State, in exercise of the powers conferred upon her by sections 60, 61(1)(a), 105(9), 114(1), 182(2) and 189(1) of the Consumer Credit Act 1974[1], hereby makes the following Regulations:

NOTE: Sections 1-14 and 16-18 have been deleted from this appendix – for the full text, see <http://www.hmso.gov.uk/si/si2004/20041482.htm>.

15. In Schedule 7 (provisions relating to the disclosure of the APR) for paragraph 1 substitute -

" Assumptions about running-account credit

1. In the case of an agreement for running-account credit, the following assumptions shall have effect for the purpose of calculating the APR in place of the assumptions in Part 4 of the Total Charge for Credit Regulations that might otherwise apply -

(1) in any case where there will be a credit limit but that limit is not known at the date of making the agreement the amount of the credit to be provided shall be taken to be £1,500 or, in a case where the credit limit will be less than £1,500, an amount equal to that limit;

(2) it shall be assumed that the credit is provided for a period of one year beginning with the relevant date;

(3) it shall be assumed that the credit is provided in full on the relevant date;

(4) where the rate of interest will change at a time provided in the agreement within a period of three years beginning with the date of the making of the agreement, the rate shall be taken to be the highest rate at any time obtaining under the agreement in that period;

(5) where the agreement provides credit to finance the purchase of goods, services, land or other things and also provides one or more of -

(a) cash loans;

(b) credit to refinance existing indebtedness of the debtor's, whether to the creditor or another person; and

(c) credit for any other purpose,

and either or both different rates of interest and different charges are payable in relation to the credit provided for all or some of these purposes, it shall be assumed that the rate of interest and charges payable in relation to the whole of the credit are those applicable to the provision of credit for the purchase of goods, services, land or other things;

(6) it shall be assumed that the credit is repaid -

(a) in twelve equal instalments, and

(b) at monthly intervals, beginning one month after the relevant date.

Permissible tolerances in disclosure of the APR

1A. For the purposes of these Regulations, it shall be sufficient compliance with the requirement to show the APR if there is included in the document -

(1) a rate which exceed the APR by not more than one; or

(2) a rate which falls short of the APR by not more than 0.1; or

(3) in a case to which either of paragraphs 2 or 3 below applies, a rate determined in accordance with the paragraph or such of them as apply to that case."