THE UNIFORM COST OF CREDIT DISCLOSURE ACT

COMMENTARY

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OVERVIEW

The Uniform Cost of Credit Disclosure Act **("CCDA"** or **"Act")** results from a project undertaken by the Uniform Law Conference of Canada **("ULCC")** in 1990 in cooperation with the Alberta Law Reform Institute **("ALRI").** Between 1990 and 1993 the ULCC and ALRI developed draft legislation that differed from existing cost of credit disclosure legislation in certain key respects. The most notable characteristic of the draft CCDA as it stood in 1993 was that it would not have required disclosure of the cost of credit as an "annual percentage rate" (commonly abbreviated as **"APR").** Instead of requiring disclosure of the APR, the 1993 draft would have combined a requirement to disclose the annual interest rate and non-interest charges with certain restrictions on the non-interest charges that could be imposed in connection with consumer credit arrangements. However, that approach to cost of credit disclosure was overtaken by developments in another arena.

In the fall of 1993 the ALRI and ULCC were informed that cost of credit disclosure legislation was part of the agenda for internal trade negotiations between the federal government and the several provinces and territories. Upon learning of this intergovernmental initiative, the ULCC decided to delay finalization of its uniform CCDA in order to consult with government officials responsible for the consumer related measures sector of the internal trade negotiations. The Agreement on Internal Trade **("AIT")** was signed in the summer of 1994. The AIT called for jurisdictions to harmonize their cost of credit disclosure legislation but did not specify the detailed content of such legislation. Instead, the AIT called for an agreement on the details of harmonized legislation by January I, 1996 with implementation by January I, 1997.[1] The AIT called for the parties to establish an interjurisdictional group of officials called the Committee on Consumer-Related Measures and Standards **("Committee").** One of the Committee's responsibilities was to work out the text of an agreement on the detailed policies to be implemented by harmonized cost of credit disclosure legislation.

In 1994, rather than adopting a Uniform Act that would reflect its own views on the relevant policy issues, the ULCC resolved to proceed in the following manner. The

[1] AIT, Annex 807.1, paragraph 10.

ULCC would present its views on relevant policy issues to the Committee. Ultimately, however, the ULCC would defer to the Committee on the policies lo be implemented in harmonized cost of credit disclosure legislation. On the other hand, the ULCC also resolved to apply its own legislative drafting standards and exercise its own judgment to develop model legislation that would implement the policy decisions reached by the Committee. The Uniform Act as adopted by the ULCC reflects the foregoing resolutions.

In 1995 the Committee circulated a document entitled "Proposals for Harmonization of Cost of Credit Disclosure Laws in Canada" In 1996, after consultation with interested parties and further deliberations, the Committee issued a revised version of the 1995 document. After further consultation and deliberation the Committee is expected to adopt a final version of the harmonization agreement in the spring of 1998. The CCDA and this Commentary reflect the draft text of the harmonization agreement as it read at the beginning of June 1998. The June 1998 draft text of the harmonization agreement is referred to herein as the **"Draft Harmonization Agreement"** or **"DHA."** The ULCC 's understanding is that the final text of the harmonization agreement wil I not differ in any material respect from the DHA. The ULCC believes that the CCDA implements all of the policy decisions articulated in the Draft Harmonization Agreement. However, in order to achieve what the ULCC considers to be an optimal legislative implementation of the policy decisions embodied in the DHA, lhe structure and terminology of the CCDA depart from the DHA's structure and terminology.

Not every provision in the Uniform CCDA corresponds to a policy decision embodied in the DHA. Some provisions of the Uniform CCDA deal with issues that are passed over by the DHA. The best example of this is in the area of *compliance.* The DHA makes no recommendations regarding the consequences of non-compliance, but the Uniform CCDA contains detailed provisions regarding the civil consequences of non-compliance. In other cases, the Uniform Act deals with issues that, although not directly addressed by the DHA, are related to issues that it does address. For example, the DHA deals with disclosure requirements where mortgage loans are renewed but does not deal with the issue of disclosure when non-mortgage loans are renewed. The Uniform Act deals with renewal in both contexts. The ULCC believes that the Uniform Act's approach to issues not addressed by the DHA is reasonable and, where the DHA addresses related issues, consistent with the Agreement's approach to those related issues.

References to DHA

This Commentary contains many cross-references to the DHA, but the task of cross-referencing is complicated by the manner in which the latter document is organized. The DHA is divided into numbered headings. Typically, under each heading a short discussion of the relevant issues is intenningled with one or more concrete proposals. The discussion and proposals are not fonnally separated, and some of the headings actually encompass several proposals that are not individually numbered. This Commentary refers to each of the numbered headings in the DHA as a "Proposal," which it identifies as **"Proposal** #," where "#" is the number of the relevant heading. Since many of the "Proposals" actually consist of several related proposals, cross-references sometimes identify particular paragraphs or even sentences within a Proposal to make the cross-reference as precise and unambiguous as possible.

In addition to the proposals that set out the agreed policies, the DHA contains what it describes as drafting template proposals: provisions that express agreed policies in legislative language. Most of the drafting template proposals are based on provisions of an earlier draft of the CCDA. Although there are obvious similarities between the drafting template provisions and provisions of the Uniform Act- in some cases they are identical - there are also differences in tenninology and structure. It is **not** one of the purposes of this Commentary to compare provisions of the CCDA with corresponding provisions in the drafting template proposals, so references to the latter are relatively rare in this document.

References are made to drafting template proposals where this is necessary to explain how a provision of the CCDA relates to the presumed intent of the Committee regarding a certain policy issue. This is necessary because in some cases the DHA sets out a drafting template proposal without describing the policy that the provision is intended to implement. This is particularly true in Part II of the DHA, entitled *LEASES,* where many of the agreed policies are not set out separately from the drafting template proposals.

Implementation Considerations

The Uniform Act is presented as a comprehensive, self-sufficient cost of credit disclosure statute. Although there are some references to regulations, the Act itself deals quite comprehensively with the details of cost of credit disclosure. This reflects the ULCC's view that a uniform act on cost of credit disclosure that left most of the messy details to be worked out in regulations "to be done by others" would not be of much assistance to anyone. At the same time, it is recognized that the Uniform Act contains many detailed provisions that jurisdictions may consider would be more at home in regulations than in an Act.

The Uniform Act is structured as a standalone statute. Some Canadian jurisdictions presently have standalone enactments that deal with pretty much the same subject matter as the Uniform CCDA. However, other jurisdictions include their cost of credit disclosure requirements in broader consumer protection legislation. The Uniform Act could be adapted to form one part of a broader consumer protection enactment without too much difficulty. It should be emphasized, however, that the provisions of the Uniform Act arc highly integrated with each other, and any mod i fications , deletions, additions or tinkering should be effected with great care.

DETAILED COMMENTARY

The following comments elaborate the Uniform CCDA on a section-by-section basis. The level of detail of the comments varies from section to section. In some cases, the comment on a particular provision consists of little more than a reference to the proposal of the DHA that the provision is intended to implement. In some cases the comment contains a brief explanation of how the relevant provision of the CCDA is intended to implement a particular proposal, where the terminology and structure of the provision depart from that of the proposal. Some comments are intended to point out nuances of provisions or relationships between provisions that might not be immediately obvious to all readers. The operation of some provisions is illustrated through brief examples. In general, the comments do not discuss the policy basis for provisions, as this is considered to be the office of the DHA. However, brief references to the policy

underlying a particular provision are made when this will help explain the provision's intended effect or where the provision does not relate directly to a proposal in the DHA.

PART I
DEFINITIONS AND INTERPRETATION

1. Definitions

(1) Subsection (1) defines more than 30 terms used in the Act. This commentary briefly indicates the contexts in which the defined terms are used and elaborates key elements of certain definitions. Where appropriate, there are cross-references to relevant proposals of the DHA; however, most cross-references are deferred until the comments on the substantive provisions of the Act.

"advance"

Several provisions of the Act require disclosure of the amount and timing of advances, and it is necessary to identify and quantify advances to calculate the total cost of credit and APR for a credit agreement. This is the first of several definitions that serve primarily as "pointers" to another provision, in this case section 2(3), where a more elaborate definition of the relevant concept is found. But the definition does emphasize that the term "advance" is a shorthand reference to value received by a borrower in connection with a credit agreement. Thus, "advance" includes but is not restricted to money lent to a borrower. For example, the cash value of goods purchased under a credit sale constitutes an advance.

See commentary on section 2(3).

"APR"

See commentary on section 2(1).

"associate"

This term appears in the definitions of "cash price" and "credit sale." It also appears in section I 5(1), which deals with cancellation of optional services, and in section 17(2), which limits default charges.

See commentary on section I (2).

"borrower"

This is the general term used throughout the Act to denote someone who receives credit, whether through a loan of money, the purchase of a product on credit terms, or any other credit arrangement. Guarantors are excluded from the definition of"borrower" because the Act is not intended to govern disclosure to guarantors.[2]

"broker"

Certain credit agreements that would not otherwise be covered by the Act are covered ifarranged by a broker: sec section 3(2)(b). Sections 12 and 13 impose disclosure requirements on brokers.

The last paragraph of **Proposal** 7 contemplates that jurisdictions may impose additional requirements on brokers beyond those addressed by the DHA. Jurisdictions that integrate such additional requirements with the requirements of this Act might find it desirable to adopt a different definition of"broker."

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[2]The absence of disclosure requirements in favour of guarantors does nor reflect a conclusion that it would be inappropriate for legislation to create such requirements. Disclosure to guarantors is simply beyond the scope of the Uniform CCDA. For a thorough discussion of disclosure and other issues relating to consumer guarantees, see Law Reform Commission of British Columbia, *Report on Guarantees of Consumer Debts* (Vancouver: LRCBC. 1979).

"business day"

This tenn is used in section 8(2), which provides that disclosure statements for mortgage loans must be given to the borrower two days before the borrower incurs any obligations in connection with the loan. The definition acknowledges that, nowadays, whether a particular day is a business day is really a question of fact.

"brokerage fee"

Sections 12 and 13 require disclosure of brokerage fees. It will be noticed that the definition does not include a commission or other remuneration paid on its own account by the credit grantor to the broker. On the other hand, if the credit grantor pays a commission to a broker and then attempts to recover the amount of the commission by imposing a corresponding charge on the borrower, the latter charge would fall within the definition of "non-interest finance charge," and would have to be disclosed as such.

"cash customer"

The Act is not concerned with cash customers as such. It is concerned with cash customers only insofar as the amount they would pay for a product detennines its cash price for a credit transaction or its cash value for the purposes of a lease. Thus, this tenn appears only in the definitions of"cash price" and "non-interest finance charge" in this subsection, in the definition of "cash value" in section 37(1) and in section 4(3)(b) of the Schedule.

"cash price"

Several provisions require credit grantors to disclose the cash price of a product. The cash price of a product also determines the amount considered to be advanced to a consumer who buys a product under a credit sale: see section 2(3)(b). This means that the cash price of a product is a key variable in determining the total (dollar) cost of credit and APR for a credit sale.

(a) Paragraph (a) will apply in the common situation where a merchant who sells a product on credit terms also sells the product for cash. Here the price cash customers would pay for the product determines its cash price for the purpose of a credit sale unless the parties to the credit sale actually agree on a lower price.

The reference to "an amount that fairly represents" the selling price to cash customers is intended to accommodate situations where different cash customers typically pay different prices because the actual selling price is negotiated by the buyer and seller. Linking the cash price to a representative price paid by cash customers is intended to provide reasonable flexibility while ensuring that the stated cash price bears a reasonable relationship to the price actually paid by typical cash customers. This is important if the APR and total (dollar) cost of credit are to serve as useful measures of the cost of credit.

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The reference to sales by an associate of the credit grantor tics in with the last part of the definition of "credit sale": see the commentary on the definition of "credit sale."

(b) This paragraph will apply to certain credit card transactions. Since disclosure of the APR and total cost of credit is not required for credit card transactions, the main reason for identifying an objective cash price does not apply to such transactions.

The usual situation where this paragraph will apply is where a consumer charges a purchase to a credit card that is not issued by the seller or an associate of the seller: e.g., to a *VISA, MasterCard* or *American Express* account. Paragraph (a) will not apply because the sale is not by the "credit grantor" (the card issuer) or an associate of the credit grantor. Where paragraph (b) applies, the cash price is simply the price agreed to by the merchant and the consumer. This agreed price is the amount that the card issuer is considered to have advanced to the card holder in respect of the transaction: see section 2(3)(d).

Paragraph (b) could also apply where a credit card issuer offers certain services, such as optional insurance or a card registry service, exclusively to card holders. Here the credit grantor is the seller of the relevant product, but paragraph (a) still

does not apply because the card issuer does not sell the product to cash customers. Since the card issuer does not sell the product to cash customers, the price paid by cash customers is not available to serve as the benchmark for the cash price. In such cases the parties' agreement determines the cash price .

"Court"

The term "Court" appears only in Part 6 "Compliance."

"credit agreement"

This is the umbrella term for all agreements that extend credit, whether as a loan of money, the sale of a product on credit terms, as a facility for obtaining credit in the future, or in any other form. The term "credit" is left undefined because its broad ordinary meaning is suitable for the purposes of the Act.

"credit card"

The definition includes what arc sometimes called "charge cards": cards issued in connection with credit agreements under which the card holder is not permitted to carry balances from one month to the next. The definition makes no distinction between "two-party" and "three-party" credit cards.

"credit grantor"

This term is used throughout the CCDA to denote the party who extends credit under a credit agreement.

(a) This paragraph focuses on the parties to the contract rather than the ultimate source of the credit extended to the borrower. For example, a merchant who sells goods under contracts in which payment of part of the purchase price is deferred is the original credit grantor under such contracts, even if the merchant's rights under the contracts are immediately and invariably assigned to a financial institution. The financial institution is not a credit grantor under this paragraph, but may be under paragraph (b).

(b) The effect of this paragraph is that an assignee becomes subject to the requirements imposed on credit grantors once notice of the assignment is given to the borrower. The DHA does not address this issue.

"credit sale"

The key requirement of this definition is that a product's seller or manufacturer, or an associate of either, finances its purchase. If one of these parties finances the purchase, the transaction is a credit sale regardless of its form. If the seller finances the purchase, the transaction is likely to take the form of a sale in which payment of the full purchase price is deferred. If the manufacturer or an associate finances the sale, the transaction might take the form of a cash loan, but it would still be regarded as a credit sale for the purposes of the Act.

The DHA uses the term "supplier credit," but it is thought that the term "credit sale" will be clearer to most users of the Act.

"default charge"

Section 17 limits default charges that can be provided for by a credit agreement and other provisions require disclosure of default charges. It should be emphasized that interest on overdue payments is **not** regarded as a default charge, so section 17's restrictions on default charges **do not** apply to interest on overdue payments.

"fixed credit"

Part 3 of the Act applies to fixed credit. The form of this definition, in which fixed credit is defined as credit other than open credit, ensures that all credit agreements will fall into one category or the other. The archetype of fixed credit is a credit sale or loan of money in which the borrower receives a single advance and agrees to pay the amount owing in a series of payments of predetermined amounts at predetermined intervals.

See commentary on the definition of"open credit."

"floating rate"

Several provisions of the Act refer to floating rates, but the context in which this concept is most important is in relation to credit cards: see sections 35(2) and 35(4)(d).

An example of where paragraph (b) would apply is an interest rate that is determined for a whole month based on the value of the index rate at the beginning of the month.

"grace period"

The CCDA distinguishes between grace periods and interest-free periods. Interest that accrues during a grace period will be forgiven if the borrower meets certain conditions. In contrast, interest does not accrue at all during an interest-free period; the credit is unconditionally interest-free during that period.

"index rate"

This term appears only in the definition of"floating rate."

"initial disclosure statement"

This definition is a pointer to provisions that describe the contents of initial disclosure statements in various contexts.

"interest"

The main reason for defining "interest" is to help clarify the definition of"non-interest finance charge," which refers to charges other than interest. A lump-sum charge imposed at the beginning of (or at some point during) a loan would be a non-interest finance charge, rather than interest, because the charge does not accrue over time. Similarly, if a charge accrues overtime, but is not based on an amount outstanding from time to time under the credit agreement, it would be regarded as a non-interest finance charge rather than interest.

"interest-free period"

See commentary on the definition of"grace period."

"lease"

The general requirements in Division I of Part 2 apply to leases as well as to conventional credit arrangements, while Part 5 deals exclusively with leases.

This definition would cover anything from a one-hour rental arrangement to a long-tenn hiring that is functionally equivalent to a credit sale. However, the Act does not apply to all such leases; it applies only to leases that meet the criteria set out in sections 3 and 38.

The qualification at the end of the definition regarding residential tenancy agreements is intended to avoid any implication that a person who rents a furnished apartment is thereby considered to be leasing the furnishings for the purposes of the Act.

"mortgage loan"

This term appears in sections 2(b), 8. 16(1), 23(I), 26 and 27 and section I of the Schedule.

This definition focuses on whether the loan is secured by an interest in real property, rather than on the purpose for which the loan is obtained. The qualification at the beginning of the definition allows for regulations that would exclude "collateral mortgages" from the definition of"mortgage loan" for certain purposes, such as the prepayment right provided by section 16. Such regulations would accommodate the statement at the bottom of page 3 of the DHA that "[c]ollateral mortgage loans will be subject to the same prepayment rights as regular loans."

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"non-interest finance charge"

A number of provisions require disclosure of non-interest finance charges and section 3(3), which excludes certain credit agreements from the application of the Act, applies only to credit agreements that **do not** provide for any non-interest finance charges. Perhaps the most important reference to non-interest finance charges is in section 16(3), which provides for the refund ofnon-interest finance charges upon prepayment of non-mortgage credit.

The definition refers to charges that the borrower is required to pay "in connection with" the credit agreement. This is broader than if the reference had been to charges "under" the credit agreement. For example, an application fee might have to be paid in connection with a credit agreement although there is no mention of the fee in the credit agreement. Application fees, administration fees, service changes all constitute non-interest finance charges.

"open credit"

Part 4 of the Act is concerned exclusively with open credit. Since the Act Jc fines "fixed credit" as credit other than open credit, the definition of "open credit" effectively defines both open credit and fixed credit. The two main categories of open credit are credit cards and lines of credit.

It should be emphasized that the two paragraphs of the definition are conjunctive. A construction loan of $I 00,000 that is to be advanced in stages upon the completion of various phases of the project is not open credit, because the total amount to be advanced to the borrower is limited to $100,000. This contrasts with a line of credit or credit card agreement, where the total amount that may be advanced over the life of the agreement is unlimited. Ifa credit card agreement has a credit limit of$ I000, the card holder might obtain advances totalling many times that amount over the life of the agreement.

"optional service"

A number of provisions require disclosure of optional services and section 17 gives borrowers a right to cancel optional services in certain circumstances. Optional insurance and extended warranty coverage are examples of optional services.

"outstanding balance"

This tenn is simply a shorthand reference to the total amount that is owing under a credit agreement at a particular time. It includes but is not limited to amounts that have not been paid when due.

"payment"

This term is used frequently in the Act. Payments are the counterparts of advances. Advances are value flowing **to** the borrower and payments arc value flowing **from** the borrower (generally, but not necessarily, to the credit grantor).

See commentary on section 2(5).

"product"

This term appears in a number of provisions of the Act, but its most important role is probably in section 2(3)(b), which states that the cash price of a product purchased under a credit agreement is value received by the borrower. The qualification that "product" does not include the extension of credit is meant to forestall any argument that the extension of credit is in itself a service that constitutes value received by the borrower under section 2(3)(b).

"scheduled-payments credit agreement"

Although most fixed credit will fall within this definition, fixed credit is not necessarily scheduled-payments credit. A loan of a specific amount of money under which the principal is to be repaid on demand, rather than in accordance

with a specified schedule, would be fixed credit but not scheduled-payments credit.

An example of a contingency that might require adjustment of a repayment schedule is the possibility of a change in the anticipated amount or timing of a future advance that is contemplated by the agreement.

"security interest"

This definition does not distinguish between real property and personal property.

"term"

A number of provisions require disclosure of the term of a credit agreement. Although the definition refers to "the first advance," most fixed credit arrangements will consist of a single advance, and the term will simply be the period between this advance and the final scheduled payment. This final payment might be a "balloon payment."

"total cost of credit"

This is a dollar measure of the cost of credit. Several provisions require disclosure of the total cost of credit and it is also used in calculating the APR.

See commentary on section 2(2).

(2) The definition of "associate" in subsection (I) points to this subsection. In focusing on "formal" linkages-partnership, kinship, formal control-this definition puts more emphasis on certainty of application than on exhaustiveness. Thus a contractual or business relationship between two entities that falls short of actual partnership will not make them associates of each other. The DHA's definition of"supplier credit" refers to an associate of a credit grantor, but does not define "associate."

2. Concepts relating to determination of cost of credit

This section gathers together several key concepts relating to the detennination of the cost of credit. Subsections (1) and (2) define the concepts of the annual percentage rate and total cost of credit, respectively. Both of these concepts involve comparisons between value received and value given by the borrower. Subsections (3) and (4) deal with the identification and quantification of value received by the borrower, and subsection (5) defines value given by the borrower. Subsection (6) deals with the special case of money paid into or out of tax accounts.

(I) This subsection's main purpose it to explain what the annual percentage rate is and is not, rather than to set out the rules for calculating it. The calculation mechanics are dealt with in the Schedule at the end of the Act.

Paragraph (a), which is adapted from the definition of"closed-end credit" in the United States' Regulation Z,[3] describes the forest that can easily be lost sight of amidst the trees of the detailed APR calculation rules. The APR is a way of measuring the cost of credit that takes account of the amount and timing of value received and given by the borrower. The statement at the end of paragraph (a) that the APR is detennined "disregarding the possibility of prepayment or default" recognizes that the APR is supposed to indicate what the cost of credit will be if the credit agreement is carried out in accordance with its tenns.

Paragraph (c) is intended to make it clear that the APR is **not** simply another name for the annual interest rate. To be sure, the numeric value of the APR for a credit agreement may be the same as the contractual interest rate for that credit agreement if there are no non-interest finance charges. For such credit agreements, there is no practical difference between the contractual interest rate and the APR. However, the APR will be higher than the contractual interest rate where the borrower must pay non-interest finance charges. For such credit agreements, the APR serves a disclosure function, but is not used in calculating

[3] 12 CFR §226.22(a).

the balance outstanding on the credit agreement at any given time; that is the function of the contractual interest rate.

(2) The definition of "total cost of credit" in section I(I) points to this subsection. The total cost of credit is simply the anticipated dollar cost of credit over the entire term of a credit agreement. It is simply the difference between the value to be given by the borrower and the value to be received by the borrower in connection with the credit agreement (i.e., total payments minus total advances).

(3) The definition of "advance" in section 1(1) points to this subsection. This subsection, along with subsections **(4)** and (5), constitute the foundation of the CCDA's approach to determining the total cost of credit and APR.

This subsection defines **what** constitutes value received by the borrower and describes how this value isquantified. It can be thought of as a positive definition of the components of"principal," as used by **Proposal 1.2.**[4]

Paragraphs (a) through (d) might be thought of as identifying "real value" received by a borrower, while (e) and (f) identify "deemed value." In theory, the charges mentioned in paragraphs (e) and (f) should be treated as part of the cost of credit, not as value received by the borrower. However, the expenses mentioned in paragraphs (e) and (f) correspond to items to be excluded from the cost of borrowing by **Proposal 1.5.** Treating a charge mentioned in paragraph (e) or (f) as value received by the borrower (an advance) excludes the charge from the cost of credit because the deemed advance "cancels out" the payment in respect of that charge when calculating the APR and total (dollar) cost of credit.[5]

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[4]The last sentence of the definition of"P." in Proposal 1.2 says that principal "is the amount advanced, exclusive of any element of the cost of borrowing". So Proposal 1.2 says what "principal" is not, but it does not say what it is.

[5]Would it not be simpler to ignore the charges mentioned in paragraphs (3)(e) and (f), rather than to treat them as advances? It might be a little simpler to ignore such charges where they are paid in cash. Often, however, charges such as those mentioned in these paragraphs are "capitalized," that is, added to the initial balance of (continued...)

(4) This subsection, which relates to Proposals I .4 and 1.5, is intended to forestall arguments that certain expenses incurred or things done by a credit grantor in connection with a credit agreement constitute value received by the borrower. For example, in the absence of this provision, a credit grantor might argue that money paid by the credit grantor for a credit report on the borrower is money paid ;;to the order of' the borrower, and thus constitutes value received by the borrower.

If the credit grantor imposes a charge on the borrower for something that is not considered to be value received by the borrower, the charge will be reflected in the APR and total cost of credit because there is no advance to offset the payment in respect of the charge.

Paragraph (4)(a) is based on items (i), (ii) and (viii) of **Proposal 1.5** (which all refer to insurance), read with **Proposal 1.4's** statement that "all charges" not excluded by Proposal 1.5 are part of the cost of borrowing. The Committee's intention appears to be that a premium for any compulsory insurance, other than insurance mentioned in Proposal 1.5, will be treated as part of the cost of credit. The Act achieves this result through the combination of paragraph (4)(a) and subparagraphs (3)(e)(iii) and (iv).

Paragraph (4)(b) is an interpretation of the reference to "all charges" in **Proposal 1.4.** Although Proposal 1.4 says that "all charges" are included in the cost of borrowing except for those excluded by **Proposal 1.5,** it seems obvious that "all charges" is not intended to be read literally. If Proposal 1.4, especially the reference to all charges, were read literally, the cash price of goods purchased under a credit agreement (being a "charge") would constitute part of the cost of credit, which would be absurd. It is assumed that Proposal 1.4 really means something like "all charges that might reasonably be regarded as part of the cost of credit" are treated as part of the cost of borrowing unless they are specifically excluded by Proposal 1.5. The charges referred to in paragraph (4) are the sorts of cost that could reasonably be regarded as part of the cost of getting credit.

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[5](...continued)
the loan and amortized over the term. In such cases, treating the charges as advances, rather than ignoring them, will actually simplify APR calculations.

(S) The definition of"payment" in section 1(1) points to this subsection. Anything that constitutes value given by the borrower must be accounted for when calculating the total cost of credit or APR. The value must be given "in connection with," but not necessarily "under," the credit agreement. Thus, payment of an application fee would constitute value given by the borrower when calculating the cost of credit, even though it was paid before the borrower entered into the credit agreement.

Paragraph (a) refers to money or property transferred by the borrower. Where a consumer trades in an old car when purchasing a new car under a credit sale, the agreed value of the old car would constitute value given - a payment - by the borrower.

Paragraph (b) deals with payments that the borrower is required to make to a person other than the credit grantor. In theory, if the object of disclosure is to disclose the cost of credit to the borrower, then the destination of a payment should be irrelevant. The question should be whether the payment increases the borrower's cost of credit, not whether the payment goes into the credit grantor's pocket. The introductory part of paragraph (b) and subparagraph (b)(i) are consistent with the theory. Subparagraphs (b)(ii) and (iii) depart from the theory, in that transfers of money that would be treated as value given by the borrower if the money was transferred to the credit grantor are not so treated if the money is transferred to a third party selected by the borrower.

The DHA does not attempt to provide an overall definition of what constitutes a payment. However, subsection (S) is intended to reflect the general thrust of **Proposals 1.4** and 1.5. The exceptions in subparagraphs (b)(ii) and (iii) reflect item (vi) of **Proposal 1.5.**

Taken together, subsections (3), (4) and (S) deal with all of the charges mentioned in **Proposal 1.5** except for items (iii) (charges for overdrawing an account), (x)(discharge payments) and (xii)(charges for shares in a credit union). Regarding item (iii), the Committee's intention appears to be that credit extended by way of overdraft would be entirely excluded from the application of cost of credit disclosure legislation, on the theory that such credit is appropriately dealt

with in legislation governing deposit accounts. Such an exclusion could be accomplished by means ofa regulation under section 3(4) of the Act.

The reference in item (x) of **Proposal 1.5** to discharge payments appears to contemplate fees that a credit grantor charges for providing documents necessary to discharge a security interest, especially a mortgage of real property. Some jurisdictions do not or might not in the future permit such charges to be imp osed.[6] Jurisdictions that do allow such charges could exclude them from the cost of credit by deeming the amount of such a charge to constitute value received by the borrower in a regulation authorized by subsection (3)(g). Another approach would be to exclude "discharge payments" from the APR and total cost of credit by a provision similar to subsection (6).

Regarding shares in a credit union - item (xii) of **Proposal 1.5** - it is worth observing that such shares presumably have a cash value (the amount for which they are sold to persons who want to join the credit union without necessarily obtaining a loan). Quite apart from any specific provision regarding such shares, if the borrower pays that cash value for their share, the borrower would be considered to have received valuc for that share (i.e., an ad vancc equal to the cash value of the share). The share purchase transaction would not affect the APR because the borrower's payment for the share would be offset by the value of the share. However. to the extent that it is considered advisable to specifically provide that charges for credit union shares are not to affect the APR. regulations under subsection (3)(g) could specify that the charge for such shares is deemed to be value received by the borrower.

(6) Mortgage lenders sometimes maintain tax accounts for the purpose of ensuring that property taxes on the mortgaged property are paid. Transfers into and out of the tax account would fall within the definition of value given and received by the borrower, but accounting for such transfers when calculating the total cost of credit and APR would complicate those calculations for no real purpose.

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[6]See *Law of Properly Act,* R.S.A. 1980 c. L-8, s. 65.1, which requires mortgage lenders in Alberta to provide such documents free of charge.

3. Application

(l) The effect of treating leases as credit agreements for the purposes of this section is that the Act applies only to leases that meet the criteria set out in subsection (2): leases to natural persons for consumer purposes. In addition, Part 5, which sets out disclosure requirements for leases, only applies to leases with certain characteristics. See commentary on section 38.

(2) Paragraph (a) reflects the first sentence under the unnumbered heading "Application" on page I of the DHA. The wording of paragraph (a) is based on the definition of"consumer" in Article 810 of the AIT.

Paragraph (b) addresses an issue that is not addressed by the DHA, which does not say anything about the characteristics of the credit grantor. A qualification such as this seems essential, however, if the legislation is not to capture private lending arrangements for which the requirements of this Act would clearly be inappropriate. The assumption underlying subparagraph (b)(ii) is that if a credit arrangement is arranged by a broker, the broker will have the expertise to provide the disclosures required by the Act even if the actual credit grantor does not.

(3) This subsection implements Proposal 9 and is intended to exclude informal credit arrangements from the application of the Act. It will be noted that the criteria in this subsection are conjunctive; all of them must be met for the exclusion to apply.

(4) This subsection does not correspond to any specific proposal in the DHA. Ifa borrower signs a statement indicating that the borrower is obtaining a loan for a commercial purpose, and the credit grantor believes the statement is true, the credit grantor would be entitled to assume that the Act does not apply to the transaction. Note that the statement of purpose itself must be signed by the borrower for this subsection to apply. That is, the borrower must specifically acknowledge the statement, rather than merely signing a document containing a statement that may or may not have been brought to the borrower's attention.

(5) The DHA does not consider whether certain types of consumer credit agreements should be excluded from the harmonized legislation. For instance, existing legislation frequently excludes credit extended by utility companies for utility services, student loans and so on. It seems prudent to authorize regulations that would exclude particular categories of credit agreements from some or all of the Act's provisions.

PART2
GENERAL

DIVISION 1
DISCLOSURE

This Division sets out general requirements regarding such matters as who is responsible for disclosure, the form of disclosure statements, when they must be delivered and so on. The content of disclosure statements is dealt with in Parts 3-5.

4. Definition

The effect of this section is that the requirements of this Division apply to leases as well as to credit agreements.

5. Requirement to disclose

Many provisions dealing with disclosure say something like, "The disclosure statement must disclose ... ," without staling who is responsible for ensuring that the disclosure statement meets the requirement. This section serves that purpose by specifying that credit grantors are responsible for making the disclosures required by the Act.

6. Form of disclosure statements

(1) The overriding requirement of paragraph (a) is that the disclosure statement be in a form that will permit the borrower to retain it for future reference. Disclosure

"in writing" (on paper) is the default method, but the disclosure can be made through other media with the borrower's consent. Paragraph (a) implements the third paragraph under the heading *Plain Language* on page 3 of the DHA.

Paragraph (b) sets out a functional specification for the visual appearance and organization of disclosure statements, rather than giving credit grantors detailed instructions on how they must design their disclosure documents. Paragraph (b) implements the second paragraph under the heading *Plain Language* on page 3 oftheDHA.

(2) This **does not** relate to a specific proposal in the DHA. Although this subsection allows a disclosure statement to be part of another document, the disclosure statement must meet the criteria set out in subsection (l)(b). Obviously, that all of the information required to be included in a disclosure statement is contained somewhere in a credit agreement does not necessarily mean that the credit grantor has provided a statement that complies with subsection (l)(b).

7. Estimates

This section, which implements the second paragraph of **Proposal 2.1,** is adapted from section 13 of the Cost of Borrowing (Banks) Regulations.7 In addition to this general provision for assumptions and estimates, other provisions describe specific assumptions to be used in particular disclosure contexts: see, e.g., sections 4(5) and 5 of the Schedule.

8. Time at which disclosure statement to be delivered

This section implements **Proposal 2.2.**

· **(1)** Unlike subsection (2), this subsection does not require any interval between delivery of the disclosure statement and the earlier of the events mentioned in paragraphs (a) and (b).

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[1] *SORI* 92-320.

(2) The second paragraph of Proposal 2.2 refers to the lender delivering the disclosure statement "at least two days before the first or only advance under the loan," while section 11(2) of the drafting template proposal says, "at least two business days before the borrower enters into the credit agreement or makes any payment, excluding disbursement charges." This subsection interprets the Committee's intention as being to ensure that the borrower receives the disclosure statement at least two business days before the borrower makes any payments or incurs any obligations to the credit grantor in connection with the mortgage loan. The exception is for obligations or payments relating to what the Committee refers to as "disbursement charges."

Care should be taken in interpreting the term "at least" in this provision and other provisions in which it appears. Reference should be made to the *interpretation Act* of the relevant jurisdiction. Under some of these acts, where a provision states that X must occur at least a certain number of days before Y, the days upon which X and Y occur are **not** counted when reckoning time.[8]

(3) This provision authorizes regulations that would allow the borrower to waive the requirement for advance delivery of the mortgage disclosure statement under prescribed conditions. Although **Proposal 2.2** does not refer to waiver of the requirement for advance disclosure, section 13(3) of the drafting template proposal refers to the requirement being waived "if the borrower obtains independent legal advice." Presumably, the provider oflegal advice would have to sign some sort of certificate, but the Committee does not indicate exactly what aspects of the transaction the advice would have to cover.

9. Delivery of disclosure statements

This section does not reflect a specific proposal in the DHA, which does not address the issues addressed by this section.

[8] See e.g. R.S.A. 1980, c. 1-7, s. 22(3); R.S.B.C. 1979 c. 206, s. 25(4); R.S.S. 1978 c. 1-11, s. 17.11.

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(1) This is intended to clarify the disclosure requirements where there is more than one borrower. The rule that only one borrower need be given the disclosure statement reflects the approach of U.S. Regulation Z.[9]

(2) This provision would be redundant in jurisdictions that deal with this issue in their *Interpretation Act* or other general-purpose legislation.

10, Disclosure in Advertisements

This implements the paragraph of **Proposal 10.1** that follows section 33 of the drafting template proposal. Proposal I 0.1 deals with fixed credit. **Proposal 10.2,** which deals with advertising for open credit, does not contain a requirement corresponding to the paragraph of Proposal l0.1. It is assumed, however, that the proposal regarding the prominence of the APR and conspicuousness of other required disclosures was meant to apply to both fixed credit and open credit.

I1. Additional requirements

The last paragraph of **Proposal 10.1** contemplates regulations specifying "minimum print sizes or proportional sizes" in advertisements. Regulations authorized by this section could do that and could also deal with other details of the form of disclosure.

DIVISION 2

CREDIT ARRANGED BY BROKERS

Proposal 7 proposes harmonized disclosure requirements for loans arranged by brokers but contemplates that individual jurisdictions may impose additional requirements on brokers "to meet legitimate consumer protection objectives beyond those of cost of credit disclosure." This division only deals with the disclosure issues directly addressed by the DHA.

[9] 12 C.F.R §226.17(d).

12. Non-business credit grantors

This section corresponds to the portion of **Proposal** 7 (second point of the fourth paragraph) that applies where a "broker obtains a loan from a lender not regulated as such under federal or provincial statute." Since this A<:_t regulates credit grantors who extend credit in the course of carrying on a business, the only credit grantors who are not regulated "as such" are those who do not extend credit in the course of carrying on a business. The credit grantor's disclosure responsibilities are transferred to the broker on the assumption that the broker will be in a better position to carry out those responsibilities than the credit grantor.

13. Business credit grantors

(I) This section applies where the credit grantor would have disclosure obligations under the Act even if a broker had not been involved in arranging the credit agreement.

(2) This subsection implements the third paragraph of **Proposal** 7, which says that the credit grantor must account for the brokerage fee in its disclosure statement only if the fee is deducted by the credit grantor directly from the amount advanced to the borrower.

(3) In accordance with the presumed intent of **Proposal** 7, this subsection only requires the broker to provide a disclosure statement if the broker takes a credit application. A broker who simply refers the borrower to a credit grantor would not have to provide a disclosure statement, even if the broker charges a fee for performing this limited service.

(4) This subsection represents an interpretation of the parenthetical material in the first item of the fourth paragraph of **Proposal** 7. The credit grantor is not to be "relieved of the responsibility ... for ensuring that the borrower receives an accurate disclosure statement." Given that the credit grantor remains responsible, it seems reasonable to allow the credit grantor to discharge this responsibility by

providing its own disclosure statement, rather than relying on the disclosure statement provided by the broker.

One less than ideal consequence of subsection (4), when read with subsections (2) and (3), is that a borrower might get two disclosure statements with slightly different information. This would occur if the broker's disclosure statement discloses an APR that includes a brokerage fee while the credit grantor's disclosure statement does not include the brokerage fee because it was paid directly by the borrower to the broker.

DIVISION 3
FEES, CHARGES AND OPTIONAL SERVICES

14. Required insurance

This section implements item (xv) of **Proposal 2.1.1** and item (xiii) of **Proposal** 2.1.2.The proposals are presented as disclosure requirements but clearly contemplate that the borrower will be given a substantive right to choose the insurer. Thus, subsection (1) provides the borrower with the right to choose the insurer and subsection (2) requires the credit grantor to disclose this right.

15. Cancellation of optional services

(1)(2) These subsections implement **Proposal 10,** except that subsection (1) provides a cancellation right where the service is provided by the credit grantor **or an associate** of the credit grantor. As mentioned in footnote *5* of the DHA, Proposal 10 leaves the treatment of optional services provided by associates to individual jurisdictions. There seems little point in providing a cancellation right for optional services ifit does not extend at least to services provided by an associate of the credit grantor. Even where optional services are promoted to borrowers by the credit grantor, the services are much more likely to be provided by an associated entity than by the credit grantor itself.

(3) This addresses an issue that is not specifically addressed by the DHA. Regulations could be made under this provision if it appeared that refunds for cancelled optional services were not being calculated in a fair and reasonable manner.

16. Prepayment of non-mortgage credit

This section implements **Proposal 4.** Subsection (3) corresponds to the first sentence of the third paragraph of Proposal 4. The latter refers to a refund of "non-interest charges other than disbursement charges." The exclusion of "disbursement charges" is built into the Act's definition of"non-interest finance charge," which excludes charges for expenses referred to in section 2(3)(e) or (t) (which mostly apply to mortgage loans in any event) ordesignated by regulations under section 2(3)(g).

17. Default charges

This section, which is adapted from section 11(I) of the Cost of Borrowing (Banks) Regulation, [10] implements **Proposal 5.** Since the definition of"default charge" in section I excludes interest on overdue payments, this section does not restrict interest on overdue payments.

Although this section restricts the default charges that may be provided for by a credit agreement, it does not restrict the costs that may be awarded by a court under its general powers respecting costs.

18. Invitation to defer payment

(I) This reflects the second paragraph of **Proposal 4.2** and the last paragraph of **Proposal 4.3** (which follows drafting template proposal section 18).

[10]SOR / 92-320.

(2) This attaches certain consequences to a credit grantor's failure to comply with subsection (1). There is no corresponding proposal in the DHA, since the latter does not deal with compliance issues.

PART3
FIXED CREDIT

DIVISION 1
GENERAL

19. Application of this Part

[No Comment]

20. Credit Sales

This section does **not** relate to any specific proposal in the DAH but reflects requirements that are implicit in some existing provincial legislation. The gist of this provision is that a credit sale to which this Part applies must provide a schedule of payments; it cannot be a "demand loan." This will facilitate disclosure to the buyer, in the sense that there will be at least a presumptive schedule for repaying the outstanding balance. The schedule of payments would not have to be written in stone. In particular, it could be subject to adjustment to accommodate changes in the interest rate: see commentary on the definition of "scheduled-payments credit agreement" in section 1(1).

Since this Part applies only to fixed credit, this section would have no application to credit sales under open credit agreements.

21. General disclosure requirements in advertisements

This section attempts to implement **Proposals 10.l** and **10.1.1.** It is difficult to detect the guiding principle underlying the various twists and turns of these proposals, but the section follows the twists and turns as diligently as possible.

(2) This subsection states the two disclosures - APR and term - required in any advertisement to which this section applies. This corresponds to items (i) and (ii) of the second paragraph of **Proposal 10.1.**

(3) This reflects the first part ofitem (iii) of the second paragraph of **Proposal 10.1,** as modified by the second sentence under the heading *Supplier Credit* in **Proposal** IO.l.l. When all is said and done, these portions of Proposals I 0.1 and I 0.1.1 seem to require disclosure of the cash price whenever the advertisement relates to a specifically identified product (such as a particular model of automobile).

(4) This reflects item (iii) of the second paragraph of **Proposal 10.1,** read with the fourth paragraph of **Proposal 10.1,** the portion of **Proposal 10.1** under the heading "Broadcast Advertisements" and the first sentence under the heading "Supplier Credit" in **Proposal 10.1.1.** Taken together, these proposals seem to contemplate that both the cash price and total cost of borrowing must be disclosed whenever there are "fixed charges" that will be reflected in the APR , except that advertisements in certain media do not have to disclose the total cost of borrowing.

(5) This subsection acknowledges that an advertisement may .relate to a range of possible credit arrangements that will not necessarily have the same APR or total cost of credit. In such cases it will be necessary to disclose the APR (and total cost of credit, where it must be disclosed) for a representative transaction.

22. Advertising interest-free periods

(I) This subsection implements **Proposal 10.3.**

(2) Although **Proposal 10.3** does not specifically address this point, it seems reasonable to require disclosure of the conditions under which interest will be forgiven, as required by paragraph (2)(b). Similarly, although Proposal I 0.3 is also silent on this point, it seems reasonable to require disclosure of the APR based on the assumption that the conditions for forgiveness of interest arc not met: a "worst-case" APR.

(3) This attaches certain consequences to a failure to comply with subsections (2) and (3). This issue is not addressed by the DHA, since it does not deal with the consequences of non-compliance.

DIVISION2
DISCLOSURE STATEMENTS

23. Initial disclosure statement for fixed credit

(I) This subsection implements **Proposal 2.1.1,** except that a couple of the items in that proposal are dealt with in other provisions of the Act. Item (xiv), brokerage fees, is dealt with in sections 12 and 13. Item (xv), choice of insurer, is dealt with in section 14.

The introductory part of this subsection requires the disclosure statement to state its effective date. For non-mortgage credit, this will usually be the date the disclosure statement is given to the borrower. But since the disclosure statement for a mortgage loan must be delivered at least 2 days before the borrower enters into the agreement, the effective date of the disclosure statement will presumably be at least two days after the disclosure statement is delivered. The logical effective date will be the date that funds are to be advanced.

The credit grantor is only required to disclose information that is "applicable" to a particular credit agreement. It should also be kept in mind that section 7 allows disclosures to be based on reasonable estimates or assumptions where the precise information is not ascertainable at the time of disclosure.

(b)(c) These paragraphs require disclosure of the amount owed by the borrower on the effective date of the disclosure statement, and how this amount is determined. The sum of the amounts in (c) should equal the amount disclosed under (b).

(c) Since the cash price ofa product is treated as a;:, advance under section 2(3)(b), the requirement in paragraph (c) to disclose the amount of each

advance would entail disclosure of the cash price of a product sold through a credit **sale.**

(e) This requires disclosure of the amortization period only ifit is longer than the term because there does not seem to be any need to disclose the amortization period separately if it is the same as the term.

(f)-(h) These paragraphs required disclosure about the interest rate. Paragraph (h)(iii), which corresponds to item (xx) of **Proposal 2.1.1,** is intended to alert the borrower to the possibility of"negative amortization."

(i) This paragraph contemplates the possibility that the borrower may have to pay non-interest charges that are not reflected in the initial outstanding balance, because they will be imposed at some later time. If the precise amount of the charge is not ascertainable, section 7 would allow the credit grantor to estimate the amount of the charge.

Item (x) of **Proposal 1.5** contemplates disclosure of the "current [discharge) fee." Jurisdictions that allow credit grantors to impose such fees may wish to add a specific provision that requires disclosure of the current amount of any fee charged by the credit grantor to provide documents acknowledging that a loan has been discharged.

(i) This contemplates disclosure of the amount and timing of future advances. Most scheduled-payments agreements will only involve a single advance, which would be accounted for in paragraph (c). But a scheduled-payments credit agreement might contemplate multiple advances.

(1)-(m) These paragraphs are grouped together because the total cost of credit (paragraph (n)) is total payments (paragraph (m)) minus total advances (paragraph (1)). It should be noted that any non-interest finance charges included in the initial outstanding balance disclosed under paragraph (b), arc **not** included in the total advances, because they would not constitute value received by the borrower under sections 2(3) and (4).

(2) This implements item (xxi) of **Proposal 2.1.1.** It is intended to clarify what information must be disclosed for fixed credit arrangements that do not specify a schedule of payments. Some of the information required to be disclosed by subsection (1) is simply not applicable to credit agreements that do not specify a schedule of payments. Other information referred to in subsection (I) would in theory be "applicable" but would be impossible to determine or even estimate in advance. Subsection (2) requires disclosure ofinfornnation that is both applicable and ascertainable, or at least capable of reasonable estimation, at the time a disclosure statement is to be given.

It will be noticed that the disclosure statement must disclose the APR for loans to which this subsection applies. If there are any non-interest finance charges, the precise APR will depend on the length of the term of the loan. Thus, the APR must be based on an assumption regarding the term of the loan. Section 5(3) of the Schedule provides the relevant assumption: that the loan will be repaid one year after the effective date of the disclosure statement.

24. Changes in interest rate

(1) This implements the first paragraph of Proposal 3.1, keeping in mind that the definition of "floating "rate" in section I incorporates the idea of a published index rate.

(2) This implements the second paragraph of **Proposal 3.1.**

25. Disclosure regarding amendments and negative amortization

(1) (2) These implement the first sentence of the first paragraph of **Proposal 3.2.**

(3) This implements the second paragraph of **Proposal 3.2.** The proposal does not mention the APR. However, the second paragraph of the proposal implies that where an amendment merely changes the schedule of payments, the only incidental changes that must be disclosed are those mentioned in that paragraph. If the APR that was disclosed in the original disclosure statement included a non-interest finance charge, a change in the schedule of payments would change the

APR for the credit agreement.[11] Since the second paragraph of Proposal 3.2 seems to assume that such incidental changes to the APR need not be disclosed, this subsection specifically states that such changes need not be disclosed.

(4) This corresponds to section 14(3) of the drafting template proposal. Missing a payment would increase principal where the interest component of the missed payment is added to principal (compounded). If the scheduled payments were barely covering the interest in the first place (as in the early stages of a loan with a long amortization period), compounding the unpaid interest could create a situation where the scheduled payments will not cover interest that accrues during subsequent payment periods. Undoubtedly, most credit granlors would hasten to bring this situation to the attention of the borrower whether they were legally required to do so or not.

26. Disclosure where mortgage loan renewed

(1) This subsection interprets the second sentence of **Proposal 3.4,** which reads:

If the lender intends not to renew a mortgage loan where the loan agreement provided for renewal, notice should be provided to the borrower at least 21 days before the expiry of the term of the loan.

The trouble with this wording, so far as a statute is concerned, is that the express language of a mortgage will probably not reflect the assumptions of the parties regarding renewal. If a consumer takes out a mortgage with a 25-year amortization period and one-year term, both parties probably assume that the lender will offer to renew the loan at the end of the term. However, the mortgage agreement probably will not reflect this assumption; it will simply require the borrower to pay the balance outstanding at the end of the term. Given this gap between parties' expectations and the language of many mortgage agreements,

[11] Suppose that the APR disclosed at the beginning of the transaction accounted for a non-interest charge of $X. An amendment that extended the payment schedule would decrease the APR; an amendment that compressed the schedule would increase the APR.

subsection (I) does not refer to agreements that "provide for renewal." Instead, it refers to a mortgage loan whose amortization period exceeds its term, which is a good indication that the parties contemplated renewal.

(2) This subsection interprets the first sentence of Proposal 3.4, which refers to "the same categories of cost information asthe disclosure statement for the loan." The information items listed in this subsection are those which seem to comprise "categories of cost information."

(3) This interprets and implements the second paragraph of Proposal 3.4, which says that changes in terms that are favourable to the borrower are permitted. This provision makes allowance for changes that are favourable to the borrower or are due to actions or elections of the borrower after the original disclosure statement was delivered. For example, the borrower might be a few days late in making the payment due on the last day of the original term, but the credit grantor is prepared to renew the mortgage loan. If extra interest that accrues because of the late payment is added to the balance outstanding on the renewal date, this will affect a number of the disclosures in the original disclosure statement. Or the borrower might make a lump sum payment at the time of renewing. Or the borrower might elect to make bi-weekly payments when the disclosure statement was based on monthly payments. In such cases, it seems appropriate to allow the credit grantor to amend the original disclosure statement within a reasonable time after the loan is renewed.

(4) This subsection interprets the portion of section 19(2) of the drafting template proposal that says that if the borrower is not given a renewal statement 21 days before the renewal date, "the borrower's rights under the original loan agreement will continue to apply until 21 days after the renewal statement is provided to the borrower." It is not readily apparent exactly what rights the Committee has in mind: most mortgage agreements do not give many "rights" to the borrower. Subsection (4) gives effect to the Committee's presumed intention by protecting the borrower from being locked into a renewal agreement or from being irrevocably committed to paying any renewal charges until the borrower hashad at least 21 days to consider a disclosure statement that reflects the actual terms of the renewal agreement.

27. Renewal of non-mortgage credit

The DHA does not deal with renewal of non-mortgage credit agreements but it is an issue that needs to be considered by legislators. Disclosure prior to the renewal date is not as crucial for non-mortgage credit as it may be for mortgage loans. Unlike mortgage loans, non-mortgage credit is always prepayable. Thus, it is unnecessary to guard against the possibility that the borrower will be locked into a renewal agreement without adequate time to consider its terms. Moreover, a borrower who prepays the outstanding balance a few days after renewing a non-mortgage credit agreement would be entitled to a refund of a charge imposed in connection with the renewal since the charge would be a "non-interest finance charge" to which section 16(3) would apply.

PART4
OPEN CREDIT

DIVISION I
OPEN CREDIT GENERALLY

28. Advertising for open credit

Subsections (I) and (2) reflect **Proposal 10.2.** Subsections (3)-(5) relate to **Proposal 10.3** and are very similar to section 22, which applies to fixed credit. See commentary on section 22.

29. Contents of initial disclosure statement

This section implements **Proposal 2.1.2,** except that disclosures that are specific to credit cards are dealt with in section 35, information about required insurance (item (xiii) of Proposal 2.1.2) is dealt with in section 14, and brokerage fees (item (xiv) of the proposal) are dealt with in sections 12 and 13.

30. Statement of account

(1)(2) These subsections implement the first paragraph of **Proposal 3.3.**

(3) This implements item (vi) of **Proposal 3.3.** Subsection (3) requires the credit grantor to provide a facility for charge-free telephone inquiries; other provisions, such as section 31(l)(n), require the credit grantor to disclose this number in various documents. A credit grantor would not necessarily have to provide a dedicated toll-free line; it could comply with this requirement by accepting "collect" calls from customers.

31. Contents of statement of account

This implements the second paragraph of **Proposal** 3.3.

Paragraphs (1)(c) and (d) require disclosure of the details of each amount that is added to or subtracted from the outstanding balance (the total amount owing) during the statement period. Paragraphs (I)(g) and (h) require disclosure of the totals of all amounts disclosed under (c) and (d).

32. Description of transactions

This elaborates on what paragraph 3 l(c) means when it requires a "description" of each transaction. This section assumes that a major purpose of providing a borrower with a statement of account, especially for a credit card, is to allow the borrower to verify the transactions. So the statement should provide enough of a description of each transaction to allow the borrower to verify the transaction.

The phrase "made available to the borrower" warrants comment. An earlier draft of this provision said "given to the borrower." The phrase was changed because there was concern in some quarters that a credit grantor might have difficulty proving that the duplicate transaction record was actually "given" to the borrower at the time of the transaction, even if it was clearly made available to the borrower at that time.

DIVISION 2
CREDIT CARDS

33. No unsolicited credit cards

This section addresses an issue that is not addressed by the DHA. However , it reflects the existing law in some Canadian jurisdictions . Individual jurisdictions must decide whether this section is in accordance with their policy objectives.

34. Application for credit card

(1) This implements the first item in the first paragraph of **Proposal 6.1.**

(2) This implements the second item in the first paragraph of **Proposal 6.1**

(3) This implements the second paragraph of **Proposal 6.t.**

(4) This reflects the last paragraph of **Proposal 6.2.**

(5) This is intended to make it clear that the requirements of this section are in addition to, not in substitution for, the requirements regarding initial disclosure statements for open credit. An application form could serve as the initial disclosure statement for a credit card agreement, in which case it would have to contain all the information required by sections 29 and 35. If the application form does not contain all of the disclosures required by sections 29 and 35, the credit grantor will have to provide a separate disclosure statement.

35. Additional disclosure for credit card

(I) This implements the first paragraph of **Proposal 6.2.**

(2) (3) These implement the last paragraph of **Proposal 3.2,** as qualified by the third paragraph of **Proposal 4.1** (i.e., advance notice of change to floating rate not required) .

36. Limitation of liability

(1)-(3) Subsections (I) - (3) implement the third paragraph of **Proposal 6.2.** The wording of the provision is adapted from section 30 of Alberta's *Consumer Credit Transactions Act.*

(4) The regulations contemplated by this subsection would deal with transactions in which a combination credit card / debit card is used as a debit card, as contemplated by the second paragraph of **Proposal** 6.2.

PARTS
LEASES OF GOODS

37. Definitions

(I)

"assumed residual payment"

This refers to a payment that the lessee is assumed to make at the end of the term for the purpose of calculating the implicit finance charge and APR. This assumed payment might be an actual cash payment (to exercise a purchase option), a notional payment consisting of the lease-end value of the goods or a combination of the two (as where the consumer must pay a "disposition fee" upon returning the leased goods).

(a) If the lessee has an option to purchase the leased goods at the end of the lease term for an amount that is less than the estimated residual value (the estimated lease-end wholesale value), he will presumably exercise the option at the end of the term in order to capture the built-up equity. If the lessee does not exercise the option at the end of the term, it is presumably because the value of the goods to the lessee at that time is less than the option price. In either case, the option price seems like the best benchmark

for the assumed end-of-term payment when calculating the APR and implicit finance charge.

(b) This paragraph would apply where there is either no option to purchase or the end-of-term option price exceeds the estimated residual value.[12] In this case the assumed residual payment potentially has two components. The first component is the estimated residual value of the leased goods. This is treated as an end-of-term payment because the definition of "implicit finance charge" and the formula for calculating the lease APR (see section 4 of the Schedule) both assume that the value received by the lessee at the beginning of the term is the entire cash value of the leased goods: the amount that a buyer would pay to buy the goods. Having made that assumption, the definition and formula also make the converse assumption that a lessee who returns the goods at the end of the term is giving back the remaining value of the leased goods: their estimated residual value.

Paragraph (b) also contemplates the possibility that the lessee will be required to make an additional payment "in the ordinary course of events" upon returning the goods to the lessor at the end of the term. The reference to payments required in the ordinary course of events is meant to exclude contingent payments such as payments for damage to or excess use of the goods or a payment that would be required under a "residual obligation lease" if the realizable value of the goods at the end of the term is less than it was anticipated to be at the beginning of the term. An example of a payment that might be required in the ordinary course of events is a "restocking charge" or a ·'disposition fee," if such a charge is provided for by the lease. Another example is an "estimated residual cash payment" that might be provided for by a "residual obligation lease."

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[12]Since the estimated residual value is based on the anticipated lease-end **wholesale** price, an option price that equals or exceeds the estimated residual value might still seem like a bargain if it is less than the anticipated lease-end retail price. The option also has value to the extent that the lessee acquires the benefit of the possibility that the actual value of the goods at the end of the term will exceed their anticipated value.

"capitalized amount"

This is analogous to the initial outstanding balance on a credit sale, after taking any down payment or trade-in into account. The capitalized amount must be disclosed in disclosure statements but its main role is as a building block for determining the implicit finance charge and APR for a lease.

Paragraph (b) refers to the cash value and "any other advances" made before the beginning of the lease term. The term "advance" is defined in section l as value received within the meaning of section 2(3) and (4).13 An example of "other advances" is where a consumer who is leasing a new car trades in an old vehicle upon which there is still an outstanding balance under a previous credit agreement. The trade-in value of the old vehicle represents a payment under section 2(5), while the amount of the preexisting obligation paid off by the lessor represents value(i.e., an advance) received by the borrower under section 2(3)(c).

A charge such as an "administration fee" would only be treated as an advance if a similar charge would be payable by a customer who paid cash to buy the goods. More precisely, ifa cash customer would not have paid an administration fee, an administration fee payable by a lessee is not regarded as an advance. But the payment of that fee would have to be accounted for when calculating the APR and implicit finance charge. In other words, the administration fee would increase the APR and implicit finance charge.

Under paragraph (c) any payments made by the lessee before the beginning of the lease term, except for payments referred to in subparagraphs (i) and (ii) are subtracted in determining the capitalized amount. The exclusion of refundable security deposits in subparagraph (c)(i) reflects a policy decision by the Committee that is embedded in the definition of"capitalized amount" in section

[13]For the purposes of this part, the definitions in Part I are read by substituting "lessor" and similar terms for "credit grantor" and similar terms: see the commentary on section 37(2).

35 of the DHA's drafting template proposal. The policy decision is that refundable security deposits will not be accounted for in the APR.[14]

The effect of subparagraph (c)(ii) (which corresponds to the second exclusion in the parenthetical material at the end of the definition of"capitalized amount" in section 35 of the drafting template proposal) is that any periodic payments paid at or before the beginning of the lease term are **not** subtracted when determining the capitalized amount. Obviously, though, if some of the periodic payments are paid before the beginning of the term, this should be accounted for when calculating the APR. This is accomplished by the lease APR calculation formula in section 4(l) of the Schedule.

"cash value"

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The cash value of leased goods must be disclosed in disclosure statements, but the major function of the concept of cash value is in determining the implicit finance charge and APR for a lease.

The definition of "cash value" is similar but not identical to the definition of "cash price" in section 1(1). Both branches of the definition tic the cash value to an amount that fairly represents what a cash customer would pay to buy the leased goods. As is the case with "cash price" for credit sales. the reference to representative amounts allows some flexibility where different cash customers would pay different prices. Again, the representative price serves as the benchmark unless the parties to the lease agree on a lower amount as the cash value.

Unlike the definition of"cash price," the definition of"cash value" does not say that it includes taxes. Including GST and PST that would be payable by cash customers could unnecessarily complicate APR calculations for some leases.

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[14] In theory, if a lessee pays a security deposit of $X at the beginning of the lease and gets back $X at the end of the lease, the effective APR will be higher than it would have been had the lessee not been required to post the security deposit.

What the Act does require is consistent treatment of truces when calculating the APR and implicit finance charge: see section 4(2)(a) of the Schedule.

"estimated residual cash payment"

This term is used only in the context of residual obligation leases. See commentary on the definition of"residual obligation lease."

Ordinarily, the estimated residual cash payment will be zero (or might consist of a modest restocking charge or disposition charge, as discussed in the comment on the definition of "assumed residual payment"). However, the estimated residual cash payment could be substantially greater than zero if the periodic payments are deliberately set al an amount that will not cover the lessor's cost of capital and the anticipated depreciation on the leased goods. Such an arrangement might be entered into in order to make the lease more attractive to a consumer who wants the lowest possible monthly payments. This arrangement would be somewhat analogous to a "balloon payment" credit sale in which the amount outstanding at the end of the term will exceed the anticipated wholesale value of the goods at that time. In either case, the credit grantor or lessor will be under-secured in the event of default: the realizable value at the goods at the end of the term will not cover the amount owed by the consumer.

"estimated residual value"

The estimated residual value plays a role in determining the assumed residual payment, which in tum is used to calculate the implicit finance charge and APR.

"implicit finance charge"

This is analogous to the total cost of credit for a credit agreement: value given minus value received by the lessee.

"option lease"

This definition does not necessarily require that the lease formally provide for transfer of ownership: a right to retain possession at the end of the term will suffice.

"option price"

'lbe option price might be a nominal amount or even zero.

"payment period"

The definition accommodates payment periods of any length , although monthly payment periods would be typical.

"periodic payment"

Under a lease the periodic payment will generally be made at the beginning of the payment period to which it rela tes . However, in some leases the payment *in respect of* a particular payment period will not be made *in* (that is, at the beginning or end of) that payment period. Instead, the periodic payment for one or more end-of-term periods is paid at the beginning of the term. For example, a lease might call for the periodic payment in respect of the last month (payment period) of the term to be paid at the beginning of the term, instead of the beginning of the last month.

"realizable value"

This concept is relevant in the context of residual obligation leases. The definition is simply a pointer to the definition of realizable value in section 7(2) of the Schedule.

"residual obligation lease"

The type of lease contemplated by this definition is sometimes called a "financing lease" or, as in the U.S. Consumer Leasing Act, an "open-end lease." The major functional difference between a residual obligation lease and an ordinary lease is that the risk of unexpected depreciation in the market value of the goods is borne by the lessee rather than the lessor. That is, if the actual realizable value of the goods at the end of the term is less than their estimated residual value, the lessee must compensate the lessor for the difference. At least, that is how such leases would work if the parties were left entirely to their own devices. In fact, the extent of the risk of unexpected depreciation that can be transferred from the lessor to the lessee is limited by section 41 and section 7 of the Schedule.

"term"

[No comment]

"total lease cost"

The reference to "non-refundable payments" would exclude a security deposit. The reference to payments that will be required "in the ordinary course of events" is intended to exclude contingent payments such as charges for damage to or excess use of the goods or an amount that would be payable under a residual obligation lease if the lease-end value of the goods is less than anticipated.

38. Application of this Part

This section reflects section 36 of the drafting template proposal, which constitutes **Proposal 11.** Paragraph (b) will bring standard rent-to-own arrangements within the ambit Part 5.

In reading this section it should be kept in mind that section 3, the Act's general application section, also applies to leases. The Act as a whole, and hence Part 5, applies only to leases to natural persons for consumer purposes.

39. Advertisements

This implements and is similar to section 41 of the drafting template proposal **(Proposal 15).**

(I) Paragraph (e) refers to other payments that the lessee would be required to make "in the ordinary course of events." This is an interpretation of the reference to "other required payments" in section 41(I)(d) of the drafting template proposal. The wording of paragraph (I)(e)is based on the assumption that the Committee's reference to "other required payments" is not meant lo require disclosure of contingent payments such as charges for early termination, damage lo the goods and so on. It is presumed that the Committee only means to require disclosure of payments that will be required in the ordinary course of events. The wording of paragraph (e) parallels the wording of the definition of "total lease cost" in section 37(1).

(2) The rationale for relaxing the disclosure requirements for advertisements in radio, television and other media with similar time and space restriction seems to be that the nature of those media constrains the amount and type of infonnation that can be conveyed. Conceding the existence of such constraints, **it** might be doubted that a requirement to disclose the term (subsection (l)(b)) and APR (subsection (l)(f)) for a lease would actually test those constraints. The statement, *"Lease this Widget: 36 months, $3000 down, $500 per month, 4.9% APR!"* contains all of the infonnation required by paragraphs (l)(a), (b), (c), (d) and (I). We suspect that many lessors would find it as convenient to disclose the term and APR for the lease in a radio or television advertisement as to provide that infonnation by telephone, as contemplated by paragraph (2)(b).

This subsection does not provide the option of referring to "an advertisement in a publication of general distribution covering the area of the broadcast", as contemplated by section 42(I)(g) of the DHT's drafting template proposal. At the time the CCDA and this Commentary were finalized, it was the ULCC's understanding that each jurisdiction would decide for itself whether to provide advertisers with the option of referring to a publication rather than providing the relevant information in the advertisement or through a toll-free number.

40. Disclosure statement for lease

This is very similar to section 37 of the drafting template proposal **(Proposal 12.1).** We comment on only a couple of the items in subsection (1).

(I)(e) The commentary on the definition of"capitalized amount" in section 37(1) gives an example of"other advances" that might be received by the lessee at the time of entering into the lease.

(1)(t) Assuming that periodic payments are made at or before the beginning of the term, the first periodic payment would be made at or before the beginning of the term. Other payments that might be made at or before the beginning of the tem1 could include a refundable security deposit, a down payment, and a payment in respect of one or more end-of-term payment periods.[15]

(1)(1) This implements the first paragraph of **Proposal 14.**

(1)(m) An example of a contingent payment that would be disclosed under this paragraph is a"per kilometre" charge for a leased vehicle that is driven more than a specified number of kilometres during the term of a lease: see subsection (2).

41. Residual obligation leases

This section, together with section 7 of the Schedule, implements **Proposal 15.** See commentary on section 7 of the Schedule.

42. Early termination

This implements the second paragraph of **Proposal 14.**

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[15]An ordinary down payment and prepayment of end-of-term payments serve essentially the same purpose. In either case, the payment reduces the initial amount financed by the lessor.

PART6
COMPLIANCE

The DHA does not deal with compliance issues. Nevertheless, the ULCC considers that harmonization of compliance provisions - especially those dealing with the civil consequences of non-compliance - is desirable. In any event, the ULCC has decided that the CCDA should contain provisions dealing with the **civil consequences** of non-compliance with the Act. The ULCC believes that Part 6 represents a balanced approach to the civil consequences of non-compliance and merits serious consideration by jurisdictions.

The provisions of this part are based on three main premises. The first premise is that borrowers should be able to rely on the information in disclosure statements, even if the disclosure statement is not formally part of their contract with the credit grantor. Secondly, borrowers who suffer actual damage as a result ofa credit grantor's failure to comply with the Act's requirements should be compensated by the credit grantor. Thirdly, in addition to their compensatory purposes, the civil remedies should be designed to promote a high level of compliance with the Act's requirements.

43. Definitions

(2) The concept of a compliance procedure plays a central role in section 46, dealing with statutory damages. Although this Part does not deal with offences or administrative proceedings, provisions that create offences or administrative sanctions could also employ this concept.

The object of a compliance procedure is to "ensure" that the Act is complied with. However, it is assumed that even a well designed and well implemented compliance procedure may occasionally spring a leak. Indeed, the issue of whether a credit grantor has a compliance procedure will only arise when there has been a leak.

While the definition of a compliance procedure does not contemplate that the procedure will be totally effective, it docs require that the procedure will not exist only on paper. Paragraph (a)(ii) of the definition requires that the credit grantor

actively monitor the effectiveness of its procedure and revise it where deficiencies are discovered.

44. Recovery of payments and compensation

Examples of payments to which subsection (l) could apply are prepayment charges or default charges that are not pennitted under sections 16and 17. While such payments might in any event be recoverable on restitutionary principles, this subsection is intended to put the right to recover such payments beyond doubt and to make it clear that the claim can be set off against amounts otherwise owing under the agreement or recovered in an action.

45. Inconsistency between disclosure statement and contract

This section can be thought of as creating a statutory estoppel in which the borrower is presumed, in the absence of evidence to the contrary, to have relied on the most favourable information in a disclosure statement or credit agreement.

46. Statutory damages

This section gives borrowers the right to recover statutory damages in certain circumstances. Its purpose is not to compensate borrowers but to encourage credit grantors to take the requirements of the Act more seriously than they might if the only sanction for non-compliance was the remote possibility of administrative action or prosecution for an offence. Most existing cost of credit disclosure legislation contains provisions that are intended to serve a similar purpose. However, the following characteristics distinguish this section from similarly-motivated provisions in existing Canadian legislation.

Firstly, this section's remedy is defined statutory damages. Existing legislation takes the approach of depriving the credit grantor of the entire cost of borrowing.

Secondly, in existing legislation the statutory penalty is automatically triggered by a contravention, regardless of whether the credit grantortook reasonable steps to prevent the contravention or not. The saving provisions of existing legislation

focus not on the conduct of the credit grantor but on whether the borrower is likely lo have been misled or prejudiced by the contravention. In contrast, because the intended purpose of statutory damages is to influence the conduct of credit grantors, rather than to compensate borrowers, this section focuses on the credit grantor's conduct rather than the effect of the contravention on the borrower. In particular, it focuses on whether the contravention occurred in spite of diligent efforts by the credit grantor to comply with the Act.

(I)(2) If the credit grantor can bring itself within subsection (1)-and it should be noted that the criteria set out in subsection (1) are conjunctive - it is not liable for statutory damages.

(3)(4) The statutory damages set out here are fairly modest when compared to the possible forfeiture of theentire cost ofborrowing under existing legislation. Even though the statutory damages are relatively modest, it is considered that the possibility of having to pay them, perhaps in class action proceedings, will have the desired effect of encouraging credit grantors to implement effective compliance procedures.

(5) This would give the Court a discretion to reduce the statutory damages that would otherwise be payable in a particular case. It isconsidered that the existence of such a discretion will not detract from the deterrent value of the statutory damages, because credit grantors' conduct will be influenced by the possibility of statutory damages being awarded more than the possibility that the Court might be persuaded to reduce the damages in a particular case.

47. Exemplary damages

Section 46 is concerned with contraventions that arise because the credit grantor has not been as diligent as it ought to be in ensuring that it complies with the Act. This section is concerned with deliberate contraventions or other flagrant misconduct. It seems appropriate. and consistent with the objective of encouraging compliance with the Act, to give Courts the discretion to award exemplary damages in such cases.

48. Assignee

This section makes an assignee liable, to a certain extent, for contraventions of this Act by the original credit grantor. Like sections 46 and 47, this section is intended to encourage compliance with the Act. It assumes that in many cases, assignees will be able to exercise considerable influence over the practices of credit grantors with whom they have an ongoing relationship. On the other hand, it does not assume that an assignee will have complete knowledge of and control over the activities of such credit grantors.

The definition of"credit grantor" in section 1(1) includes an assignee after the borrower is given notice of the assignment. Therefore, once notice of the assignment has been given to the borrower, the assignee has the responsibilities of a creditor and will be directly liable for the consequences of failing to carry them out.

(1) This subsection does not refer to section 47 because it is not considered appropriate to make an assignee vicariously liable for exemplary damages.

(2) The effect of this subsection is that the assignee's maximum liability is the amount assigned to it.

(3)(4) These subsections are loosely based on provisions of the U.S. Truth in Lending Act.[16] Essentially, the assignee's liability is limited to contraventions of which the assignee had knowledge before notice of assignment was given to the borrower or that the assignee could have discovered by exercising reasonable diligence in reviewing the relevant documentation.

49. Other remedies

[No comment)

[16] 15 U.S.C. §1641.

PART7
REGULATIONS AND TRANSITIONAL PROVISIONS

The two sections in this Part are essentially place holders for actual provisions that would vary from jurisdiction to jurisdiction. The extent of the regulation-making powers that would be necessary would depend on how much of what is in the Uniform Act a particular jurisdiction decides to deal with through regulations. It will be noted that in a number of places the Act authorizes regulations dealing with specific matters. All of these enabling provisions could be collected in a provision such as section 50.

SCHEDULE

1. APR for certain mortgage loans

This section implements **Proposal 1.3:** "mortgage APR calculation will be subject to the requirements of Section 6 of the *Interest Act* ." Section 6 of the *Interest Act* is concerned only with disclosure of the interest rate, while the APR accounts for non-interest charges as well as interest. The Committee appears to contemplate that although the mortgage loan APR will account for relevant non-interest charges, it will be calculated using the rules that govern the expression of the interest rate under section 6 of the *Interest Act.*

Proposal 1.3 appears to assume that all mortgage loans are governed by section 6 of the *Interest Act,* which is not in fact true. Section 6 applies only to mortgage loans that have certain characteristi cs.[17] Indeed, given the manner in which section 6 has been interpreted by the courts over the years, it could be argued that section 6 does not really apply to many mortgage loans at all. Neve rtheless, whether strictly required to do so or not, Canadian mortgage lenders generally disclose the interest rate on standard "blended payment" mortgage loans in the

[17]Given the jurisprudence regarding section 6 of the *Interest Act,* it might be more accurate to say that section 6 applies to mortgage loans with *uncertain* characteristics, or that it applies to mortgage loans with certain characteristics but no one, including the courts. knows what those characteristics are.

manner contemplated by section 6 of the *Interest Act.* It is with this in mind that this section focuses on whether the interest rate is **in fact** disclosed in accordance with section 6 of the *Interest Act,* rather than whether section 6 actually "applies to" the mortgage.

This section leaves implicit a point that is explicitly stated in section 2(2) for non-mortgage loans. If there are no non-interest finance charges that would have to be accounted for in the APR, the APR is simply the stated annual interest rate.

An earlier draft of this section specified a mathematical formula for calculating a "section 6" APR. However, it was ultimately decided not to specify a formula in this section because a yet-to-be-proclaimed amendment to the *Interest Act* will replace the existing section 6 with a new section under which the method of calculating interest will be prescribed by regulation.[18] It is conceivable that such regulations could change the method of expressing the interest rate under section 6 of the *Interest Act,* so it was not considered prudent to explicitly specify a formula based on the current section 6.

Suppose that a mortgage loan to which this section applies involves a substantial1[9] non-interest finance charge, such as a brokerage fee, which must be accounted for in the APR. Here the APR must actually be calculated because it will be higher than the annual interest rate. How is this done, given the existing wording of section 6 of the *Interest Act?*

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[15]The unproclaimed amendment to section 6 of the *Interest Act* is in the *Agreement on Internal Trade Implementation Act,* S.C. 1996 c. 17, s. 18. Most sections of the latter Act were proclaimed in force on July 15, 1996, but sections 17 (which replaces section 4 of the *Interest Act)* and **18** have not yet been proclaimed.

[19]Strictly speaking, any non-interest finance charge, no matter how small, affects the APR. But section 5(5) of the Schedule only requires the APR to be accurate to within 1/8 of one percent, and a small charge might not increase the actual APR by as much as 1/8 of one percent.

In its existing form, section 6 of the *Interest Act* requires disclosure ofan annual interest rate "calculated yearly or half-yearly, not in advance," and lenders generally base the disclosed rate on "half-yearly" calculation. The following formula could be used to derive an APR based on half-yearly calculation of interest for a loan with virtually any schedule of advances and payments, so long as the amount and timing of all advances and payments was known (or could be assumed) at the time the APR was to be calculated.

General formula for APR based on "half-yearly" calculation

The APR is the value of "r" (expressed as a percentage) that satisfies the equation:[20]

$$\sum_{j=1}^{j=m} \frac{A_j}{\left(1+\frac{r}{2}\right)^{2t_j}} \qquad \sum_{k=1}^{k=n} \frac{P_k}{\left(1+\frac{r}{2}\right)^{2t_k}}$$

where

j, k is the sequential number of a particular advance (j) or payment (k);

m,n is the total number of advances (m) or payments (n) anticipated by the credit agreement;

A_j, P_k is the amount of advance number j or payment number k;

t_j, t_k is the time at which advance j or payment k occurs, measured in years (and fractions of years) from the date of the first advance.

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[20] In certain circumstances there could be multiple solutions to the equation. Technically, to anticipate this possibility one should take the same approach as the drafter of the U.K. regulations and specify that the APR is the positive value of"r" closest to zero that satisfies the equation, or ifno positive value satisfies the equation, the negative value closest to zero: see Consumer Credit (Total Charge for Credit) Regulations 1980, SI 1980/51, s. 9(3). But most legislation leaves this refinement implicit.

Like any APR equation, this equation would be solved through an iterative (trial-and-error) process that starts with a guess at the value of"r" and adjusts the estimated value of"r" up and down until a sufficiently accurate approximation of the APR is reached.

This general equation could be used to determine a "section 6" APR for a mortgage loan with multiple advances and a highly irregular payment schedule (so long as the amount and timing of all advances and payments was known or could be assumed). But the garden-variety residential mortgage tends to be much less complicated, consisting of a single advance followed by a series of equal payments at equal intervals. The general equation can be simplified when calculating the APR for such garden-variety mortgage loans.

2. APR for other credit agreements

This section implements **Proposal 1.2.**

(1) This section would apply to all credit agreements that are not mortgage loans. It would also apply to mortgage loans where the interest rate is not disclosed in accordance with section 6 of the *Interest Act.*

(2) This subsection implements (with some elaboration) the second sentence of the first paragraph of **Proposal 1.2.**

The purpose of paragraph (2)(b) is best illustrated through an example of where it would **not** apply. Suppose that the interest rate on a loan with a three-year term is 2.9% for the first six months and "prime+ 3%" thereafter. The relevant prime rate is currently 6.5 %. The effect of section 5(2) of the Schedule is that the interest rate for the last 30 months of the term is assumed, based on the current prime rate of 6.5%. So the interest rate for the last 30 months of the term is assumed to be 9.5%. Therefore, paragraph (2)(b) is **not** satisfied because the assumed interest rate for the last 30 months of the term is different from the interest rate for the first six months.

Paragraph (2)(c) would be satisfied where the stated annual rate is based on a compounding period that matches the payment periods. It would **not** be satisfied where, for example, the borrower must pay interest monthly but interest is compounded daily, and the stated annual interest rate is the daily rate multiplied by 365. In such a case the calculated APR would be higher than the stated annual interest rate.[21]

(3) The fonnula in this subsection appears to be different from the fonnula set out in **Proposal 1.2.** However, when the definitions of terms and calculation rules set out in this subsection and in Proposal 1.2 are taken into account, they are mathematically equivalent toeach other2[2] (and to the APR calculation procedures

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[21]Although the true APR will be higher than the annual interest rate, a disclosed APR based on the annual interest rate might be within the 1/8 ofone percent (.125%) tolerance pennitted by section 5(5) of the Schedule. Whether it is or not depends on the magnitude of the interest rate: the higher the interest rate the greater the gap between the interest rate and the APR. For the example of daily compounding and monthly payments, rm APR based on the annual interest rate would be within the permitted tolerance when the interest rate is 16% (true APR 16.10%) but outside the permitted tolerance at 18% (true APR 18.13%).

[22]This statement is based on an interpretation of the ambiguous reference in Proposal l .2's definition of"P." to "the principal outstanding at the end of each of a series of equal interest calculation periods, as provided for in the loan contract". Suppose that the loan contract provides for **monthly** payments but also provides for the **daily** calculation and compounding of interest. According to the contract, within each monthly payment period the principal outstanding will increase on a daily basis, as interest is added to principal. The quoted phrase from the definition of"P." seems to imply that for the purposes of calculating the APR, the principal is assumed to increase on a daily basis as provided by the contract. However, this implication would offend the concluding statement in Proposal l.2's definition of"P.": "The principal is the amount advanced, **exclusive of any element of the cost of borrowing"** [emphasis added]. Since interest is an element of the cost of borrowing, adding interest to principal would offend the explicit statement that principal excludes any element of the cost of borrowing. The APR calculation algorithm in subsection (3) implements (continued...)

specified by existing provincial legislation). The algorithm in this subsection is more straightforward than the algorithm outlined in Proposal 1.2 because the former dispenses with the latter's concept of the"average principal outstanding" during the term. Employing the concept of average principal merely adds redundant steps to the calculation of the APR.[23]

When a credit agreement requires a borrower to pay non-interest finance charges, the total cost of credit will comprise two components: **(1)** interest; and (2) non-interest charges.[24] However, the APR is calculated by **pretending** that the cost

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[2] (...continued)
the "principal excludes cost of borrowing" rule through calculation rule (c).

[23]The terms of the equation in section 2(3) can be rearranged like so:

$$r = \frac{C}{\sum_{x=1}^{n} L_x p_x}$$

Letting T represent the length of the term in years (as in Proposal 1.2), simultaneously multiplying and dividing the denominator of the foregoing equation by T gives the following:

$$r = \frac{C}{T \left[\frac{\sum_{x=1}^{n} L_x P_x}{T} \right]}$$

Simultaneously multiplying and dividing the denominator by *T* is obviously pointless, except that the expression in square brackets gives the average principal outstanding during each year of the term (*Pa* in Proposal 1.2). Using the average principal to calculate *r* simply adds an unnecessary step to the calculation of the APR.

[24]The interest component will be $0 in the special case where the interest rate is 0%. This would not be all that uncommon, since retailers frequently offer "0% interest" financing arrangements with an administration fee. Since the administration (continued...)

of credit consists entirely of interest. The APR for the actual credit agreement equals the annual interest rate on this hypothetical "interest-only" loan.[25] For an interest-only loan, the sum of the interest that accrues during each calculation period (*r.rL,,P,,*) will equal the total cost of credit (i.e., C, which is defined as total payments - total advances). The objective is to find the annual interest rate for the hypothetical interest-only loan that satisfies this equality. This is accomplished by an iterative process in which the estimated value *of r* is adjusted up and down until a suitably accurate approximation of the APR is derived.

The formula and calculation rules set out in this subsection comprise what the U.S. Regulation Z refers to as the *United States Rule Method.* Regulation Z allows credit grantors to calculate the APR for closed-end credit using either the *actuarial method* or the U.S. Rule method.[26] The actuarial method assumes that interest is compounded at intervals determined by the frequency of payments, whereas the "U.S. Rule produces no compounding of interest in that any unpaid accrued interest is accumulated separately and is not added to principa l."[27] As noted in the commentary on Regulation Z,[28] the U.S. Ruic and actuarial methods produce identical APRs where all payments occur at regular intervals (e.g., monthly). They may differ slightly where the payment schedule has irregularities. such as skipped payments.[29]

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[2] (... continued)
fee will be a non-interest finance charge (unless it is also payable by cash customers), the total cost of credit and APR will be greater than 0%.

[25]The actual contractual interest rate is **irrelevant** when calculating the APR, except that the contractual interest rate determines the amount of the borrower's payments.

[26]12 CFR §226.22(a).

[27]12 CFR Pt. 226 Supp. I, §3 of commentary on section 226.22(a).

[28]12 CFR Pt. 226 Supp. I, §I of commentary on section 226.22(a).

[29]Suppose,for example, that a 36 month loan is to be paid off in 30 equal monthly payments; the first regular payment not being made until the end of the

(continued...)

3. Rebates

This section implements **Proposal 1.6.** It addresses a situation where a consumer is given an option of getting a cash rebate or a low interest rate. Subtracting the foregone rebate from the cash price decreases the amount that is considered to have been advanced to the borrower for the purpose of calculating the APR and total cost of credit. This will have the effect of increasing the APR and total cost of credit that is disclosed to the borrower.

4. APR for leases

(I) This reflects the formula set out in section 38 of the DHA's drafting template proposal **(Proposal 13.2),** with a couple of stylistic adjustments and corrections to defined terms.[30] Firstly, the variables in the CCDA equation are all represented by a single letter: P instead of "PMT" and so on. Secondly, C (the capitalized amount) appears by itself on the left side of the equation in the CCDA, whereas the DHA equation has "PMT" (the periodic payment) on the left side of the equation. The terms of the CCDA equation can easily be rearranged so that P is alone on the left side of the equation, as in the DHA drailing template proposal:

$$P \quad \frac{C - R(1+i)^{-n}}{1-(1+i)^{-n}} + X$$

One advantage of arranging the terms of the equation as they are in the CCDA, rather than as they are arranged in the template proposal, is that the CCDA's form of the equation can readily be restated in words. It can be read as stating that

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[29](...continued) seventh month. All else being equal, the APR for this loan would be somewhat lower if calculated using the actuarial method (as defined by Regulation Z) than it would be when calculated using the U.S. Rule. But the difference will not be dramatic, which presumably is why Regulation Z allows U.S credit grantors to use either method.

[30]It may be noted that, given their respective definitions of terms, the exponent $x-n$ in the CCDA equation is equivalent to the exponent $-(N-A)$ in the DHA.

the capitalized amount equals the present value of all periodic payments plus the present value of the assumed residual payment.

Traditionally, in contrast to what happens under instalment loans, the periodic payments for leases are made at the beginning, rather than the end, of each payment period. For example, for a 24 month lease the first periodic payment would be made at the beginning of month 1 and the last would be made at the beginning of month 24. For a lease where precisely one periodic payment is made at or before the beginning of the tenn, x would be equal to l, and the equation in subsection I would simplify to either of the following:

$$C = 11 \frac{- P(l + i)l-n}{j} + 1 + \frac{R}{(l+ it}$$

$$C = \frac{P(l+i)l- \quad P \; l+if''}{I} + \frac{R}{(1+i)''}$$

Although leases traditionally call for payments to be made at the beginning of payment periods, there is no reason in principle why a lease might not call for payments to be made at the end of payment periods. In such a case, since none of the periodic payments would be made at or before the beginning of the term, the value of x would be O and the equation in subsection (I)could be simplified to:

$$C = P\frac{1 - (1+i)^{-n}}{i} + \frac{R}{(1+i)^{n}}$$

Suppose that a 24 month lease calls for the periodic payments to be made at the beginning of each month and also calls for the last two months' payments to be made at the beginning of the term. Since three periodic payments are paid at or before the beginning of the lease term, the value of x is 3. Apart from its effect on the value of x, prepayment of the payments for one or more end-of-term payment periods docs not complicate the APR calcuation.

(2) This subsection requires the lessor to be consistent in its treatment of taxes. If an amount in respect of a tax is treated as an advance in determining the capitalized amount, any subsequent payment in respect of **that** must be factored into the APR and implicit finance charge. For example, the GST component of periodic lease payments would be ignored in calculating the APR and implicit finance charge, because an amount in respect of the GST would not have been added to the capitalized amount. However, a tax such as a tire recycling tax or air-conditioning tax might be treated as an advance in calculating the capitalized amount. In that case, any subsequent payments by the lessee in respect of such a tax would be taken into account for the purpose of calculating the APR and implicit finance charge.[31]

Suppose, for example, that a recycling tax is payable to the ta"<ing authority at the time the lease is signed; the lessor is responsible for collecting the tax from the lessee and remitting it to the taxing authority. If the lessor collects the tax from the lessee at the outset, the tax will not affect the implicit finance charge and APR. However, instead of collecting the tax from the lessee up front, the lessor might instead add the tax to the capitalized amount, to be amortized over the term of the lease. Where this is done, the payments in respect of the tax must be accounted for in calculating the implicit finance charge and APR.

(3) The equation in subsection (I) accommodate leases that characterize the periodic payments as being made either at the beginning or the end of payment periods. It also accommodates leases in which the payment for one or more end-of-term payment periods is actually paid at the beginning of the term. A lease might have a payment schedule that has irregularities that would not be accommodated by the equation in subsection (I) without certain adjustments. For example, the lease might require the lessee to pay the **first,** rather than the last, few months' payments in advance. Instead of attempting to anticipate and provide specifically for this and other possible permutations oflease payment schedules, subsection

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[31] In fact, if a tax is added to the capitalized amount and amortized over the term of the lease, it is unlikely that the portion of each monthly payment that is attributable to that tax will be specifically identified.

(3) requires the basic equation to be modified as necessary to ensure that the periodic rate is calculated in accordance with actuarial principles.

(4) Part 5 of the Act applies to leases with indefinite tenns. Tocalculate the APR and implicit finance charge for such a lease, it is necessary to make some assumption about the length of the tenn. The assumption that is set out in this section is similar to the assumption for demand loans set out in section 5(3) of the Schedule.

5. Assumptions and tolerances

(2) For a straightforward floating rate loan, this subsection amounts to a requirement that the APR and other information that depend on the interest rate will be calculated by assuming that the interest rate will not change during the term.

The commentary on section 2(2)(b) of the Schedule gives an example of a more complicated arrangeme nt, where there is a low "teaser rate" for the first part of the tenn. The example describes a loan with a three-year tenn under which the interest rate is 2.9% for 1hc first six months and prime plus 3% for the remaining 30 months. The prime rate is 6.5% at the beginning of the term. This subsection requires all relevant calculations to be made on the assumption that the interest rate for the last 30 months of the term will be determined on the basis of the circumstances existing at the time of the calculation. The relevant "circumstance" is that the current prime rate is 6.5%, so all calculations must be made on the assumption that the index value for the last 30 months of the tenn will be 6.5% and that the interest rate will be 9.5%. The result will be a composite APR that is much closer to 9.5% than to 2.9%.

(3) This subsection would apply, for example, to a demand loan. If a non-interest finance charge is imposed in connection with a demand loan, the charge's effect on the APR will depend on the duration of the loan. All else being equal, the actual effect ofa given charge on the APR will diminish as the duration of the loan increases. This subsection adopts the convention, which is fairly common in this sort oflegislation. that the outstanding principal will be repaid after one year.

(5) Accuracy to within one eighth of I percent is a fairly standard requirement in existing North American cost of credit legislation. It must be said that the U.K. approach[32] of requiring the APR to be expressed to the nearest decimal place (e.g., 8.9%) seems more in keeping with the usual manner in which interest rates (and APRs) are expressed. However, a credit grantor who adopts the practice of rounding its correctly calculated APRs to the nearest decimal place will ensure that its disclosed APRs are within the permitted tole rance.[33]

(6) The assumptions set out in this section are by no means exhaustive of the assumptions that might be useful; hence subsection (6) authorizes regulations that would prescribe additional assumptions. It should also be kept in mind that section 7 of the main part of the Act provides a general authority to make reasonable assumptions about information that is not ascertainable at the time of disclosure.

6. **Calculation of prepayment refund**

This implements **Proposal 4.1.** For example, ifa loan were prepaid 2/3 of the way through the term, 1/3 of any non-interest finance charge imposed at the beginning of the term would have to be refunded to the consumer. --

7. **Maximum liability under residual obligation lease**

This implements **Proposal 15.** It is assumed that the intention of the proposal is to put a cap on the consumer's liability for unanticipated decreases in the lease-end market value of leased goods. Thus, this section does not place any

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[32]Consumer Credit (Total Charge for Credit) Regulations 1980, SI 1980/51, s. 6.

[33]Rounding a correctly calculated APR to the nearest decimal place (e.g 8.9%) yields a disclosed APR that will be within 1/20 of one percent (.05%) of the actual APR. Rounding a correctly calculated APR to the nearest quarter of one percent (e.g 7.25%) yields a disclosed APR that will be within 1/8 of one percent (.125%) of the actual APR.

restriction on the amount of the "estimated residual cash payment." It will be recalled from the commentary on the definition of this tenn in section 37(1) that the estimated residual cash payment represents an amount that the consumer has agreed to pay at the end of the lease term, assuming that the actual lease-end value of the goods equals their anticipated value. The estimated residual cash payment will often be nil.

(I)(2) The following example illustrates the application of subsections (I) and (2). A residual obligation lease for a car provides for monthly lease payments of$600. The estimated residual value is$ I 0,000 and the estimated residual cash payment is $0. Because of unanticipated market conditions at the end of the tenn, the lessor is only able to sell the car for $7000. Leaving aside the possibility of an appraisal pursuant to regulations under paragraph (b), the realizable value of the leased goods would be the greater of the amounts detennined under paragraphs (2)(a), (c) and (d):

(a) $7000 (the price for which the lessor sold the car);
(c) $8,000 (80% of the estimated residual value);
(d) $8,200 ($10,000 minus 3 times the $600 monthly lease payment).

Thus, the realizable value of the goods is deemed to be $8,200 and the lessee's maximum liability, applying the formula in subsection (I) is $1,800.

The possibility of an appraisal to detennine the value of the goods is **not** addressed by **Proposal 15.** The U.S. Consumer Leasing Act provides consumers with an appraisal right; the lessee has the right to obtain. at his or her own expense, an appraisal from an independent third party agreed to by both parties, and that appraisal is binding.H Paragraph (2)(b) would allow jurisdictions to provide a similar appraisal right through regulations, should they decide that it is appropriate to do so.

[34] P.L. 90-321, Title I, Ch *5* §183(c), as added P.L. 94-240, §3, 90 Stat. 259, 15 U.S.C. 1667b(c).

(3) This somewhat convoluted subsection asswnes that Proposal 15 intends to cushion consumers from unexpected decreases in the residual value of the goods because of market conditions or other circumstances beyond the consumer's control. Conversely, it assumes that the proposal is not intended to protect consumers from the consequences of their own actions.

To illustrate the operation of this subsection, suppose that the car referred to in the preceding example is worth $7,000, rather than the expected $10,000, not because of unanticipated market conditions or other events beyond the lessee's control, but because of damage caused by the lessee's improper use of the car. In this circwnstance, the realizable value would be reduced from $8,200 to $7,000 because the difference in the amounts is attributable to damage for which the lessee is responsible. The result is that the lessee would be liable for the entire difference between the estimated residual value and the actual value.