MoneySavingExpert

It's time for a 'Typical' solution to interest rate shock

Now the UK has 'freedom' to do so, it should ditch the European Union's 'Representative' APRs and return to its own 'Typical' APRs – so fewer people are hit by far higher rates than advertised

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MoneySavingExpert.com is the UK's biggest consumer website dedicated to saving people money on anything and everything by finding the best deals, beating the system and campaigning for financial justice. Founded by Martin Lewis in 2003, it's based on detailed journalistic research and cutting edge tools, and has one of the UK's top 10 social networking communities. Around 8.2 million people have opted-in to receive the weekly MSE's Money Tips email, and MoneySavingExpert.com has more than 13.5 million unique monthly site users who visit more than 23.5 million times a month, including the MSE Forum, which has more than 2 million registered users.

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Introduction by Martin Lewis, MoneySavingExpert.com Founder & Chair

For years credit applications have been inherently anti-competitive. The only way to find out what rate you'll be charged is to apply – yet that marks your credit file – likely reducing your ability to get credit elsewhere if the rate offered isn't good enough.

Then it got worse. In April 2011, the UK moved from a 'Typical' APR rate regime for loans, credit cards and more, which means 66% of accepted customers need be given the advertised rate, to 'Representative' rates – where now only 51% must.

The change was brought in to homogenise rules across the European Union (EU) – though even back then I remember questions over whether it was truly legally necessary.

That was a bad outcome. When people apply for debt, they usually apply based on the advertised rate. The fact a huge number of people can be accepted but charged more is demoralising and dangerous. And staggeringly, there is no cap on what they can be charged.

This is a particular problem, as lenders tend to make most of the profit from the tail, those that get charged a higher rate – often those with weaker finances.

Now the UK is no longer part of the EU these rules no longer need apply, and we have the 'freedom' to return to – at the very least – the old Typical rates. That would mean more people get the rate they expect. And with a new Brexit Opportunities Minister in place, this seems the right time to push for the change.

And it's needed. Our new research shows that in the last three years, among those who know the details of their experiences:

- 40% of **personal loan applicants** have been offered a higher rate than advertised
- 28% of **credit card applicants** have had the same experience

Many of those offered a higher rate under the Representative APR regime only found out about this after submitting a full application. That means many of those offered higher rates may feel forced to accept the offer, or instead be left with unnecessary marks on their credit files should they reject it.

Being offered a higher rate can negatively impact consumers' financial and emotional wellbeing too.

- Over 40% of those offered a **higher loan rate** since 2011 said this had a negative impact on both their financial and emotional wellbeing; the same can be said for 35% of those offered a **higher credit card rate**.

*As one survey respondent told us, "[Credit card rate was] 10% higher than advertised! …I felt **out of options and cornered**. The overall experience made me feel anxious and not good."*

The whole system needs an overhaul. We will be submitting this report to the Treasury, the Financial Conduct Authority, and the Minister for Brexit Opportunities. And we call upon them to change the rules to…

- Replace Representative APRs with Typical APRs. This means at least 66% (currently 51%) of successful applicants are offered the advertised rate. Though even higher is better.
- Cap the difference between the Typical and maximum APR.
- Apply the improved APR rule to advertised 0% deals lengths for credit cards too (so at least 66%+ accepted must get the advertised 0% length). Currently there isn't any rule on this (it should also apply to other risk-based pricing models).
- Consider mandatory quotation searches for credit card and personal loan applications, or at the very least, before application, firms should communicate prominently the rate range for those not accepted at the advertised rate.

Doing this would still allow the risk-based pricing model the industry is based on to continue, but more fairly, more transparently and better managing consumer expectations. This should reduce the harms caused by the current system.

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*'Don't know' and 'Prefer not to say' answers have been removed from the statistics on Page 4, where personal loan / credit card applicants could not recall whether or not they had been offered a higher interest rate than first advertised.

What are Representative and Typical APRs?

The Annual Percentage Rate (APR) is a calculation that shows the total cost of borrowing, as a percentage, over a year. APRs are advertised alongside consumer credit products such as credit cards or personal loans. Although this is the advertised rate, it is not the rate all successful applicants will be offered:

- **Before 2011, the Typical APR approach was used**
  This meant that 66% or more of successful applicants for a product would be given the advertised rate.

- **Since 2011, Representative APRs have been used**
  Under the Representative APR regime, 51% or more of successful applicants for a product must receive the advertised rate.

This 51% minimum was brought in as a result of the EU Consumer Credit Directive which was legislated in 2008.[2] The Directive was then transposed into UK law through several pieces of legislation, including the Consumer Credit (Advertisements) Regulations 2010, SI 2010/1012, which came into force in February 2011.

[2] Directive 2008/48/EC of The European Parliament and of the Council on credit agreements for consumers and repealing Council Directive 87/102/EEC.

Problems with Representative APRs

Representative APRs hide the real rate from consumers

When choosing a credit product, a key consideration for consumers is, of course, getting the lowest interest rate available, or at least a competitive rate. To do this, consumers will often compare APRs, for example by using best buy tables, a comparison site or different banks' websites.

But the Representative APR rule means that up to 49% of applicants who apply for a credit product may be offered a worse rate than the one they have seen and applied for. This harms consumers, as it makes it difficult for up to almost half of consumers to compare the rates they would be offered in reality. It also makes it impossible for many potential applicants to accurately determine the cost of credit based solely on the Representative APR.

At its core, the issue is that for up to almost one in two applications, with Representative APRs *what you see is not what you will definitely get*.

Consumers are generally unaware that so many might not get the rate they have seen advertised. A 2018 report by The Centre for Economics and Business Research for Shawbrook Bank found that a majority (57%) of loan applicants were not aware of the specific rule that the Representative APR would be offered to a minimum of only 51% of successful applicants.[3]

In recent years the growth of eligibility calculators (including MSE's) using soft credit searches to provide consumers with an indication of their chance of acceptance has helped. Yet while consumers will often be able to see whether or not they'll be accepted for credit products when using these tools, in most cases they can't be sure of the rate they'll be offered.

[3]CEBR, Are consumers being misled by Representative APRs? Research into the UK personal loans market and lenders' use of Representative APR in advertising (2018), p.15. Accessible at https://www.shawbrook.co.uk/media/1848/apr-campaign-report.pdf [last accessed 30/3/22].

In a few rare examples, some firms provide data so that consumers might be pre-approved for a credit card, and a particular rate. Similarly with loans, some products may be offered to consumers at a guaranteed rate. These innovations are helpful for consumers, and they are available on the MSE website (as well as others) for a few lenders, but more needs to be done to fully address the issues arising from Representative APRs. Consumers are often facing opaque choices when deciding which loan or credit card to apply for, and this needs urgent change.

Loan applicant: "It was a way to reel you in"

"I took out a Sainsbury's loan. They were offering something along the lines of 2.9% but when it came back it was a higher rate – I questioned it and they stated that the 2.9% was not all applications…

"Felt like it was a way to reel you in and because a credit check had been done felt I had to take the higher rate as didn't want it to affect my rating. If I remember this was also the same for a Nationwide one as well."

Paul, MSE user

Credit card applicant: "Annoyed rates are so high"

"I did see the interest rate at 12.9 % but when I applied was offered a rate of 34% [for a] Capital One card...

"I accepted the rate but only use it when I have to. I am annoyed rates are so high. I would not use it at any one time over £50 for purchases."

Anonymous, survey respondent

Credit card applicant: "It made me feel disappointed"

"[Credit card rate was] at least 5% higher… I didn't go for it, and it made me feel disappointed and discriminated against."

Anonymous, survey respondent

Credit card applicant: "I felt like I'd been misled"

"Offered rate [for my most recent credit card application] was 5-6% higher than that advertised…

"I didn't take the credit card. I felt like I'd been misled and not like a valued customer."

Anonymous, survey respondent

Representative APRs make it harder to shop around, as consumers have to apply to find out their rate – and mark their credit files in the process

As well as a lack of transparency, Representative APRs hinder the ability of consumers to shop around.

Many lenders and card providers will not confirm an applicant's rate until after they have completed a full application, including a hard credit search, and been accepted. If the consumer is then unhappy with the rate offered, they would need to apply elsewhere, which would again potentially result in a hard credit search being recorded on their file. Each full application will have a negative impact on creditworthiness, making it less likely that consumers will be accepted for subsequent applications – or if they are, they could be more likely to be offered a worse rate due to recent applications.

Loan applicant: "Personal loan advertised at 3.4%... Paperwork showed 17%!"

"Near perfect credit score, no missed payments on file, lived at house for 22 years, worked for same employer for 23 years, NatWest customer for 10 years.

"NatWest personal loan advertised at 3.4%. Conveniently their quote system isn't working so had to put full application in. Paperwork showed 17%!"

Pam, MSE user

Loan applicant: "It's a lucky dip"

"I recently applied for a loan of £15,000 with an advertised rate of 3.3% and did lots of enquiries and was very frustrated that I couldn't find out before a hard search went on my file.

"Eventually I took the plunge and with my credit rating being 995 out of 999 and 0 debt I was confident I would get the lower rate.

"Sadly I got 7.8% but had no option but to go with the APR offered as the mark was already on my file as a hard search.

"I think and feel this is absolutely disgusting as in theory it's a lucky dip when applying and can actually put you in a worse financial situation. The law needs changing on this definitely."

Dean, MSE user

Credit card applicant: “A waste of time”

“[Credit card rate was] 5% higher [than advertised]…

“I declined the offer. It made me feel it was a waste of time and harmed my credit rating.”

Anonymous, survey respondent

Credit card applicant: “They prey on vulnerable people”

“It was a roughly 2-3% increase than had been advertised [for the credit card] previously…

“It made me feel angry, because they prey on vulnerable people who are looking for a financial solution to their current problem. It is so frustrating. I continued to look for other providers.”

Anonymous, survey respondent

APRs are currently uncapped relative to the advertised, Representative rate

For most consumer credit products, there is no cap on the APR that can be charged. This means that when successful applicants are not offered the headline rate, they could be offered one much, much higher.

As an example, if a major high street bank has a Representative APR of 2.8% for a personal loan, but offers a maximum APR of 39.9% for that product, this could add hundreds of pounds to the monthly repayment. In reality, the likelihood is that the applicant will simply reject the loan, leaving an unnecessarily marked credit file.

The Representative APRs system means that up to 49% of successful applicants are in this position. Under a Typical APR system, this would fall, but still affect 34% of successful applicants without additional protection measures.

Loan applicant: “I cancelled the application”

“I had seen on the MoneySavingExpert Credit Club that I had a guaranteed APR of 9.9% with Zopa, and a 95% chance of a 3.4% APR with Admiral. I applied for the 3.4% loan and they offered 18.9% even though my credit score was showing in the high 800s.

“I cancelled the application and went with Zopa in the end, but I still had the hard search which I wouldn’t have accepted if I knew they were going to offer such a poor loan rate.”

Stacy, MSE user

Consumer experiences with Representative APRs

Nationally representative polling results

MoneySavingExpert commissioned YouGov Plc to run two nationally representative surveys each of 2000+ GB adults, from 28-29 September and 2-3 November 2021.[4]

The total sample sizes for these separate surveys were 2,113 and 2,065 GB adults respectively. All figures, unless otherwise stated, are from YouGov Plc. The surveys were carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

Key findings for personal loans and credit cards are below.

For personal loans

- **Being offered a higher personal loan rate than advertised is widespread**
    - In the last three years, two in five (40%[5]) **personal loan applicants** who know the details of their experiences have been offered a higher interest rate at some point in the application journey compared to what was first advertised, at least once.
        - As it stands under the Representative APR rule, up to 49% of successful credit applicants may be offered a worse rate than the one they have seen and applied for. Although some of the two in five personal loan applicants mentioned above may not have followed up on their application after being offered a higher interest rate, these figures show that the reality could be getting close to this maximum figure of 49%.

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[4] Methodology: The surveys were conducted using an online interview administered to members of the YouGov Plc UK panel of 800,000+ individuals who have agreed to take part in surveys. Emails are sent to panellists selected at random from the base sample. The email invites them to take part in a survey and provides a generic survey link. Once a panel member clicks on the link they are sent to the survey that they are most required for, according to the sample definition and quotas. (The sample definition could be "GB adult population" or a subset such as "GB adult females"). Invitations to surveys don't expire and respondents can be sent to any available survey. The responding sample is weighted to the profile of the sample definition to provide a representative reporting sample. The profile is normally derived from census data or, if not available from the census, from industry accepted data.

[5] Figure excludes personal loan applicants selecting "Don't know" or "Prefer not to say" when asked: "Have you ever been offered a higher interest rate compared to what was advertised for any personal loan you have applied for [during the last 3 years]?"

- **Many borrowers find out about the rate rise late in the application process**
  - A third (32%) of those offered a higher loan rate since the Representative APR rule came in said that this happened after they had submitted a full application, but before accepting the product.

- **Borrowers see big rate increases**
  - When offered a higher rate, for 30% it increased by up to half, for 12% it increased by at least half (but didn't double); and for 12% the rate **doubled or more**.

- **Many borrowers take the higher rate**
  - 28% of personal loan applicants took the higher rate when they were offered it, 14% took out a different personal loan, and 11% respectively used another form of credit or gave up and didn't take any borrowing actions.[6]

- **Being offered a higher personal loan rate negatively affects consumers' financial and emotional wellbeing**
  - This problem doesn't impact everyone equally – 34% of those who had been offered a higher rate said that it didn't have an impact on their financial wellbeing, and 40% said it hadn't affected their emotional wellbeing, however:
  - Over two in five (43%) say that being offered a higher rate had a negative impact on their **financial wellbeing**. 27% said that being offered a higher rate had a <u>fairly</u> negative impact on their **financial wellbeing**, and for 16% this was a very negative impact.
  - When asked about the impact on **emotional wellbeing**, 23% said that being offered a higher rate had a <u>fairly</u> negative impact, while for 18%, this was a <u>very</u> negative impact. The net negative response is 41%.

For credit cards

- **Being offered a higher credit card rate than advertised is widespread**
  - In the last three years, almost three in ten (28%[7]) **credit card applicants** who know the details of their experiences have been offered a higher interest rate at some point in the application journey compared to what was first advertised, at least once.

[6] Respondents were asked "…Which ONE, if any, of the following best describes the MAIN action you took as a result of being offered a higher rate than you'd expected?" and given a series of answer options, of which the most likely to be selected are shown here.

[7] Figure excludes credit card applicants selecting "Don't know" or "Prefer not to say" when asked: "Have you ever been offered a higher interest rate compared to what was advertised for any credit card you have applied for [during the last 3 years]?"

- **Many applicants are told about the rise after an eligibility check or full application**
    - For almost a quarter (23%) of those offered a higher credit card rate since the Representative APR rule came in, this was after an eligibility check; for 21% it was after submitting a full application.

- **Rate rises are significant**
    - 19% said it was by up to half; 13% said it was more than half, but not double, and 9% said that the rate more than doubled.

- **A large minority take the higher rate when it's offered**
    - 23% took the higher rate, 17% took a different card and 16% gave up.

- **Being offered a higher credit card rate negatively affects consumers' financial and emotional wellbeing**
    - This problem doesn't adversely affect everyone – 39% of those who had been offered a higher rate said that it didn't have an impact on their financial wellbeing, and 41% said it hadn't affected their emotional wellbeing, however:
    - Over a third (35%) said that being offered a higher rate had a negative impact on their **financial wellbeing**. A significant 20% said that being offered a higher rate had a fairly negative impact on their financial wellbeing, and for 15% this was a very negative impact.
    - When asked about the impact on **emotional wellbeing**, a significant 20% also said that being offered a higher rate had a fairly negative impact, and for another 15% this was also a very negative impact. The net negative response is 35% again.

One survey respondent described his distress like this:

"This has happened with several credit card companies… The interest at the time of opening the account was around 5% higher than the advertised rate…

"Felt distraught and depressed that companies like to take advantage of the poor, sick and disabled. I have several disabilities and have been treated unfairly and differently all my life."

Recommendations: the changes needed

The Financial Conduct Authority (FCA) and HM Treasury (HMT) should use their powers to address the harms identified in this paper. We encourage the FCA and HMT to work together to find the best route forward for implementing this suite of reforms.

1. Replace Representative APRs with Typical APRs – as a bare minimum, or go even stronger

The case is clear. When choosing which product to apply for, it's unreasonable that up to 49% of consumers applying for a product could get a rate they didn't expect. Consumers deserve a reasonable degree of certainty of a product's APR before they make an application.

The replacement of Representative APRs with Typical APRs would increase transparency, and mean a more reasonable proportion of consumers would get the rate that they expect.

Mandating that a larger proportion of applicants than 66% is given the advertised rate would boost consumer protection even further, so the best consumer outcome would be above this level. However, we anticipate industry pushback against such a move, probably on the grounds of interference with risk-based pricing. Taking that into consideration, we believe a return to the previous levels used before 2011 should be the bare minimum.

How this change can happen
Representative APRs were brought in as a result of an EU Directive, and the UK is now able to alter this requirement on firms. The FCA should consider changes to the Consumer Credit sourcebook (CONC) that would bring this change into effect, or alternatively HMT could consider how best to implement these changes as part of its response to the FCA's Review of retained provisions of the Consumer Credit Act.

2. A relative cap on maximum APRs

It is unreasonable that consumers can apply for credit cards or loans and be offered a rate that is dramatically higher than the Representative APR, as there is currently no cap on most products.

A sensible cap on the maximum APR offered, in proportion to the product's Typical APR, should be applied to consumer credit products. This should be done in conjunction with the reintroduction of Typical APRs – or an even higher threshold of successful applicants being offered the advertised rate – and would have the effect of increasing price transparency for those who are not offered the Typical rate. The maximum APR should be advertised prominently.

How this change can happen
A cap on the maximum APR compared to the Typical APR could be implemented by the FCA, and we call on the regulator to investigate how a cap can be appropriately introduced.

3. Mandate firms to disclose the average proportion of successful applicants who don't get the advertised APR, and by how much

To position consumers to make better-informed decisions before they apply, alongside the Typical (or higher) APR, firms should be required to disclose the average proportion of successful applicants that are not offered the advertised APR, and the average APR offered to them. This would help to demonstrate the likelihood of not getting the advertised rate, and the outcome of that.

There are different ways of achieving this, but also some considerations to be made when deciding the methodology. For example, the information would need to be workable and meaningful while still allowing firms to introduce new products, and to vary the rates of existing products over time.

A possible example of how this could be done:

- *Typically, 70% of successful applicants for this product will get the advertised rate, while the remaining 30% could be charged more and be offered an average rate of 7.9%.*

How this change can happen:
A disclosure remedy such as this could be implemented by the FCA, and MSE strongly encourages the regulator to consider how it might do this to better protect consumers.

4. Apply the improved APR rule to advertised 0% deals for credit cards

A large part of the credit card market operates around 0% introductory deals, where borrowers are offered interest-free use of the card for spending, balance transfers and/or money transfers for a specified amount of time.

But many successful applicants will ultimately be offered a shorter period than they had seen advertised, and hoped for. There are currently no rules in place here. The APR rule should apply here too – so the same proportion of applicants who get the advertised rate, also have to receive the introductory deal.

Similar rules should apply to any other advertised elements of debt which use rate-for-risk pricing.

How this change can happen
The FCA has the power to address this recommendation and apply the improved APR rule to advertised 0% deals for credit cards through changes to its rules. MSE urges the regulator to make this move.

5. Consider how to increase the usage of quotation searches to offer an expected APR

Quotation searches are currently sometimes used to offer consumers guaranteed acceptance for a product, if a full application confirms the information provided.

In the FCA handbook, CONC.2.4.3G says "A firm undertaking a credit reference search should not leave evidence of an application on a credit file where a customer is not yet ready to apply. Where practicable, firms should facilitate customers shopping around for credit by offering a 'quotation search' facility".[8]

Taking this a step further and mandating the use of quotation searches to tell consumers the expected APR before a full application is submitted would empower consumers to make much more informed credit decisions. At the moment this only happens where the lender does so voluntarily.

If firms are not required to tell applicants an expected APR before application, then at the very least, they should prominently communicate the rate range for those not accepted at the advertised rate.

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[8] Financial Conduct Authority, FCA Handbook: CONC 2.4 Credit references: conduct of business: lenders and owners. Accessible at https://www.handbook.fca.org.uk/handbook/CONC/2/4.html?date=2019-09-01&timeline=True [last accessed 30/3/22].

Information revealed by a full application may still mean that lenders decide to offer a higher APR, but if this is the case, the consumer protection backstop should always be the relative cap described in Recommendation 2.

We note that, while the majority of lenders already use credit reference agencies, consideration would need to be made to those that do not.

How this change can happen

While some firms currently carry out quotation searches to offer an expected APR when making a credit offer, this approach is not consistent. We urge the FCA to investigate solutions that could mandate quotation searches for this purpose, and mean that consumers would not need a hard credit search to be conducted in order to know the APR they would be offered.

Conclusion

The UK is able to alter the rules around Representative APRs, and Typical APRs could and should be brought back, as a bare minimum.

But MSE believes we should aim higher. Setting the minimum proportion of applicants who are offered a more expensive rate at a level above 66% would provide even stronger consumer protection.

Alongside this, changes to the mechanics of the Typical APRs system could make the system easier to understand, and empower consumers to make more informed decisions.

We call on the FCA, with support from HMT, to find the best avenue for the speedy implementation of these recommendations.

Annex: further consumer case studies

Loan applicant: "I didn't want to keep applying for loans at low rates which then come out at a higher rate"

"A couple of days ago I applied for personal loan for home improvements. The advertised rate with cahoot / Santander was 2.8%. When I used the loan calculator this worked out to just over £205 a month which was something I was happy with. I applied for this loan and within five minutes the return response was that I had been accepted, however the rate was 8.9% making the payment £236.25 a month.

"Maybe naively I didn't realise this is what would happen. I then began to worry that this would've affected my credit rating. I called Santander to ask the reason why it did this to which I was advised it all depended on your credit scores, ratings etc as to what the rate would be. I have a high credit rating, no other loans or credit card debt and as my mortgage was with Santander, I was shocked that I was offered an 8.9% rate. They suggested I contacted Experian to find out more. I asked was I able to reduce the loan I had applied for to bring it down to the amount of £200 should I need to. I was advised this is not possible and I would have to apply again.

"I then tried to call Experian which was impossible to get through to.

"Next I called HSBC which is who I bank with. I spoke to the advisor to see if they could help on understanding how to apply for a loan and get the lower advertised rate. They advised that they weren't allowed to do this. I explained to them how nervous I was that I'd already applied to Santander and that it was going to affect my credit score as it would leave a footprint and I didn't want to keep applying for loans at low rates which then come out at a higher rate. I'd been advised this could've been anything between the 2.8% advertised and 24.9%.

"Nervously I went through the loan application on the HSBC banking app. The advertised rate was 3.3% – worrying that I wouldn't be able to get a low rate I applied for £11,000. Luckily for me this loan was agreed at the 3.3% rate and the money was in my bank within seconds…"

Sheree, MSE user

Loan applicant: "The whole situation was a shambles and put me off getting a personal loan in the future"

"Back in 2017 we took out a loan [for over 5 years] with Santander. We had been customers with the bank since 2014 and always found their service good. Using their online loan calculator, a rate of 3.6% was advertised but upon loan approval it went up to 6.5% taking our monthly payments from c. £200 up to £220.

"Unfortunately, we didn't want to keep looking around as we thought it may appear on / affect our credit score and we were saving for our first home.

"We complained to Santander [but] they just whitewashed the situation with a standard reply i.e., the rate shown was indicative etc. The whole situation was a shambles and put me off getting a personal loan in the future."

Chris, MSE user