

Summary of feedback received

December 2018

<p>Consultation title</p>	<p>GC18/2: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015</p>
<p>Date of consultation</p>	<p>17 May 2018 to 7 September 2018</p>
<p>Summary of feedback received</p>	<p>Introduction</p> <p>This document provides a summary of the feedback we received and our responses.</p> <p>We received 13 responses, from industry associations, firms, other stakeholders and individuals. We believe these responses represent a fair cross-section of views from the financial services industry. We intend our guidance to be useful for consumers and consumer groups too.</p> <p>Respondents generally welcomed the draft guidance which focuses on the fairness of variation terms in financial services consumer contracts, and were broadly positive and supportive of its content. They also raised some issues: we set out the main points below, together with how we will deal with them.</p> <p>Respondents welcomed our recognition of the role and value of fair unilateral variation terms to firms and consumers, for example in variable-rate contracts. Some wanted maximum flexibility to deal with commercial pressures and market developments generally, as well as for passing on costs. Some respondents requested more examples and more clarity in certain areas, along with various minor clarifications. Some comments suggested a lack of understanding that the purpose of the guidance is to identify factors that are relevant to the assessment of fairness of variation terms, not to set out what terms would or would not be considered unfair.</p> <p>We would like to thank all respondents for taking the time to reply and for their constructive feedback. We have carefully considered all responses and have revised our guidance where appropriate.</p>

Response to feedback received

Some general points

1. Forward-looking guidance.

Some respondents asked for clarification that the guidance is forward-looking only, and that it had no application to existing contracts. Some also suggested they could rely on our previous withdrawn guidance on the basis that this was in existence at the time the contract was entered into.

Our response: We have not made the requested change. The guidance does not alter the law. In particular, it does not alter the impact of the Court of Justice of the European Union (CJEU) cases, which is declaratory of the law back to 1995 when the Unfair Terms Directive came into force.

Further, as we said in our consultation document, we are not proposing to conduct further work, such as a proactive review under the CRA, to assess the fairness of variation terms in contracts entered into before this guidance, as we do not consider that the evidence of harm from our specific unfair terms case work would support such a step.

However, on our website we give examples of good practice by firms, including:

- frequent reviews of all consumer contracts for fairness
- reviewing standard consumer contracts to ensure they comply with the CRA
- assessing contracts as part of regular reviews of all product documentation

We have made clear that ultimately it is for the courts to assess whether a term is unfair in applying the law.

2. Relevance of cases decided by the Court of Justice of the European Union (CJEU).

In the guidance, we have referred to a number of rulings of the CJEU. Some respondents said these cases are very fact specific and, where they do not concern financial services contracts, do not apply.

Our response: As mentioned above, the purpose of the guidance is to identify factors that are relevant to the assessment of fairness of variation terms. It is not to set out what terms would or would not be considered unfair. The Unfair Terms Directive applies to all sectors, including financial services. The CJEU case law is therefore relevant to the interpretation and application of the unfair terms legislation regardless of the sector from which it derives. Further, whilst the CJEU has made clear that it is for the

national courts to determine whether a term is unfair in the circumstances, the CJEU, in its case law, sets out criteria to be applied when assessing the fairness of a contractual term: see C-472/10 *Invitel* at paragraph 22, C-415/11 *Aziz* at paragraph 66 and C-92/11 *RWE Vertrieb* at paragraph 48.

3. Distinction between terms themselves being fair and the firm exercising the right to vary in a fair way.

Several respondents thought we should make this distinction clearer in the guidance, and one respondent noted that there are separate regulatory tools to deal with the fair treatment of customers.

Our response: We believe that the guidance text makes this distinction in a clear and appropriate way. We deal with the conduct aspects by referring at paragraph 14 to Principles 6 and 7 of our Principles for Businesses. At paragraph 34 we distinguish the non-binding nature of an unfair term against the consumer and the risk of consumer harm from its unfair use. We therefore have not made any further changes in the Finalised Guidance.

Question 1: factors relevant to determining the fairness of variation terms (paragraphs 36 to 39)

4. Contracts of indeterminate duration and 'valid reasons' to vary them.

A number of respondents argued that the 'derogations' in Part 2 of Schedule 2 to the Consumer Rights Act 2015 (the CRA) have the effect that a fair variation term need not specify valid reasons to rely on the term in an indeterminate duration contract. This is provided that the term requires the firm to inform the consumer with reasonable notice, and the consumer is free to dissolve the contract (paragraph 23 of Schedule 2). They believed that this was not made clear in the draft guidance.

Our response: We agree that in principle a variation term in a contract of indeterminate duration that did not specify any reasons for variation is less likely to be unfair than a similar term in a contract of determinate duration. Such a term would need to be assessed for fairness in the usual way. However, our view is that a variation term in a contract of indeterminate duration that did specify reasons would be more likely to be considered fair as it would be more transparent for the consumer. We have therefore made changes in the Finalised Guidance to make this clear. Further, as already stated in the draft guidance, the 'derogations' in Part 2 of Schedule 2 to the CRA are not

exemptions from the application of the fairness test. Nor are such terms presumed to be fair.

5. Factor 8 in paragraph 36 of the draft guidance: the method for varying the price and economic consequences of variation.

Some respondents asked for further clarification on what is meant by 'method' of the variation. They also asked for more detail on our expectations as to how a variation term can fairly disclose the method of variation. Some respondents have also suggested that providing details about the timing and method of notice for variations would be sufficient.

Our response: The extracts from the CJEU judgments cited at paragraphs 29 and 30 of the Finalised Guidance, refer to the consumer being able to foresee the economic consequences derived from a variation. These extracts indicate that transparency in this area is about more than the timing and method of notice of a variation. We have amended paragraph 56 of the Finalised Guidance to provide further help. However, firms should note that the suggestions are not definitive and that just because a term sets out the method of variation does not in and of itself make the term fair.

Question 2: validity of reasons (paragraphs 40 to 41)

6. A valid reason would enable a firm to pass on only the costs that customers would reasonably expect a firm to bear.

Several respondents asked whether a firm would need to take account of consumers' expectations, as this was subjective and that in practice most consumers may think that firms should bear most risks and costs.

Our response: We have added to the guidance an explanation of what we mean by the 'consumer', and have amended the text about passing on costs to make clear that in this context we are referring to a reasonable consumer (see paragraphs 31 to 33 and 47 of the Finalised Guidance).

Question 3: examples of reasons (for varying a contract) used by firms (paragraphs 42 to 49)

7. Passing on only those costs that can be fairly allocated to the product

A number of respondents said that in some circumstances it may not be possible to identify precisely the costs to be allocated to a particular product or service where those

costs have been incurred for a number of different products or services. One respondent, for example, referred to development costs that benefit customers generally, rather than being specifically linked to a particular product or service.

Our response: We recognise the practical issues in this area, including the difficulties and cost implications of calculating in detail the costs attributable to each of a firm's different products. However, equally, it seems to us that firms must have some idea of those costs so that they can assess the profitability of their various product lines and that, where appropriate, firms make reasonable assumptions about the allocation of costs to particular products and services. Our guidance does not suggest that firms need to carry out a precise arithmetical calculation but, where the reason for a variation relates to changes in costs, we expect firms to take a pragmatic and fair view in the circumstances of what costs should be fairly allocated to the product or service.

8. **A reason which allows the firm to make changes to reflect changes in regulatory requirements/legislation is generally likely to be valid, particularly if the firm's discretion to make changes is confined to only those changes directly required to meet the new legislation or requirement.**

Some respondents felt the guidance suggested that a variation to the consumer's advantage that went beyond the minimum of what was required by regulatory or legislative changes would not be considered as a valid reason.

Our response: As noted above, the valid reasons and the examples in the guidance are not exhaustive. The existence of a valid reason is just an indicator of fairness to be considered as part of the overall assessment of fairness. Variations that can only benefit the consumer are generally likely to be fair. However, we recognise that there may be circumstances where firms may wish to go beyond minimum requirements and where those changes are to the consumer's advantage, and we did not intend to rule this out. So we have amended the guidance to make this clear (see paragraph 49 of the Finalised Guidance).

9. **The likely invalidity of a reason enabling a variation that allows the firm to remain competitive.**

Several respondents asked for clarification on this point, with some suggesting that to remain competitive may be a valid reason, since firms needed to respond to changes in the market place.

Our response: We note respondents' comments on this point, but remain of the view in the draft guidance and do not propose to make any changes. We have however clarified further that the list of valid reasons set out in the guidance is not exhaustive and that there may be other reasons not specified in the guidance that may be valid.

Question 4: transparency (paragraphs 50 to 52)

10. The provision of policies on interest-rate setting.

Several respondents made the point that they would not be able to disclose commercially sensitive information and that may breach competition law.

Our response: We have made amendments in the Finalised Guidance to make clear that firms should, when considering what information to provide to their customers, consider their obligations under competition law. They are expected not to disclose commercially sensitive information, such as pricing or price planning, customer or market information or customer strategy. Any such disclosure could lead to prosecution not only of the firm disclosing but of other firms receiving the information.

Question 5: notice (paragraphs 54 to 60)

11. The requirement to give notice to customers.

Some respondents thought that the guidance should clarify that prior notice may not be required for the purposes of paragraphs 21 and 22 of Part 2 of Schedule 2 to the CRA. They also wanted clarification that the length of notice and whether it was given beforehand should depend on whether the change was to customers' advantage or not. One respondent said that personal notice should not be required for advantageous changes, and another that it was unrealistic for notice to always allow time for the customer to find another provider, for example in the case of re-mortgaging.

Our response: Providing notice is one factor in the assessment of fairness. As we state in the guidance, where a term falls within one of the paragraphs in Part 2 of Schedule 2, this may remove the indication of unfairness but does not in itself make the term fair. What is reasonable notice will need to be assessed on a case by case basis taking into account all the relevant facts and circumstances.

We recognise that there are practical issues with giving notice, and that changes that benefit the consumer may be considered differently from those that are not. We have

made an amendment in the Finalised Guidance to reflect this.

Question 6: freedom to exit (paragraphs 61 to 63)

12. The financial and practical barriers to consumers' exercising the freedom to exit.

A number of respondents made the point that financial and practical barriers to a consumer's exiting a contract should be assessed by reference to all the circumstances at the point of entering the contract, and not when the variation was made.

Our response: We acknowledge the point that practical barriers that were not known or were unlikely at the time the contract was entered into should not affect the assessment of fairness of the term. We have amended the guidance to make this clear.

Question 7: other comments

13. The circumstances which could have been known to the firm at the time the contract was concluded, including those known to the consumer (paragraph 23).

Several respondents asked whether, in assessing the fairness of a term, account should be taken of all the circumstances known to the consumer, as they queried how a firm could be expected to know what each individual consumer knew.

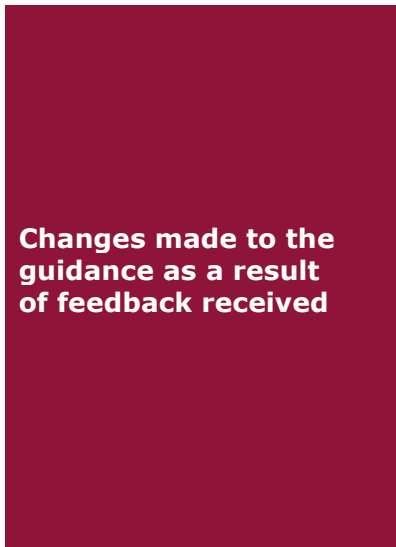
Our response: We agree that only those circumstances reasonably known to, or reasonably foreseeable by, the firm at the time of entry into the contract need to be taken account of when assessing the fairness of the term. We have made changes to paragraph 23 in the Finalised Guidance to reflect this.

14. Appropriate allocation of the responsibility for ensuring that consumer contracts are fair and transparent.

Some respondents made the point that responsibility for ensuring contractual terms were fair and transparent could fall to more than one individual. One respondent also suggested that if we required firms to formally allocate responsibility then we should clearly state this in the Senior Managers Regime or the FCA's systems and controls sourcebook in the FCA's Handbook (SYSC), rather than locating this in guidance.



Our response: We have amended the wording of paragraph 2 of the draft guidance (paragraph 4 of the Finalised Guidance). Our amendment clarifies that, in line with the principles of accountability from the Senior Managers Regime, we expect responsibility for ensuring that consumer contracts are fair and transparent to be clear from Statements of Responsibilities for firms within the regime.



Changes made to the guidance as a result of feedback received

As well as the changes noted above, we have made several other changes to the guidance to:

- add an explanation of what is meant by 'the consumer' (see paragraphs 31 to 33)
- clarify that in assessing the fairness of a term firms must consider both the legitimate interests of the firm and the legitimate interest of the consumer (see paragraphs 20, 35, 43, 45, 51, 52 and 69)
- update and clarify references to case law
- provide consistency of language
- generally, provide clarity through re-ordering paragraphs and other changes, including plainer language

You can access the full text of the guidance consulted on here
