Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015

BSA response to FCA guidance consultation GC18/2

21 August 2018

Building Societies Association

Executive summary

(i) **Stable law**

It is important to note that the statutory provisions material to FCA GC18/2 (the CP), ie those relating to unfair variation terms in consumer contracts, are substantively unchanged since the relevant legislation first came into force over 23 years ago (despite changes from time-to-time in the relevant legislative vehicle and amendments to related law).

(ii) **Variation terms**

The BSA welcomes the CP's acknowledgement of the benefits of fair unilateral variation terms. Consumers who require greater certainty than variable rate products (even with the protection of the various statutory contract terms fairness mechanisms) can opt for fixed rate or tracker products.

(iii) **Valid reasons**

We support the CP's acknowledgement of the potential usefulness of valid reasons and their scope. We also welcome the statement that FCA day-to-day casework generally shows that firms' use of variation terms has been for valid reasons, and that the changes have not gone beyond what was necessary to respond to the particular issue in each case. The CP's list of potentially valid reasons is generally helpful, but by no means comprehensive and we do not agree with all of the CP's analysis. It is also important to note that valid reasons are not necessarily required for every unilateral variation.

(iv) **Circumstances at the time of the contract**

We further support the CP's statement that "*Future events that were not predictable at the time the contract was entered into should not affect the assessment of the fairness of the term. Only circumstances existing at the time the contract was entered into are taken into account (including how the term will affect the parties when agreed), not circumstances arising later.*" In this context for example, firms are entitled to rely on regulatory guidance that was in place at the relevant time.

(v) **Purpose of the unfair contract terms provisions**

It is important that regulators, courts and ombudsmen do not over-interpret the unfair contract terms provisions, stretching them beyond their explicit boundaries, in order to achieve what they see as a fair outcome in respect of a firm that had *treated* customers unfairly. The provisions examined by the CP relate to the fairness and intelligibility of contract terms, but not to *broader* treatment of customers. There are numerous separate provisions designed to address TCF and it is important, in the interests of certainty, that they are utilised appropriately.

(vi) **Regulatory language and guidance**

It is also important that regulatory language is consistent with that used in the law because there is a risk, in departing from that language, of generating uncertainty, unforeseen consequences and unfair retrospectivity. In addition, as noted above, firms are entitled to rely on regulatory guidance that was applicable at the time they entered into the contracts. Regulatory guidance must not of course be retrospective.

(vii) **Legal judgments**

Some of the legal judgments referred to in the CP were very fact-specific. As such, their findings are not of general application to cases where the facts are distinguishable.

(viii) **Sharing of rate-setting policies**

We strongly doubt that the sharing of rate-setting policies with customers, suggested by the CP, would be practical or competition law compliant. However, we fully acknowledge that accurate and realistic pre-contract information sometimes constitutes relevant circumstances in assessing the fairness of a contract term. We therefore welcome and support the FCA's work in relation to customer communication.

(ix) **Regulatory co-ordination**

If it were possible to have a greater degree of co-ordination of the numerous regulatory changes, especially those requiring amended customer documentation, this would be of great help to consumers and firms.

Background

We begin with some comments on the main body of FCA GC18/2 (the CP) and on the subject of unfair contract terms generally. We then respond to each of the CP's specific questions.

It is important to note that the statutory provisions material to the CP, ie those relating to variation terms in consumer contracts, are substantively unchanged since the relevant legislation first came into force in July 1995 (Directive 93/13/EEC). This is despite the fact that the legislative vehicles have altered from time-to-time (currently, for the UK, it is the Consumer Rights Act 2015 – the CRA). Certain amendments to unfair contract terms law, including a number introduced under the CRA, do not directly concern variation terms.

Certain UK and European court (CJEU) judgments have interpreted some of the legal provisions on unfair contract terms. A small number of judgments provided broad assistance on the interpretation of some of the provisions (eg *DGFT v First National Bank plc* [2001] UKHL, which was informative about the nature of the fairness test, and *OFT v Abbey National plc and Others* [2009] UKSC, which provided clarifications about the transparency aspects). However, most tended to be fact-specific, illustrating the application of rules to particular facts (please see below). Therefore, the CP covers no new substantive ground.

During the 23 years since the relevant law came into effect, there have been a number of regulators/qualifying bodies responsible for the subject in the UK, each regulating consumer contract terms and providing (and, in some cases, withdrawing) successive guidance covering the same or similar ground. The Office of Fair Trading in the mid-late 1990s, the FSA in the earlier 2000s, the FCA later in the 2010s and, most recently, the CMA all published guidance or other relevant materials. The FCA is now consulting again through the CP.

The relevant law is, of course, 'horizontal' so all providers are potentially in scope, not just financial services. During the last two decades or so, UK court and CJEU judgments have found both for and against firms' contract terms across a wide range of business areas, including contracts relating to gym membership, estate agency, telecommunications, gas supply, public car parks, mobile caravan parks, financial services, and others. Therefore, we welcome the CP's intention to provide financial services-specific guidance on a key aspect of contract terms.

Between them over time, the financial services regulators (previously the FSA and now the FCA) required more than 50 firms to provide undertakings where the regulator took the view that a firm's individual contract terms were unfair, but we are not aware of the regulators levying any substantial fines or directing significant remediation.

Therefore, the 23-year picture is of certain individual firms, across a range of business areas, having sometimes included unfair terms in their contracts and the regulators or the courts holding them to account. However, during that long period, and with so many diverse regulators and business areas involved, there has been no evidence of sustained, substantial or widespread consumer detriment stemming from breach of the relevant laws in the UK.

The CP supports this assessment in respect of financial services, even in the light of circumstances since the financial crash ten years ago – *"The evidence of our day-to-day unfair terms casework to date suggests that in general firms' adaptation to the changing costs of their funding over time has not led to widespread harm to consumers"* (paragraph 2.9).

Indeed, some of the most egregious individual examples have been external to the UK and outside financial services; for example, in Hungarian telecoms and German gas supply. In some of those cases, the firms provided their customers with very little, or no, relevant information

so not surprisingly the CJEU, in deciding relevant cases, focused on transparency of information to customers.

For example, paragraphs 29-30 of Annex 2 to the CP quote at some length from some of the CJEU judgments, most of which were very fact-specific. In *Invitel* (2012, C-472/10), for instance, the change in question related to the introduction by a Hungarian telecoms company of certain fees into contracts for the first time – not the variation of existing fees or charges. The contracts in this case were fixed term without explicit valid reasons dealing with the matter.

These judgments do not create new law; they do not change the statutory architecture – rather, they illustrate the principles that the courts had regard to in dealing with particular circumstances (that, in some of the cases, were extreme). It would be equally possible to select extracts from earlier judgments, including UK cases, which made very similar points.

Nonetheless, it is crucial that UK businesses (including financial services firms) are not complacent. Consumers are entitled to the full protection of the law regarding their contracts with businesses and, while our members have applied strong due diligence to their contracts with consumers over many years, it is important to review these matters from time-to-time. In order to help, the BSA has liaised closely with the regulators and other relevant bodies, provided a range of detailed guidance to members, and included the subject prominently at numerous seminars and workshops.

Scope of the unfair contract terms regulations

The CP makes the important distinction between fair contract terms and fair treatment of customers. The regulations governing unfair contract terms concern the intelligibility and fairness of a term at the time of the contract (taking into account all relevant circumstances at that time). It is, of course, possible for a firm to have fair terms but to treat a customer *un*fairly, or to have *un*fair terms but to treat a customer fairly.

There is a wide range of horizontal (cross-sector) and vertical (financial services-only) provisions regulating fairness to customers. Some relate to specific products, while others are generally applicable.

The provisions include FCA Principles for Business, FCA TCF outcomes, certain senior management and individual conduct rules, FCA conduct of business rules (COBS, ICOB, BCOBS, MCOB, CONC) and other provisions (eg DISP). In addition, there is the CRA (both the unfair contract terms provisions and various other requirements), the Consumer Protection from Unfair Trading Regulations, the Consumer Credit Act (including the 'unfair relationships' test), and various other statutory and common law provisions.

They also include a range of broad legislative provisions that have components relating to certain aspects of the treatment of customers (eg General Data Protection Regulation, Payment Services Regulations, the Equality Act etc).

Some of the provisions relate to wide aspects of the business-consumer relationship (eg the FCA Principles, the Consumer Protection from Unfair Trading Regulations and the 'unfair relationships' test). Others are limited to a specific part of a product life-cycle (eg the unfair contract terms provisions, some of the other CRA provisions and certain aspects of the FCA's conduct of business rules).

Overall, it is a complicated picture that (despite some helpful consolidation under the CRA) still merits further simplification. However, it certainly represents a wide-ranging regime. With so

many consumer protection measures available, it is particularly important that regulators, courts and ombudsmen do not over-interpret the unfair contract terms provisions, pushing them beyond their well-recognised and legislatively explicit boundaries, in order to achieve what they see as a fair outcome in respect of a firm that has treated customers unfairly.

Such a gold-plating route could call into question *fair* terms used by firms that treat their customers fairly and the resulting confusion would certainly not be in the consumer interest. If terms are unfair on the CRA test, then of course it is right to judge them as unfair and take appropriate steps.

However, if the problem is poor TCF, rather than unfair terms, then the appropriate course (indeed, the *only* legally permitted course – see below) is to proceed under one of the many other provisions that govern non-contractual unfair treatment. This point has been clear for many years and, only this month, the ECJ reiterated it as follows –

> *"In that regard, as the Advocate General notes in point 43 of his Opinion, it is apparent from the wording of Article 1(1) and Article 3(1) of Directive 93/13 and from the general scheme thereof, that* ***the directive applies only to contractual terms and excludes mere practices****."* [Our emphasis]
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> (*Banco Santander v Demba and Bonet* (2018) C-96/16)

This is by no means a purely academic matter – there are potential consequences of conflating unfair terms and unfair customer treatment. For example, if a variation term is found to be unfair, a firm will be unable to rely on it and this could affect large numbers of financial services contracts written over many years. On the other hand, the actual unfair treatment might only affect a small number of individuals. One must also consider the potential impact of ombudsman decisions.

Variation clauses

The BSA strongly welcomes the CP's acknowledgement of the benefits of fair unilateral variation terms. As the CP states *"they give consumers greater choice and flexibility . . . . such scope for changes allows firms to offer competitively-priced products that go beyond ones that simply track base-rate."* (paragraph 1.8).

The CP goes on to state that *"This range of choice for the consumer is available on the basis that the interest rates charged by the firm can be varied to reflect changes in circumstances, particularly changes in the firms' own cost of funding."* We also support the equivalent points set out in paragraph 31 of Annex 2 to the CP.

The CP notes that the departure from historic patterns of rate changes, since 2007-08, is not a reliable measure of the existence of harm (paragraph 2.9). In terms of practical detriment, paragraph 2.10 reports that the FCA's relevant casework does not suggest widespread harm to consumers from variation terms. Furthermore –

> *"The day-today case work that we do has generally shown that firms' use of variation terms has been for valid reasons, and the changes made as a result have not gone beyond what was necessary to respond to the particular issue in each case. Further, from cases we have reviewed for unfair terms issues, we do not believe that in most cases firms' treatment of their customers amounts to mistreatment."*

In particular, in the UK consumers are very familiar with variable rate savings and mortgage products. Indeed, existing MCOB requirements require lenders to set out in illustrations and

offers the impact of an interest rate rise up to a certain level, which provides direct information on the potential implications of having a variable rate mortgage.

Nevertheless, while those customers who choose variable-rate products understand that changes in the product rate are integral to the offering, they are of course entitled to fair contract terms. Firms must take all reasonable steps to ensure that they employ fair terms in their consumer contracts and, where individual firms have unfair terms in their contracts, it is of course absolutely right for the regulator to intervene.

Therefore, the BSA welcomes the CP and, with it, the FCA's intention to make its view clear on the appropriate way to assess the fairness of variation terms, for firms to take account of when drafting or reviewing their own consumer contracts.

The CP acknowledges that the regulator will assess variation terms for fairness under the statutory fairness test (currently set out in section 62(4) CRA). This provides that "*A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer".* The CP further notes that the statutory fairness test is supplemented by other relevant provisions in the legislation, notably the 'grey list' (currently in Part 1 of Schedule 2 to the CRA), and by relevant case law.

We naturally accept the CP's reminder that the 'grey list' (now in Part 1 of Schedule 2 to the CRA), parts of which are particularly relevant to variation terms, is 'indicative' only and is not comprehensive. Nevertheless, the legislators explicitly included unilateral variation (among other) terms in the grey list and this represents an important legislative confirmation of the *potential* validity and fairness of the mechanisms specified in the grey list.

Valid reasons

Among the important concepts introduced by the grey list were 'valid reasons', 'notice' and 'freedom to dissolve', which firms have always had regard to in formulating their arrangements. Therefore, any assessment of a firm's unilateral variation terms that does not at least have explicit regard to the grey list provisions is, in our view, incomplete and therefore unreliable.

There is no rule mandating the use or non-use of valid reasons in contracts for particular types of product, although there are indications in the grey list. It is important to note that valid reasons are not necessarily required for every unilateral variation. The main point is that, whatever mechanism a firm uses in its contracts to protect consumers, it must be fair within the CRA. The CP's list of valid reasons is potentially useful but by no means comprehensive.

As the CMA explained in its 2015 guidance (CMA 37), a valid reason can help protect a consumer "*against encountering unexpected and unacceptable changes in his or her position"* (paragraph 5.22.7). However, it does not create (and never has created) an obligation to increase or reduce interest rates or charges at any particular time or by any given amount. As noted earlier in this response, tracker and fixed rate products are available for consumers who require a greater degree of certainty.

Annex 1

Although the FCA does not ask consultees to comment on the contents of Annex 1 to the CP (existing guidance), we believe it important to set the Annex in context. As noted in the introduction to the CP, the FCA withdrew certain guidance and other material in March 2015 and May 2016, (including guidance published by the FSA in 2005 and 2012), which the FCA has not reinstated.

The FSA explicitly recognised the fact that, while ultimately only the courts could decide whether a term was unfair, firms were entitled to take account of the regulatory guidance applicable at the relevant time.

Indeed, any assessment of a term's fairness or unfairness must relate (among other things) to the circumstances at the time of the contract (section 62(5)(b) CRA). The CP usefully underlines this general point in paragraph 23 of Annex 2 –

> *"Future events that were not predictable at the time the contract was entered into should not affect the assessment of the fairness of the term. Only circumstances existing at the time the contract was entered into are taken into account (including how the term will affect the parties when agreed), not circumstances arising later."*

Therefore, while Annex 1 provides a useful summary of existing guidance, firms could still call upon the withdrawn material if it had been applicable at the relevant time (including statements about valid reasons). We believe that the FCA should clearly state this in Annex 1.

Otherwise, there is a real danger that contract terms entered into, say, 23 years ago may be judged against this latest guidance and there should be nothing to indicate that those terms were necessarily unfair. To do so would only serve to invite unmerited challenges. It should also be noted that for some contracts, in particular mortgage contracts, there might be no right to vary existing variation clauses.

FCA Questions and BSA Responses

1. **Do you agree with the FCA's views on the factors that we consider relevant to determining the fairness of variation terms (see paragraphs 36 to 39)? If not, what are consultees' views on these factors?**

Some of the factors appear to be very broad, while others are narrow, and there are some overlaps. Furthermore, the wording of some of the factors departs from the explicit terminology used in the relevant sections of the CRA and in case law.

It is important that regulatory language is consistent with that used in the law because there is a risk, in moving away from that language, of generating uncertainty, unforeseen consequences and unfair retrospectivity. However, we presume that the CP intends some of the terms used in the list in paragraph 36 simply as plain English shorthand.

Therefore, we take it that the CP promulgates the terms *'legitimate objective'* and *'legitimate purpose'* (factors 1-3), *'objectivity'* (factor 4), *'clearly expressed'* (factor 7) and *'fair balance'* (factor 11) on the basis of the provisions in the statutory fairness test (currently set out in section 62(4) CRA). If this is not the case, then we believe it is important for the FCA to explain why and how it is departing from the legal position.

As noted above, the law provides that "*A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract*

to the detriment of the consumer". A leading judgment, Lord Bingham in *DGFT v First National Bank plc* [2001] UKHL (see above), stated –

- that the requirement of **significant imbalance** is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour, and

- that the requirement of **good faith** is one of fair and open dealing –

    - *openness* requires that the term should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps, and appropriate prominence should be given to terms that might operate disadvantageously to the customer.

    - *fair dealing* requires that a supplier should not, whether deliberately or unconsciously, take advantage of a customer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or other similar factors.

Other relevant provisions in the legislation, notably the 'grey list' (which Annex 2 to the CP explains in paragraphs 32-34), and case law supplement the fundamental test.

We could analyse each of the eleven factors in the light of the legislation and material judicial decisions but, in order to illustrate our point, we select a few examples, as follows.

Therefore, regarding **factor 7** for instance, any specified reasons must of course be transparent. As the CP acknowledges elsewhere, this is a statutory requirement in section 68 of the CRA, and section 64(3) states that "*A term is transparent for the purposes of this Part if it is expressed in plain and intelligible language and (in the case of a written term) is legible".*

Among other UK and EU legal judgments, paragraphs 29-30 of the CP provide extracts from some of the recent European Court (CJEU) judgments regarding variation clauses. Those cases are very fact-specific, impacted to some degree by local regulation and conditions, and they do not introduce new principles or even new reasoning (for example, their reasoning about transparency is similar to that in, say, *OFT v Abbey National plc and Others* [2009] UKSC). In view of the fact that the CP refers to these judgments, we believe the FCA should explicitly note these points in its final paper.

Is the statutory transparency requirement, together with subsequent judicial interpretation (see below), what the CP means by 'clearly expressed'? If not, what does the CP consider it to mean?

Turning to **factor 6**, a variation term would surely not be valid if a contract expressed it in such a way that it allowed changes that benefitted the firm only. Therefore, we are not sure what this factor in the CP adds. A variation term could, however, distinguish between changes in a consumer's favour and changes to a consumer's disadvantage and there is no need to have a valid reason to make a change in a consumer's favour.

A term should capture the circumstances that the CP refers to, as far as it is practicable to do so, but would not be able to comprise detailed scientific calculation of how the firm would decide a variation. What is more, unless the product was a tracker, it could not mandate when or by how much a firm varied interest rates. For the avoidance of doubt, it would be helpful if the guidance expressly stated that 'valid reasons' do not confer an obligation on firms to make changes.

While we do not believe that the FCA is seeking super-equivalence, we would respectfully caution anyone who expects more than the law requires in this area. There are practical limits to the detail that a firm can include in a variation term or related information; for example,

because certain circumstances are inevitably beyond the firm's control, unforeseeable, or involving complex business decisions (Annex 2 to the CP helpfully acknowledges this general point at the start of paragraph 51 – *"Depending on whether it is practical in the circumstances"*). This general observation also applies to some of the other factors set out in the CP, including **factors 7 and 8**.

Thus, while the Bank of England can, and does, explain in broad terms how it decides Bank base rate, it would be impossible for the Bank to state in advance precisely when the rate will change, and the amount by which it will increase or decrease. If a consumer sought this level of certainty regarding pricing over time of a financial services product (such as, say, a mortgage or savings account) then the consumer in question should enter into a fixed-rate product.

Regarding **factor 10**, we recognise that, for some time, the FSA and FCA took into account the extent to which a consumer could freely exercise a right to terminate in practice. We also recognise that the CJEU has made essentially the same point.

The only caveat we would make is that, as the Annex 2 to the CP acknowledges in paragraph 23, *"Future events that were not predictable at the time the contract was entered into should not affect the assessment of the fairness of the term.*" This could be relevant, for example, to vulnerable or 'trapped' customers where there might well be TCF considerations, including forbearance for example, but not necessarily unfair terms.

Therefore, in any relevant individual case, it would be necessary to examine whether or not a firm could reasonably have foreseen - *at the time of the contract* - the practical barrier to the customer's freedom to exercise the right to terminate.

On balance, we conclude that it would be unhelpful to consumers and firms for the FCA to provide a list of factors that departed from the regulatory language and, therefore, could give rise to the detrimental consequences that we outlined above. Accordingly, if the FCA decides to provide such a list in the final guidance, we believe that it should map each element across the underlying legal provision.

2. **Do consultees agree with the FCA's views on the validity of reasons (see paragraphs 40 to 41)? If not, what are consultees' views on the validity of reasons?**

Apart from a couple of points set out below, we have no objection to the CP's analysis, as long as the FCA recognises the practical limitations on what a firm can reasonably foresee and what information it can reasonably include within contract terms. It is crucial that regulatory guidance does not lose this fundamental point.

As already indicated, a firm (in drafting valid reasons) would need to balance commercial and prudential considerations with the need to ensure that its contractual power was fair.

Although sensibly hedged with the term 'reasonable', we are still not clear of the legal basis for the CP's statement about consumer expectations. Again, we caution against the use of non-legal language in providing guidance on legal provisions and refer back to the House of Lords' explanations of 'significant imbalance' and 'good faith' ('openness' and 'fair dealing').

3. **Do consultees agree with the FCA's views on the examples of reasons used by firms (see paragraphs 42 to 49)? If not, what are consultees' views on the reasons used by firms?**

We recognise that there is no statutory definition of a 'valid reason', that only a court could decide what constitutes a 'valid reason', and that the list in the CP is not comprehensive. The

CP suggests that the following examples would be among those that the FCA would likely assess as valid (although naturally an assessment of fairness would also require analysis of the specific contract, the circumstances at the time it was entered into, and the application of other relevant provisions in the CRA) –

(a) changes in technology/other systems
(b) regulatory requirements/legislative changes/court of Financial Ombudsman decisions
(c) changes to cost of funding.

In principle, we support the specified reasons and the CP's commentary on them although (c), in focusing on only one source of costs is too restrictive (see below). We repeat our concern that there is limit on the amount of information that a firm can reasonably include within a stated valid reason. It is also important to remember that technology, systems, products, costs (operational, funding, capital etc) are not homogenous across all firms. Therefore, firms' analyses supporting a decision to frame or use a variation term, based on one or more such reasons, will not all be identical.

We appreciate that the reasons set out in the CP are only examples and several other reasons are potentially valid. For instance, there are reasons relating to the prudential requirements/financial strength of an organisation that, if expressed sufficiently clearly, would in our view be valid. In addition, permitting a firm to respond to a change in the sums payable to the Financial Services Compensation Scheme is a long-standing, and in our view, perfectly reasonable term and one recognised in previous regulatory guidance.

The CP goes on to suggest that the following reasons would not be 'valid' –

(d) to remain competitive
(e) a statement that the terms may be varied for any other reason/an indication that the list of reasons is non-exhaustive.

We believe that (d) merits further consideration. Remaining competitive is a factor that influences other valid reasons, such as cost of funds. Deposits are the main source of funding for lending for most firms and therefore there is a need to balance interest rates paid on deposits and charged on credit. If, say, mortgage interest rates must remain low in order to stay competitive, then inevitably the rates on deposits would also be forced downwards.

The existence of a competitive market is good for consumer choice and, of course, the FCA has a pro-competition remit. In a competitive market firms will often react to what competitors do. Therefore, a reason based on the need to remain competitive could, in our view, potentially be valid if it, as far as is practicable, provided relevant information. Where a firm has adopted pricing for risk, a change in credit risk has also long be accepted as a valid reason. One of our members stated –

> *"On the face of it competiveness as a reason can appear to be unfair but the reality is that people understand it, it is the reality of business and therefore to state it as unlikely to be fair is to take a very narrow view."*

We also accept the point about a direct connection between an increased cost and the product in question. As paragraph 43 acknowledges, some costs might be common to a number of products, and a firm could allocate a reasonably appropriate part of the cost among those products. However, in practice, this could involve complex calculations and business decisions – it is by no means a straightforward matter. Again, it would be impractical to include a detailed explanation within a contractual reason, but many firms have reached reasonable compromises by way of their contract terms and pre-contract information.

It should be remembered that fairness of a term must be assessed taking into account the nature of the subject matter of the contract, and by reference to all the circumstances existing when the term was agreed and to all of the other terms of the contract (section 62(5) CRA).

Regarding (e), certain CJEU judgments make it clear that it is not appropriate to use the formula "*or any other valid reason*" for fixed term products, although the UK courts did not see any difficulty with it (*Du Plessis v Fontgary Leisure Parks* [2012] EWCA Civ 409). The FSA also tended to disapprove of such contractual wording for fixed term products, very much on the lines discussed by the CP in paragraphs 47-48, so the CP's position comes as no surprise.

Of course, as the CP notes, the situation is different with contracts of indeterminate duration and the wording of the CP appears to be confused on this point. Paragraph 35 (and footnote 50) implies, with reference to the CJEU cases, that a valid reason for price variations needs to be specified in the contract even where that contracts is for an indeterminate duration and, if so, this would be inconsistent with paragraph 48 (and we believe the latter to be correct). It would be helpful if the final guidance clarified this point.

The FCA's predecessor, the FSA, indicated that it would not in principle object to a number of other specified reasons (see eg Para 3.7 of *Unfair contract terms: improving standards in consumer contracts*, January 2012). Some firms will naturally have taken that guidance into account in framing contract terms.

4. Do consultees agree with the FCA's views on transparency (see paragraphs 50 to 52)? If not, what are consultees' views on transparency?

We strongly welcome the CP's acknowledgement (in the first sentence of paragraph 51) that there are practical limits to what firms can provide in terms of information relevant to variations. The limitations are two-fold. First, as this response has already pointed out, firms naturally cannot provide information that they do not, and cannot, know (please see our example above concerning the Bank of England and information about Base Rate changes).

Second, there are practical limitations on the amount of information that customers are willing, or able, to receive and digest. This is not always a straightforward matter. Thus, for example, paragraph 51b of the CP suggests that a firm wishing to use a variation term to vary an interest rate due to changes in its cost of funding might provide customers with a copy of its policy for doing so as part of the pre-contractual information.

There would be very serious obstacles and the suggested approach is probably impossible in practice for a number of reasons.

First, a firm must be very cautious about disseminating commercially sensitive or competitive material and it is difficult to see the how the sharing of rate-setting policies with consumers (and, by effectively making them public, with competitors) would comply with competition law.

Second, we do not believe that it is consistent with the findings in another current consultation (*Modernising Consumer Mark*ets by BEIS – April 2018) or, indeed, the spirit of some of the FCA's publications regarding customer communications.

Paragraph 129 of the BEIS CP states that consumers are more likely to read and understand information that the firm has shortened and simplified. While the reference was to terms and conditions, rather than pre-contractual material, the underlying point is the same: ie, information overload is unhelpful to consumers.

There was also the undertaking given by a major bank in relation to its mark-to-market early repayment charges. If information is so complex as to be beyond a consumer's understanding,

that itself is likely to lead to unfairness. Most consumers will not be able to understand the detail of complex funding arrangements and how they might influence interest rates.

We acknowledge that accurate and realistic pre-contract information is very important. Indeed, depending on the circumstances of a case, it might form part of the relevant circumstances in assessing the fairness of a contract term.

It is also worth noting that, for many financial services products, there are already prescribed pre-contract disclosures that comprise the key information that consumers need to be aware of. A supplementary document that placed a great deal of emphasis on a single term may only serve to undermine the wider disclosures.

The BSA encourages members to examine terms to ensure consistency with other customer materials eg marketing, product literature, KFIs etc. We support the FCA's work on customer communications, especially as products and means of delivery change. We would be happy to work with the FCA to explore in more detail what is helpful to consumers, legally compliant and realistic depending on the nature of the product and other factors.

We stated earlier in this response that the fundamental legal requirements relevant to the CP are unchanged over 23 years. As the CP notes, legal judgments have considered how the fairness test applies in practice and many have emphasised transparency.

As noted above, we welcome some of the other work the FCA has carried out in relation to customer communications, which is a part of an important continuing discussion (and not only in relation to contract terms). We believe that, generally speaking, our members achieve a fair balance but, as products, customers and means of delivery change, firms need to keep the matter under review.

5. Do consultees agree with the FCA's views on notice (see paragraphs 54 to 60)? If not, what are consultees' views on notice?

As the CP acknowledges in paragraph 55, in many instances there will be specific statutory or regulatory requirements regarding notice eg BCOBS, PSRs, MCOB, CONC etc. Compliance with those statutory and regulatory provisions will be a relevant circumstance when assessing fairness. While, as we have already noted, the law that underpins the regulation of variation terms is substantively unchanged, it is right for firms to review arrangements from time-to-time, including how it communicates with its customers.

We have already acknowledged the points made elsewhere in the CP that the 'grey list' items (including paragraphs 22 and 23, which are particularly relevant to variation terms) are indicative. We also fully recognise that the fundamental test of fairness is that set out in section 62(4) CRA, as interpreted by the courts.

However, the European Parliament specifically included the grey list in the Directive and, unless and until, the EU (or, after Brexit, the UK Parliament) decides to amend the greylist, it remains a part of the law. Therefore, courts, regulators, Ombudsmen etc must have due regard to its provisions in relevant circumstances.

Some readers might interpret Paragraph 56 as placing value judgments on different provisions in the greylist. This is a particularly important point because, over decades, firms have – perfectly appropriately – configured their contractual arrangements (whether they included valid reasons, notice, freedom to exit, or a combination) on what was set out in the law including, where relevant, the greylist. While we are sure that the FCA does not intend this outcome, it would be unacceptable if there appeared to be retrospective, extra-judicial, extra-

legislative remodelling of legal provisions that firms have been (and continue to be) fully entitled to take into account.

Equally, paragraph 58 appears to imply that a lender can foresee market conditions well into, in some cases several years into, the future. As we note elsewhere, there are realistic limits on the information that a contract term can carry.

6. **Do consultees agree with the FCA's views on freedom to exit (see paragraphs 61 to 63)? If not, what are consultees' views on transparency?**

We have little to add, except to repeat the point made above (and acknowledged by paragraph 22 of Annex 2) that any assessment of a term's fairness or unfairness must be made in relation to the circumstances at the time of the contract.

7. **Do consultees have any other comments on the contents of the Consultation Paper?**

We reiterate that we welcome the CP (albeit that we disagree with certain points in it and would welcome certain clarifications), strongly support further work on customer communications and believe it very important that regulators, courts and ombudsmen continue to have proper regard to the unfair contract terms provisions now embodied in the CRA.

Finally, we make one broad comment. Over the last few years firms have had to change their documentation following the Mortgage Market Review, the Mortgage Credit Directive, FCA Guidance on *Bank of Scotland v Rea*, PSD2, GDPR (and, of course, many sequential – and probably continuing – changes for those firms with consumer credit products). We now have this draft guidance and the impending final report of the Mortgage Market Study. Open banking changes are likely to be rolled out more widely fairly soon as well.

The cost of making changes, issuing notices of variation to terms and conditions are significant (one of our regional members estimates between £150,000 to £200,000 per change to its savings terms, purely for printing and mailing costs. That does not include the cost of taking external legal advice nor the internal time reviewing and approving changes to T&Cs).

The constant change cannot be easy for consumers to follow as they receive numerous notices from their financial providers as well. A greater degree of coordination, where practicable, to determine sensible timelines for change, where more than one change can be carried at the same time, would be very helpful to firms and consumers.

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