

Guidance consultation GC18/2

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

May 2018

1 Why we are consulting

Introduction

- 1.1 The FCA has decided to consult on new guidance on unfair contract terms. In March 2015 the FCA withdrew some unfair contract terms material from its website. Further material was withdrawn in May 2016. The proposed new guidance reflects current legislation and case law.
- 1.2 We have engaged with the Competition and Markets Authority (CMA),¹ trade associations and some firms in relation to our unfair contract terms material. We think it would help firms if we provided further guidance. So we are consulting on draft guidance on the fairness of variation terms in consumer contracts on the basis of the developments referred to at paragraph 1.1. This guidance, when final, should be read with the material already in the unfair contract terms library on the FCA website.²

¹ The CMA has a leadership role in relation to unfair terms

² <https://www.fca.org.uk/firms/unfair-contract-terms/library>

1.3 This document is structured as follows:

- Part 1: Why we are consulting
- Part 2: The consultation process
- Annex 1: Existing guidance
- Annex 2: Our draft guidance, on which we are consulting. Our draft guidance is broken down into three chapters: (1) an introduction, (2) context to the guidance and (3) variation terms.

1.4 As stated above, Annex 2 to this document contains the draft guidance for consultation. We welcome consultees' views on the questions we ask about the draft guidance. You can find them in Part 2 of this document, from paragraph 2.16 onwards.

1.5 This draft guidance relates to all financial services consumer contracts entered into since 1 July 1995. Part 2 (the unfair terms aspects) of the Consumer Rights Act 2015 (CRA) came into force on 1 October 2015, and now implements the Unfair Contract Terms Directive.³ The CRA revoked the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs). For contracts entered into before 1 October 2015 we have provided references to the relevant provisions in the UTCCRs.

The role of the FCA in relation to unfair terms

1.6 The FCA is a regulator under the CRA.⁴ The FCA may consider the fairness of terms in any type of contract, whether or not it relates to regulated products. Under its Memorandum of Understanding⁵ with the CMA, the FCA will consider the fairness of terms under the CRA in consumer contracts issued by firms it regulates⁶ and their appointed representatives.

Why we are consulting

1.7 Following the removal of some unfair contract terms material from the FCA website in March 2015, we received some views from trade associations and firms about how the fairness of variation terms under unfair contract terms law should be interpreted.

1.8 We want to make our view clear on the appropriate way to assess the fairness of variation terms, not just for the trade associations and firms that have been in contact with us, but for industry and consumers as a whole. A large proportion of the contract terms referred to us give firms the right to vary contracts without obtaining consent from consumers. Consumers may typically be given notice of any proposed changes and may be able to exit their contracts if they do not want to accept the change. Our draft

³ Council Directive 93/13/EEC on unfair terms in consumer contracts

⁴ Under the UTCCRs the FCA is a qualifying body

⁵ <https://www.fca.org.uk/publication/mou/fca-cma-consumer-protection-mou.pdf>

⁶ Currently authorised firms, payment services providers and e-money issuers

guidance focusses on these terms. We acknowledge the benefit of fair unilateral variation terms to firms and consumers. Because these terms provide scope for changes in the lifetime of long or open-ended contracts, they give consumers greater choice and flexibility. For example, in relation to variable-rate contracts, such scope for changes allows firms to offer competitively-priced products that go beyond ones that simply track base-rate. 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 firms' own costs of funding. However, appropriate drafting is required as variation terms, if they are unfair, risk causing consumer harm through unfair use.

1.9 Unilateral variation terms appear in the indicatively unfair list of terms in Part 1 of Schedule 2 to the CRA, commonly known as the 'grey list'. The unfairness is only indicative as it is possible to have a fair unilateral variation term in a contract if it is drafted appropriately, taking into account the factors listed in our draft guidance. There are some qualifications to the grey list for financial services contracts at paragraphs 22 and 23 of Part 2 of Schedule 2 to the CRA. It has been suggested that, if a variation term falls within one of these qualifications, it should be considered fair. In the draft guidance at Annex 2, we make clear that variation terms cannot be carved out from the fairness test under the CRA simply because they may fall under a qualification to the grey list. Each term should be assessed for fairness on a case-by-case basis.

1.10 Our draft guidance focusses on unilateral variation terms in particular because:

- We acknowledge that these are some of the most complex terms to assess for fairness because of both the legislative provisions which apply to them and the case law. As we recognise the potential benefits of fair variation terms to both firms and consumers, we want to help firms to ensure that their variation terms are likely to be fair.
- The Court of Justice of the EU (CJEU) has issued a series of rulings which relate to assessing the fairness of variation terms. We consider the principles in these cases are relevant to financial services contracts, even though not all of the rulings involved financial services products.
- Consumers are a significant source of the variation terms issues the FCA receives for consideration and/or investigation.

1.11 We are not consulting on guidance on other aspects of the law regarding unfair contract terms. We may however consider doing so in due course. Firms can of course refer to the CMA's guidance of July 2015⁷ for a discussion on the fairness of other types of terms.

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/450440/Unfair_Terms_Main_Guidance.pdf

Existing guidance

- 1.12 Annex 1 contains existing material available on the FCA website, not included in the consultation. We have added it here as a helpful reminder to firms about our expectations of them. There are also examples of what we see as good and poor practice in the way that firms review unfair terms issues.

2 The consultation

- 2.1 The draft guidance upon which we are consulting on is set out at Annex 2.

The effect of the guidance and our expectations

- 2.2 We have produced this draft guidance in the context of the existing UK and EU statutory and regulatory framework. We will keep it under review to assess whether any amendments may be required in the event of changes in the regulatory or statutory framework. This will include changes made as a result of any negotiations following the UK's vote to leave the EU.
- 2.3 Our expectations of firms are set out on our website.⁸
- 2.4 Once issued in a finalised form, we expect firms to take account of this guidance when drafting and reviewing consumer contracts.
- 2.5 The senior managers' regime specifies principles of accountability. In line with these, we expect firms to allocate appropriately responsibility for ensuring that consumer contracts are fair and transparent under unfair terms law to an appropriate individual in a suitable role at the firm.⁹
- 2.6 The draft guidance sets out the FCA's understanding of how the law on unfair terms operates in the context of variation terms. We discuss certain elements that firms may wish to consider when drafting unilateral variation terms that we think are likely to contribute to terms meeting the requirements of the CRA. This includes the relevance to the fairness assessment of information provided to the consumer at the time of concluding the contract, including for example any policies of the firm, such as on how interest rates will be set.
- 2.7 The interpretation and application of the law is ultimately a matter for the courts. When final, the guidance will not change the law. However, whether firms have taken account

⁸ <https://www.fca.org.uk/firms/unfair-contract-terms/what-firms-should-focus>

⁹ The senior managers regime came into force on 7 March 2016 for deposit-taking firms, and is due to come into force for dual-regulated insurers from December 2018. Our expectation is that commencement of the regime for solo-regulated firms will take place in mid-to-late 2019. The actual commencement dates will be announced and set by Treasury in due course.

of the guidance is a relevant factor when we are considering whether to take action against a firm for unfair terms. Our Handbook Guidance at UNFCOG details factors we take into account in deciding whether or not to take action against firms by using our powers under the CRA.¹⁰ The first factor is whether or not the term in question is potentially unfair under the CRA. Note that fair treatment of customers in practice does not rectify an unfair term and we may still decide to take action in these circumstances to address any issues the term causes for the future operation of the contract, for example ensuring customers are provided with more information about variations. Other relevant factors include whether use of the term has caused consumer harm.

Consumer harm and variation terms

- 2.8 In considering whether harm has already been caused by the use of a term, we take into account both the fairness of the term (under the CRA) and whether it has been operated fairly (under Principle 6 and other FCA rules). We also consider the wider circumstances applying to the sector as a whole and whether a consumer has suffered any harm relative to other consumers within the sector. This assessment will take account of relevant external events, for example the 2007-08 financial crisis.
- 2.9 In relation to certain variable interest rates, such as SVR rates, the main influence¹¹ on the level of a firm's variable rate is the firm's cost of funding, which takes account of many factors specific to that firm.¹² In 2007-08 the financial crisis both reduced available sources of funding for firms and increased the cost of it. Whilst a departure from historic patterns may be discernible since the financial crisis between, for example, SVR rates and reference rates such as the Bank of England base rate, this is not a reliable measure of the existence of harm. Harm is more appropriately assessed by considering the relationship between the variable rate charged to consumers and the drivers behind setting that rate. 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.
- 2.10 When looking at whether harm has been caused more generally, our day-to-day unfair terms case work has considered variation terms from a variety of products. This particular case work does not suggest that variation terms have generally been used in a manner likely to cause widespread harm to consumers. The day-to-day case work that we do has generally shown that firms' use of variation terms has been for valid reasons,¹³ 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 the cases we have reviewed

¹⁰ To learn more about our approach on how we assess cases and when we may take one forward, please see UNFCOG: <https://www.handbook.fca.org.uk/handbook/UNFCOG.pdf>

¹¹ Other factors may also trigger a change in variable rates as set out in the draft guidance, for example costs attributable to changes in technology or changes in regulatory requirements.

¹² Factors impacting on the cost of funding include the credit rating of the firm, the base rate, other interbank lending rates, liquidity rates, costs of capital, costs of fundraising and regulatory changes impacting funding costs. This article from the Bank of England explains the impacts of changes in cost of funding: <http://www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2014/qb14q4prereleasearticlebankfundingcosts.aspx>

¹³ See the draft guidance at paras 39-48.

for unfair terms issues, we do not believe that in most cases firms' treatment of their customers amounts to mistreatment. Where in our ongoing work, for example, in market studies, we have seen issues that have a connection to such terms, we are considering various ways to address any harm, including through the promotion of competition or the introduction of consumer protection remedies. In light of this, 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.

2.11 Where unfair variation terms come to our attention in our day to day case work and we consider that firms have been relying, or could rely, upon them in a way that harms customers, we may challenge firms by using our powers accordingly. This includes the following instances:

- where we receive a referral from industry or consumers
- where we become aware of reliance or proposed reliance on potentially unfair terms in the course of firm supervision

2.12 We also remind firms of the need to comply with the relevant provisions of DISP 1 should they receive any consumer complaints about contractual terms.

What we are consulting on

2.13 Below we set out a summary of what we are consulting on in our draft guidance at Annex 2, together with the specific questions we would like consultees' views on.

2.14 In Chapter 1 (Introduction), we explain what the FCA's powers are under unfair terms law, the roles of other enforcement bodies and private action, and the scope of this guidance.

2.15 In Chapter 2 (Context), we provide a summary of the key concepts under unfair terms law.

2.16 In Chapter 3 (Variation terms), we set out a non-exhaustive list of factors that we consider are relevant to determining whether or not a variation term is fair.

2.17 We would welcome consultees' views on the following questions:

- 1. Do consultees 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?**
- 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?**
- 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 examples of reasons used by firms?**

4. Do consultees agree with the FCA's views on transparency (see paragraphs 50 to 52)? If not, what are consultees' views on transparency?
5. Do consultees agree with the FCA's views on notice (see paragraphs 54 to 60)? If not, what are consultees' views on notice?
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 freedom to exit?
7. Do consultees have any other comments on the contents of this Consultation Paper?

2.18 We may in due course consider whether we should produce guidance on terms other than variation terms.

Who does this consultation affect?

2.19 You should read this guidance consultation if you are:

- a firm
- a trade association
- a consumer or a representative of consumers
- a consumer association, or
- another interested stakeholder

Is this of interest to consumers?

2.20 Yes. Although the draft guidance sets out factors that in our view should be considered by firms when drafting variation terms in their consumer contracts, we believe the draft guidance will help consumers understand whether or not the terms of their contracts are likely to be fair under the CRA.

Cost benefit analysis

2.21 Under section 138I FSMA, when the FCA wishes to introduce any new rules it must publish a cost benefit analysis (CBA) along with the proposed rules. Since this consultation concerns proposed guidance only, the obligation to publish a CBA does not apply and, consequently, we have not prepared one.

2.22 The draft guidance provides our view on firms' obligations when drafting fair variation terms in their consumer contracts under the current legal framework. It does not alter the substance of firms' legal obligations. We expect firms to have regard to this guidance

as part of their usual contract review processes and therefore do not think that firms' costs will increase as a result of this guidance. Firms may incur costs in becoming compliant with the law but this guidance has no impact on that.

Compatibility statement

- 2.23 Section 1B of FSMA requires the FCA, when discharging its general functions, as far as is reasonably possible, to act in a way that is compatible with its strategic objective, and which advances one or more of its operational objectives. The FCA also needs to, as far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, carry out its general functions in a way that promotes effective competition in the interests of consumers.
- 2.24 We are satisfied that the draft guidance is compatible with our general duties under section 1B of FSMA, having regard to the matters set out in section 1C(2) FSMA and the regulatory principles in section 3B.
- 2.25 The draft guidance will help us deliver our operational objectives of providing an appropriate degree of protection for consumers, seeking to advance market integrity and promoting effective competition by setting out our view on how the law should operate. Contracts that contain fair terms genuinely protect consumers in their dealings with firms. Where consumer contracts contain fair terms, there is reduced risk of competition between firms operating to consumers' disadvantage. Greater clarity provided by the guidance will help firms set their strategies with greater confidence.
- 2.26 In producing the draft guidance we have had due regard to the principles in the Legislative and Regulatory Reform Act 2006 and the provisions in the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that our proposals are proportionate and will produce an appropriate level of consumer protection and market integrity when balanced with their impact on firms and on competition.
- 2.27 We have also had due regard to the recommendations made by the Treasury under section 1JA FSMA about aspects of the economic policy of Her Majesty's Government. The Treasury published its first set of recommendations for the FCA on 8 March 2017. In particular, the draft guidance takes into consideration the recommendations relating to competition and better outcomes for consumers. The purpose of the guidance is to set out the FCA's views on the fairness of variation terms under the CRA. When the guidance is final, firms must have due regard to it when reviewing existing terms for fairness and drafting terms in new contracts. Contracts that contain fair variation terms will help consumers to select the product that best meets their needs, promoting effective competition and best outcomes for consumers.

Equality and diversity considerations

- 2.28 We are required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we have considered the equality and diversity issues that may arise from the proposals in this guidance consultation. Overall, we do not consider that the proposals in this guidance consultation adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. We have not specifically referred to any of the protected characteristics in the draft guidance as part of promoting equality of opportunity, because we do not think this is appropriate in the context of the technical nature of this guidance, and because certain key issues in a fairness assessment fall to be assessed by reference to the 'average consumer'.¹⁴
- 2.29 We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final guidance. We welcome any input to this consultation on such matters.

Next steps

What do you need to do next?

- 2.30 We would welcome your views on the guidance consultation which you can find at Annex 2. Please send us your comments by 7 September 2018.

How?

- 2.31 Use the online response form on our website or write to us at the following address:

Tina Archer
Consumer Contracts Team
Financial Conduct Authority
25 The North Colonnade
London
E14 5HS

Email address: gc18-02@fca.org.uk

- 2.32 We make all responses to formal consultations available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.
- 2.33 Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we

¹⁴ See for example C-186/16 Andricuic at paragraph 47 – the national court must assess whether the terms are drafted in sufficiently plain intelligible language to enable the average consumer to estimate the costs.

make not to disclose the response is reviewable by the Information Commissioner's Office and the Information Rights Tribunal.

- 2.34 All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to Editorial and Digital Team, Financial Conduct Authority, 25 The North Colonnade, London E14 5HS.

What will we do?

- 2.35 We will consider your feedback and publish our final guidance in due course.

Annex 1 – Existing guidance

1. We are not consulting on the material contained within this annex. This is existing guidance available on the FCA website.¹⁵ We include it here as a helpful reminder about our expectations of firms.
2. On the FCA website we provide information on what firms should focus on when drafting consumer contracts, including key messages and examples of good and poor practice.
3. There are five key messages to focus on:
 - Firms should take into account consumers' legitimate interests in relation to contracts;
 - Fairness is not contrary to the prudent management of the business, but part of it;
 - Focusing on narrow technical arguments to justify a contract term that, in fact, may be unfair, risks future challenge;
 - Schedule 2 to the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and the Consumer Rights Act 2015 (CRA) each contain an indicative and non-exhaustive list of types of terms in consumer contracts that may be regarded as unfair. The fact that a term does not resemble any of the indicatively unfair terms listed in Schedule 2 may not, in itself, remove the risk of unfairness. Firms need to assess whether a term is fair under the UTCCRs/CRA as a whole and in the context of the particular product or service; and
 - Firms should take into account developments in legislation and relevant case law concerning Council Directive 93/13/EEC on unfair terms in consumer contracts (including relevant UK and European case law).
4. The test of fairness includes the need for firms to take into account consumers' legitimate interests in the context of the inequality of bargaining power between a firm and its consumers. This is important, for example, to a firm in deciding on the extent of any discretion that it will reserve to itself at the time of drafting a standard form contract. If a firm retains extensive and/or open-ended discretion as to if, when and how it changes a contract term, this may indicate a failure to take into account consumers' legitimate interests and so make the term(s) unfair.

Examples of good practice:

- 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.
- Assessing contracts as part of regular product reviews throughout the product lifecycle to ensure the firm can demonstrate it is treating customers fairly.
- Reviewing contracts after having received complaints, cancellations or evidence that terms may be unfair.

¹⁵ <https://www.fca.org.uk/firms/unfair-contract-terms/what-firms-should-focus>

- Monitoring updates and emails from the FCA.
- Reviewing undertakings obtained by the FCA about terms in consumer contracts.
- Reviewing other FCA publications on unfair terms, e.g. thematic work and speeches.
- Monitoring updates about the fair treatment of customers.
- Monitoring the CMA website for updates on the fairness of terms in consumer contracts.
- Reviewing undertakings obtained by the CMA relating to unfair terms in consumer contracts.
- Using management information on complaints received about unfair terms to identify potentially unfair or unclear contract terms and making appropriate changes.
- Monitoring alerts and industry guidance from trade associations.
- Checking for new legislation and guidance and reviewing it as soon as it comes out.
- Improving staff training to ensure staff meet the standards set out in product literature, including contracts.
- Checking the work conducted by contracted external compliance consultants.

Examples of poor practice:

- Internally-focused reviews of consumer contracts of 'what looks fair', without consideration of external legal or regulatory information.
- Being passive and relying on external publications through monthly emails.
- Reviewing external publications and updates only during the annual review of consumer contracts.
- Not assessing contracts for fairness, frequently resulting in contracts containing out-of-date material.
- Relying on external compliance firms without checking or questioning their work.

Annex 2 – Fairness of variation terms in consumer contracts under the Consumer Rights Act 2015

Chapter 1: Introduction

1. This guidance is produced in light of Part 2 and Schedule 2 (Parts 1 and 2) of the Consumer Rights Act 2015 (CRA), which set out provisions on unfair contract terms in consumer contracts. In this guidance, reference to the CRA should be read as referring to these provisions in that Act. The CRA replaced the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) on 1 October 2015.¹⁶ This guidance also reflects case law developments at both UK and EU level. It sets out the FCA's understanding of the provisions of the CRA and recent case law developments in respect of unilateral variation terms.
2. In line with the principles of accountability from the senior managers' regime, we expect firms to allocate appropriately the responsibility for ensuring that consumer contracts are fair and transparent under unfair terms law to an appropriate individual in a suitable role at the firm.¹⁷
3. We expect firms to consider this guidance when reviewing their existing contracts and when drafting new ones. Firms should ensure that variation terms in their contracts are transparent and not unfair.
4. This guidance is not a full legal explanation of the CRA and does not set out an exhaustive list of all the relevant factors to determine whether or not a variation term is fair. Ultimately, only a court can determine the fairness of a term. Firms are responsible for ensuring their terms meet the requirements of the CRA. The FCA cannot approve terms for these purposes. This guidance aims to raise awareness and to provide our view on the factors firms should consider when thinking about fairness issues under the CRA to draft and review unilateral variation terms in their consumer contracts.

FCA's powers under unfair terms legislation

5. The FCA is a regulator under the CRA and a qualifying body under the UTCCRs. As such the FCA has the power to consider complaints and challenge firms on unfair contract terms. The FCA can take injunctive action against a firm, preventing reliance or proposed reliance on an unfair term, or can accept an undertaking in lieu. The FCA also has the power under the CRA

¹⁶ Part 2 of the CRA implements Directive 93/13/EEC on unfair terms in consumer contracts, which was previously implemented by the UTCCRs. The UTCCRs replaced the Unfair Terms in Consumer Contracts Regulations 1994 on 1 October 1999.

¹⁷ The senior managers regime came into force on 7 March 2016 for deposit-taking firms, and is due to come into force for dual-regulated insurers from December 2018. Our expectation is that commencement of the regime for solo-regulated firms will take place in mid-to-late 2019. The actual commencement dates will be announced and set by Treasury in due course.

to seek an undertaking or an injunction from firms where contracts breach the requirement of transparency.

6. Our regulatory guide in the FCA Handbook, The Unfair Contract Terms Regulatory Guide (UNFCOG), explains our policy on how we will use our powers under the UTCCRs and the CRA.¹⁸

Other enforcement bodies and private action

7. The Competition and Markets Authority (CMA) has a leadership role in the enforcement and compliance with unfair terms legislation. The CMA can consider the fairness of terms in all consumer contracts under the CRA. However, under its Memorandum of Understanding with the CMA, the FCA will consider the fairness of terms under the CRA in consumer contracts issued by the firms it regulates and their appointed representatives. It should be noted that the Memorandum of Understanding does not stop the CMA considering the fairness of a term issued by an FCA-regulated firm and taking enforcement action against it.
8. There are also other regulators and qualifying bodies with enforcement powers in addition to the CMA and the FCA.
9. The CMA has issued detailed guidance on the unfair terms provisions of the CRA which still applies to all firms.
10. Where a term fails the fairness test under the CRA, it will not be binding on a consumer. Consumers may rely on the fairness test under the CRA in taking action in the courts or making complaints to firms, and referring them to the Financial Ombudsman Service.

Scope of the guidance

11. This guidance is *general guidance* under section 139A FSMA.
12. This guidance applies to FCA authorised persons¹⁹ (and their appointed representatives), electronic money issuers and payment service providers in relation to any consumer contracts they issue which contain variation terms. This guidance uses 'firm' to refer to all such persons.
13. Insofar as this guidance represents our views in relation to the UTCCRs and the Unfair Terms in Consumer Contracts Regulations 1994, it applies to consumer contracts governed by those regulations. The 1994 regulations entered into force on 1 July 1995 and the UTCCRs were revoked with effect from 1 October 2015. Insofar as this guidance represents our views in relation to the CRA, this guidance applies to consumer contracts entered into on or after 1 October 2015.

Other rules and guidance

14. Note that there are other rules and guidance that apply to terms in consumer contracts in the FCA Handbook.²⁰ Firms should have regard to both this guidance and any applicable rules when drafting and operating variation terms in their consumer contracts to ensure they have complied with all applicable requirements.

¹⁸ <https://www.handbook.fca.org.uk/handbook/UNFCOG.pdf>

¹⁹ This includes solo-regulated and dual-regulated firms.

²⁰ In addition to the FCA Handbook, firms should also have regard to other relevant legislation relating to terms in consumer contracts, such as the Payment Services Regulations 2009 for example.

15. In particular, firms are reminded that the Principles for Businesses are also relevant when drafting and operating consumer contracts.²¹ In the context of contract terms, Principles 6 and 7 are of particular relevance:

- Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.
- Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

²¹ <https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html>. Note that rules and guidance in the FCA Handbook may not apply to electronic money issuers and payment service providers.

Chapter 2: Context

The Directive, the CRA, and the UTCCRs

16. The CRA and the UTCCRs implement Council Directive 93/13/EEC on unfair terms in consumer contracts (the Directive). Under the current legal framework between the UK and the EU, judgments of the Court of Justice of the European Union (CJEU) on the interpretation of the Directive are binding on UK courts. This section provides a summary of the key concepts in assessing fairness. The concepts have been discussed in case law both at domestic and CJEU level, and in more detail in the CMA guidance. Firms may also wish to seek legal advice if necessary.
17. Part 2 of the CRA, concerning unfair terms, came into force on 1 October 2015 and applies to consumer contracts entered into on or after that date. The provisions of the UTCCRs continue to apply to consumer contracts entered into between 1 October 1999 and 30 September 2015 inclusive.²² Although the remainder of this guidance will discuss unfair terms in the context of the CRA, it applies equally to factors that should be considered to achieve fairness under the UTCCRs.²³
18. The CRA applies to terms in standard form and individually negotiated contracts between a firm and a consumer.²⁴ Under the CRA, terms should be both fair (subject to the core exemption explained below) and transparent.

Timeline of Unfair Terms Legislation:

1 July 1995: Unfair Terms in Consumer Contracts Regulations 1994 come into force

1 October 1999: The Unfair Terms in Consumer Contracts Regulations 1999 come into force, replacing earlier Regulations from this date

1 October 2015: The Consumer Rights Act 2015 comes into force, replacing earlier Regulations from this date

Example case studies

- A consumer enters into a standard-form contract with a firm on 4 September 1998 – the Unfair Terms in Consumer Contracts Regulations 1994 apply.
- A consumer enters into an individually negotiated contract with a firm in March 1999 – the Unfair Terms legislation does not apply as it only applies to standard-form contracts, not those that are individually negotiated.

²² The Unfair Terms in Consumer Contracts Regulations 1994 came into force on 1 July 1995. The UTCCRs came into force on 1 October 1999 and replaced the Unfair Terms in Consumer Contracts Regulations 1994.

²³ And under the Unfair Terms in Consumer Contracts Regulations 1994 (see footnote 22)

²⁴ It may also apply to terms in other contracts if these terms fall within the scope of s72 CRA (application of rules to secondary contracts). Both the application to negotiated contracts and to secondary contracts is different to the position in the UTCCRs, which only apply to terms in standard form contracts between a firm and a consumer.

- A consumer enters into a standard-form contract with a firm in April 2014 – the Unfair Terms in Consumer Contracts Regulations 1999 apply.
- A consumer enters into a standard-form contract with a firm in June 2017 – the Consumer Rights Act 2015 applies.
- A consumer enters into an individually negotiated contract with a firm in August 2017 – the Consumer Rights Act 2015 applies as there is no longer a requirement for the contract to be in a standard form to be assessable under the CRA.
- A business enters into a contract with another business on any date – none of the unfair terms legislation cited above applies to contracts concluded between businesses. The legislation only applies to consumer contracts.²⁵

The fairness test and the relevance of transparency to the test

19. 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.²⁶ Part 1 of Schedule 2 to the CRA contains an indicative and non-exhaustive list of terms of consumer contracts that may be regarded as unfair. This list is known as the grey list. The fact that a term does not fall within the grey list does not necessarily mean that it is fair.
20. The fairness test has two key elements – good faith and significant imbalance.²⁷ The fairness assessment is a holistic assessment and these elements may overlap with each other in their application to any particular set of facts.²⁸ *It is important to bear in mind that a term that meets the requirements of fairness in one particular consumer contract is not necessarily fair in another.*
21. Whether a term is fair is to be determined by:
- taking into account the nature of the subject matter of the contract, and
 - referring to all the circumstances at the time the term was agreed and to all of the other terms of the contract or of any other contract on which it depends (including implied terms)²⁹
22. The circumstances existing when the contract is agreed would include, for example, how the product has been advertised, any promotional material, required pre-contractual information,

²⁵ Business to business contracts are governed by the Unfair Contract Terms Act 1977

²⁶ Section 62(4) CRA and Regulation 5 UTCCRs

²⁷ The CMA guidance provides further detail on the fairness test. To note, since publication of the CMA guidance in July 2015, there has been a Supreme Court ruling which considered the fairness test under the UTCCRs: *ParkingEye v Beavis* [2015] UKSC 67. This Supreme Court case draws on the CJEU case of C-415/11 *Aziz*.

²⁸ See *DG of Fair Trading v First National Bank plc* [2002] 1 AC 481 at para 37 (Lord Steyn)

²⁹ See section 62(5) CRA and Regulation 6(1) of the UTCCRs. As regards implied terms, see *Parker and another v the National Farmers Union Mutual Insurance Society Limited (NFU)* [2012] EWHC 2156 (Comm) at paragraph 189

details of any relevant policies of the firm, for example on interest rate setting, and any other material provided by the firm to the consumer.

23. The assessment of the term should take account of all the circumstances which could have been known to the firm at the time the contract was concluded (having regard to the expertise and knowledge of the firm) and which could affect the future performance of the contract.³⁰ It should also take account of circumstances known to the consumer. 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.³¹

24. The meaning of unfairness was considered by:

- the House of Lords in *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52 [2002] 1 AC 481 and
- the Supreme Court in *ParkingEye Ltd v Beavis* [2015] UKSC [2015] 3 WLR 1373

We do not provide here general guidance on the meaning of unfairness. However, we draw attention to one facet of fairness, referred to as transparency, which has also been discussed in the recent case law of the CJEU.

Transparency as a requirement under the CRA

25. The CRA requires that terms are transparent.³² A term that fails to meet the CRA requirement for transparency is not necessarily unfair (which must be determined in the light of all the relevant factors: see paragraphs 21 and 22 above). However a lack of transparency on its own may also have consequences:

- the FCA may seek an undertaking or an injunction, and/or
- where a lack of transparency causes ambiguity and potential confusion, because there is more than one possible meaning, the court must apply the interpretation that is most favourable to the consumer³³

26. The CRA states that a term is transparent for this purpose if it is in plain and intelligible language and is legible.³⁴ According to the CJEU, transparency is not only concerned with whether the term makes grammatical sense. The CJEU states that:

“Information, before concluding a contract, on the terms of the contract and the consequences of concluding it is of fundamental importance for a consumer. It is on the basis of that information in particular that he decides whether he wishes to be bound by the terms previously drawn up by the seller or supplier.”³⁵

³⁰ See C-186/16 *Andricuic* at para 38

³¹ See Lord Hope at para 45 in *Director General of Fair Trading v First National Bank plc* [2002] 1 AC 481

³² Section 68(1) CRA. Regulation 7(1) of the UTCCRs has a similar requirement

³³ Section 69 CRA and note in particular that section 69(2) means that section 69 does not provide a firm with a defence against regulatory action

³⁴ Section 64(3) CRA

³⁵ C-92/11 *RWE Vertrieb* at paragraph 44. See also C-26/13 *Kasler* at paragraph 69-71

"The requirement of transparency of contractual terms laid down by Directive 93/13 cannot therefore be reduced merely to their being formally and grammatically intelligible."³⁶

The core exemption

27. A term will be exempt from the fairness test to the extent that:

- a) it specifies the main subject matter of the contract, or
- b) the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it³⁷

Terms must however be transparent and prominent before they can fall within this exemption. This exemption is commonly referred to as the core exemption.³⁸

Case law

28. Recent CJEU case law emphasised the importance of the transparency of a term for determining whether or not it is fair. At paragraph 36 of Chapter 3, we present a list of factors that we see as relevant to determining whether or not a variation term is fair. This list includes transparency. Below is a short summary of the key points from the recent CJEU cases:

29. On terms that allow the seller or supplier to vary the charges or price payable under the contract, the CJEU said (emphasis added):

"Consequently, in the assessment of the 'unfair' nature of a term, within the meaning of Article 3 of the Directive, **the possibility for the consumer to foresee, on the basis of clear, intelligible criteria, the amendments**, by a seller or supplier, of the [contract] with regard to the fees connected to the service to be provided **is of fundamental importance.**" (C-472/10 Invitel at 28)

"As regards the assessment of a term that allows the supplier to alter unilaterally the charges for the service to be supplied, the Court has previously stated that it follows from Articles 3 and 5 of and points 1(j) and (l) and 2(b) and (d) of the annex to Directive 93/13 that **it is of fundamental importance for that purpose, first, whether the contract sets out in transparent fashion the reason for and method of the variation of the charges for the service to be provided, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges** and, secondly, whether consumers have the right to terminate the contract if the charges are in fact altered." (C-92/11 RWE Vertrieb at 49)

"It follows, in particular from Articles 3 and 5 of Directive 93/13 and Paragraph 1(j) and (l) and Paragraph 2(b) and (d) of the annex to that directive that **it is of fundamental importance, for the purpose of complying with the requirement of transparency,**

³⁶ C-26/13 Kasler at 71

³⁷ Section 64 CRA. Regulation 6(2) UTCCRs is differently worded, but the FCA considers that in substance the core exemptions under the CRA and the UTCCRs are the same.

³⁸ Section 64(2) CRA and regulation 6(2) UTCCRs. The prominence requirement does not expressly apply to terms falling under the UTCCRs. However, in *Office of Fair Trading v Abbey National plc* [2008] EWHC 875 (Comm) Andrew Smith J expressed the following obiter view on the UTCCRs at para 104: "There was some discussion whether the expression 'plain intelligible language' was to be interpreted widely enough to include the clarity of the presentation of the terms. For my part, I would consider it proper when assessing whether terms are in plain intelligible language to take into account clear and accessible presentation with, for example, useful headings and appropriate use of bold print, which can contribute to the intelligibility to the typical consumer of the language."

to determine whether the loan agreement sets out transparently the reasons for and the particularities of the mechanism for altering the interest rate and the relationship between that mechanism and the other terms relating to the lender's remuneration, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it" (C-143/13 Matei at 74³⁹)

30. Regarding transparency more generally, the CJEU states (emphasis added):

"...the requirement of transparency of contractual terms, laid down by Directive 93/13, cannot be reduced merely to their being formally and grammatically intelligible. On the contrary, as the system of protection introduced by Directive 93/13 is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards, in particular, his level of knowledge, that requirement of transparency is to be interpreted broadly." (C-96/14 Van Hove at 40-41)⁴⁰

"Information, before concluding a contract, on the terms of the contract and the consequences of concluding it is of fundamental importance for a consumer. It is on the basis of that information in particular that he decides whether he wishes to be bound by the terms previously drawn up by the seller or supplier." (C-92/11 RWE Vertrieb at 44)

"Those strict requirements as to the information to be given to the consumer [i.e. the obligation to inform the consumer, before the conclusion of the contract and in clear and intelligible terms, of the principal conditions of the exercise of the right of unilateral variation], both at the stage of the conclusion of the supply contract and during the performance of the contract, as regards the right of the supplier unilaterally to alter the terms of the contract, correspond to a balancing of the interests of the two parties. **To the supplier's legitimate interest in guarding against a change of circumstances there corresponds the consumer's equally legitimate interest, first, in knowing and thus being able to foresee the consequences which such a change might in the future have for him and, secondly, in having the data available in such a case to allow him to react most appropriately to his new situation.**" (C-92/11 RWE Vertrieb at 53)

"...the requirement that a contractual term must be drafted in plain intelligible language requires, in the case of loan agreements, financial institutions to provide borrowers with sufficient information to enable them to take prudent and well-informed decisions." (C-186/16 Andricuic at 51)

³⁹ See also C-26/13 Kasler at 73

⁴⁰ Van Hove concerned the scope of an insurance policy, not a variation term. However, the quoted statement is of general application. See also C-26/13 Kasler at 60-75.

Chapter 3: Variation terms

31. Unilateral variation terms are commonly used in financial services consumer contracts, particularly for those of long or indeterminate duration, such as current account, personal pension, mortgage or credit card agreements. We acknowledge the benefit of fair variation terms to firms and consumers, because they allow contracts to be changed in their lifetime, making them more available to consumers. For example, the scope to change variable-rate contracts allows firms to offer competitively-priced products that go beyond ones that track base rate, therefore offering greater choice to consumers. This is because firms know that they may vary the interest rates they charge to reflect changes in circumstances, particularly changes in firms' own costs of funding (see paragraph 45). However, appropriate drafting is required as an unfair variation term is not binding on the consumer and also risks causing consumer harm through unfair use.
32. Firms might legitimately need to make changes to their contracts in certain circumstances. However they should always consider whether a variation term is necessary or appropriate for a contract before including it. Variation terms may not be appropriate in every consumer contract. This is particularly true for contracts of a defined, short duration where the natural expectation of the consumer will be that the terms of the contract are fixed. An example of this would be a one-year insurance contract which is then renewable.
33. We briefly explained the meaning of the core exemption at paragraph 29 above. Note that a variation term cannot benefit from the core exemption under the CRA and is therefore assessable for fairness.⁴¹

The grey list and the qualifications in respect of a) financial services and b) contracts which last indefinitely

32. As noted above, Part 1 of Schedule 2 to the CRA contains an indicative and non-exhaustive list of terms of consumer contracts that may be regarded as unfair. This list is known as the grey list and it covers the types of variation terms listed below:
- Paragraph 11 - A term which has the object or effect of enabling the trader to alter the terms of the contract unilaterally without a valid reason which is specified in the contract⁴²
 - Paragraph 12 - A term which has the object or effect of permitting the trader to determine the characteristics of the subject matter of the contract
 - Paragraph 13 - A term which has the object or effect of enabling the trader unilaterally without a valid reason to alter any characteristics of the product⁴³
 - Paragraph 14 - A term which has the object or effect of giving the trader the discretion to decide the price payable under the contract after the consumer has become bound by it, where no price or method of determining the price is agreed when the consumer becomes bound

⁴¹ See C-472/10 Invitel, at paragraph 23

⁴² Also Schedule 2 paragraph 1(j) UTCCRs

⁴³ Also Schedule 2 paragraph 1(k) UTCCRs

- Paragraph 15 – A term enabling the trader to raise the price without giving the consumer a corresponding right to cancel the contract should the price be too high compared with what was originally agreed⁴⁴

33. The grey list is subject to certain qualifications in Part 2 of Schedule 2 to the CRA. These relate to specific types of terms in specific types of contracts, in particular financial services contracts and contracts of indeterminate duration.

34. The following qualifications relate to paragraph 11 of the grey list:

- Qualification in respect of financial services: paragraph 11 does not include a term whereby a financial services firm reserves the right to alter the **rate of interest payable** by or due to the consumer, or the **amount of other charges** for financial services without notice where **there is a valid reason**, providing that
 - (a) the supplier is required to inform the consumer of the alteration at the earliest opportunity, and
 - (b) the consumer is free to dissolve the contract immediately⁴⁵
- Qualification in respect of contracts which last indefinitely: paragraph 11 does not include a term under which a firm reserves the right to alter unilaterally the conditions of a **contract of indeterminate duration** if
 - (a) the firm is required to inform the consumer with reasonable notice, and
 - (b) the consumer is free to dissolve the contract⁴⁶

35. Where a term falls within one of these qualifications, it does not make the term fair. The term will still be assessable for fairness.⁴⁷ The CJEU is clear that firms cannot rely only on the conditions in the qualification for contracts of indeterminate duration (giving notice and cancellation rights to the consumer)⁴⁸ to achieve fairness. The CJEU has also made it clear that transparency is relevant in assessing the fairness of price variation terms falling within that specific qualification.⁴⁹ In our view the same would apply to the qualification for variation terms in financial services contracts.⁵⁰

Factors relevant to determining whether or not a variation term is fair

36. Any assessment of the fairness of a term must follow the fairness test under the CRA, and be interpreted in light of the Directive and the relevant case law (see Chapter 2). This section is not intended as a substitute for the application of the general law on unfair contract terms. Subject to the general law on unfair contract terms and to proper consideration of all the relevant circumstances, the factors listed below are relevant when assessing the fairness of

⁴⁴ Schedule 2 paragraph 1(l) UTCCRs

⁴⁵ CRA Schedule 2, paragraph 22, UTCCRs Schedule 2, paragraph 2(b) first indent

⁴⁶ CRA Schedule 2, paragraph 23, UTCCRs Schedule 2, paragraph 2(b) second indent

⁴⁷ This follows from the fact that the grey list is indicative only, and a term that does not appear on the grey list may be unfair. See C-237/02 *Freiburger* at 19 and *Peabody Trust Governors v Reeve* [2008] EWHC 1432 (Ch) at 48-51.

⁴⁸ CRA Schedule 2, paragraph 23, UTCCRs Schedule 2, paragraph 2(b) second indent

⁴⁹ For example, Case C-92/11 *RWE* paragraph 52

⁵⁰ CRA Schedule 2, paragraph 22, UTCCRs Schedule 2, paragraph 2(b) first indent. Although C-92/11 *RWE* focused on the second indent of paragraph 2 (b) of the Annex to the Directive, the reasoning in *RWE* and *Invitel* indicates that the requirement of transparency is also relevant to assessing the fairness of price variation clauses that relate to interest rates and financial charges falling into the first indent of paragraph 2(b), and other significant variation terms more generally. Later cases have also emphasised the importance of transparency to the fairness of a term: see in particular *Kasler* Case C-26/13 at 73, C-143/13 *Matei* at 74 and C-96/14 *Van Hove* at 40-41.

variation terms. There may be other factors to consider, and as previously stated, the presence or absence of one or more of the factors does not necessarily mean that a term is fair or unfair. The factors are not listed in order of importance and there is some overlap between them.

1. Has the firm included the variation term to achieve a legitimate objective?
 2. In this guidance we refer to the reasons that a firm uses to justify amending contract terms using the variation term as 'the reasons'. Are the reasons no wider than is reasonably necessary to achieve a legitimate objective?
 3. The variation term permits a change to the contract. Is the extent of that change no wider than is reasonably necessary to achieve a legitimate purpose?
 4. Are the reasons objective?
 5. Will it be possible to verify whether or not the reasons have arisen (ie whether or not the firm is entitled to vary the contract when it invokes the variation term)?
 6. Does the variation term allow for:
 1. variations in favour of the consumer where the reasons may in some circumstances justify changes in favour of the firm but in other circumstances justify changes in favour of the consumer (eg price decreases as well as increases)?
 2. variations in only the consumer's favour?
 7. Are the reasons clearly expressed?
 8. Will the consumer understand at the time the contract is concluded the consequences that a change to the terms might have for him or her in the future? In particular, for a variation term that entitles the firm to vary the price:
 1. does the contract (or other information provided to the consumer before the contract is concluded) set out the method for varying the price?
 2. will the consumer understand the economic consequences of the variation term?
 9. What, if any, notice of any variation does the contract require the firm to give the consumer?
 10. Does the contract give the consumer the right to terminate the contract before or shortly after any variation takes effect? To what extent could that right be freely exercised in practice?
 11. Does the term strike a fair balance between the legitimate interests of the firm and the legitimate interests of the consumer (taking into account any notice provisions, rights the consumer may have to terminate the contract, and the extent to which such rights could be freely exercised in practice)?
37. Firms are reminded that the fair treatment of customers when making a change will not change an unfair variation term in their contract into a fair one (for example, by providing adequate advance notice and freedom to exit even where these are not required by their consumer contracts). The FCA may still take action under the CRA to ensure that only fair terms are drafted and used in consumer contracts. Firms should consider how they will draft fair variation terms in light of our guidance.

The firm's objective in including a variation term

38. The first factor concerns the firm's aims in having the right to vary the terms of the contract.⁵¹ As already noted (paragraph 32 above), firms should consider whether a variation term is necessary or appropriate for the contract.

The scope and effect of the variation term

39. The second to fifth factors concern the scope and effect of the variation term, and are also related to factors seven and eight, ie the transparency of the variation term.⁵² Variation terms should not be wider than reasonably necessary to achieve a legitimate objective, and should not grant a firm an unreasonably wide discretion to make changes to the contract, both in relation to when changes can be made and in relation to what changes can be made. Even if there is no intention to use a variation term to reduce benefits or to require a customer to accept unanticipated costs, if the term allows it to be used in this way, it may be too broad.⁵³
40. When drafting a variation term, firms should carefully consider what, if any, changes might be reasonably necessary during the duration of the contract. This should include consideration of both when a change may be required and what that change might be. Firms should also bear in mind the reasons that may require such changes, taking account of the legitimate interests of not only the firm but the consumer as well, and make appropriate provision for making any changes. Firms should ensure that each reason for varying their contract is clear and does not overlap with other reasons.
41. Reasons are more likely to be valid if they relate to matters that are outside the firm's control. They should not enable the firm to pass on risks and costs that the consumer would reasonably expect the firm to bear.

Examples of reasons used by firms

42. Firms commonly use variation terms in consumer contracts to increase the price of fees and charges, for example, or to make other changes to terms. We comment below on the likely validity of some examples of reasons that firms commonly rely upon. We should not be taken as expressing any view (whether expressly or impliedly) on the likely validity of reasons not covered by the examples.⁵⁴ **The validity of the reasons for amending the terms does not necessarily equate to fairness, particularly if the variation term lacks transparency.**

(a) Changes in technology/other systems

43. A reason which allows the firm to increase its charges because it has made changes to its technology/other systems is generally likely to be valid because these are part of the costs of providing the product. It is generally in the consumer's interests that firms take advantage of technology and develop their systems. We have seen this type of reason used in a number of different product contracts such as credit cards and pensions. Relevant factors in considering

⁵¹ See ParkingEye para 105(4); C-415/11 Aziz para 74

⁵² See for example C-472/10 Invitel paras 24-28, RWE Vertrieb C-92/11 paras 42-49)

⁵³ Any implied terms that restrict the scope of an apparently wide express term are relevant to the assessment of the fairness of the express term (see for example Abbott v RCI [2016] EWHC 2602 (Ch) at paras 45- 46). However, the FCA considers that an express term whose scope is narrowed by an implied term, with the result that its effect is different from what a consumer would reasonably believe from the wording of the term, may lack the required transparency.

⁵⁴ For the avoidance of doubt the FCA's views on the validity of the examples listed apply only to these examples as used in financial services consumer contracts and should not be read as applicable to similar reasons used in consumer contracts in other sectors.

the validity of this are likely to include the duration of the contract, the type of changes to systems that could trigger the change and what costs are being passed on to the consumer under the term. This will include whether the costs being passed on actually belong to the product or, in the case of costs that are common to a number of products, are only those costs that can be fairly allocated to the product. It will also include the proportion of costs that can be passed onto the consumer under this reason.

(b) Regulatory requirements/legislative changes/court or Financial Ombudsman Service decisions

44. A reason which allows the firm to make changes to reflect changes in regulatory requirements⁵⁵/legislation (including prudential requirements) or to reflect case law is generally likely to be a valid reason, because it is in the interest of consumers that firms comply with the law. This is particularly true if the firm's discretion to make changes is confined to only those changes directly required to meet the new legislation or requirement. This would include:

- increasing charges to reflect increased costs arising from new legislation or requirements in relation to the product, or
- for example where the legislation or requirement is general rather than product-specific, to reflect increased costs fairly allocated to the product

Changes for these reasons are outside the control of the firm and changes in costs attributable to this will form part of the costs of providing the product. We have seen this type of reason used in many product contracts including for pensions and mortgage products. Variations are less likely to be for a valid reason if they allow firms to make changes that go beyond what is necessary to comply with the law/regulatory requirements.⁵⁶ In considering the validity of such a reason, the duration of the contract and the nature of the product including in particular whether it is a product where it is generally understood by the consumer that these costs are passed on will be relevant.

(c) Changes to cost of funding

45. A reason is generally likely to be valid if it allows a firm to change rates due to:

- changes in its cost of funding in relation to the product, or
- where funding is general rather than product-specific, to changes in its general cost of funding that are fairly allocated to the product

Changes to cost of funding are generally likely to be outside the direct control of the firm, as cost of funding will vary according to a range of factors. Factors relevant to cost of funding include the credit rating of the firm, the base rate, other interbank lending rates, liquidity rates, cost of capital, cost of fundraising, cost of attracting retail deposits, and regulatory changes impacting funding costs.

The cost of funding is part of the costs of providing the product, and it is appropriate for firms to manage the risks posed by changes to their cost of funding. In some cases, in particular for firms that are also PRA authorised, firms are required by law to manage these

⁵⁵ In our view, regulatory requirements would encompass Supervisory Statements issued by (or contained in formal correspondence from) the Prudential Regulatory Authority.

⁵⁶ Guidance issued by and supervisory views expressed by a firm's regulator will be relevant when considering what is necessary for compliance with legislation/regulatory requirements.

risks.⁵⁷ The exact approach to managing these risks is likely to vary between firms as different types of firms rely on different types of funding, depending on their particular business models.⁵⁸ Considering all the circumstances and the options open to firms, a fairly drafted variation term may be an appropriate tool for a firm to use. Reasons for varying such as the cost of funding are commonly used in SVR mortgages, credit cards and other contracts where there is a relationship between the cost to the consumer and firms' costs of funding. In considering the validity of such a reason in addition to the general factors in paragraph 39 and 40, relevant factors include the duration of the contract and the nature of the product, including in particular whether it is generally understood by the consumer that these costs are passed on.

(d) To remain competitive

46. In our view this reason is unlikely to be valid because remaining competitive is not part of the costs of providing the product. Nor is it otherwise directly connected to providing the product. Also this is unlikely to provide an objective, clear and intelligible criterion for varying the terms. Such a term is likely to lack transparency as consumers are unlikely to understand how a firm might change their contracts in the future to reflect what other firms are doing in the market at that time. Consumers will not be able to make an informed decision about entering a contract allowing variation on this basis as they are unlikely to be able to foresee the consequences of such a term. We make clear at paragraph 49 that we will not question the fairness of a variation term (which would include the reason relied on by the firm to vary) where it operates only in the consumer's favour.

(e) Statement that the terms may be varied for any other reason / an indication that the list of reasons is non-exhaustive

47. In contracts of **determinate duration**, a statement that the terms may be varied 'for any other reason' is unlikely to be valid as it would enable the firm to amend the terms for reasons that do not strike a fair balance between the legitimate interests of the firm and the seller. It would enable the firm, for example, to increase the price simply because it wanted to increase profits. Such terms are likely to lack the required transparency as consumers will be unable to foresee how a firm might change the contract over the lifetime of the contract or what the consequences of the change might be.

48. Different considerations may apply to contracts of **indeterminate duration**. This is the case if the variation term enables the firm to achieve no more than it could properly achieve if it instead gave the consumer notice in accordance with the contract to terminate the contract and offered to enter into a new contract. Firms should carefully consider the fairness of wide powers to vary contracts of indeterminate duration. Firms should also consider how they can satisfy themselves that consumers have been treated fairly when making changes to indeterminate duration contracts on this basis.

Whether or not the term can operate in the consumer's favour

49. Many of the reasons relied on by firms to change the terms in their favour may, depending on the circumstances, also justify changes in the consumer's favour. The sixth factor relates to:

⁵⁷ For example, firms subject to Regulation 575/2013/EU (CRD IV Regulation) will be required to comply with specific rules around managing their funding and liquidity risks.

⁵⁸ In 2014, the Bank of England produced a short guide to explain more about bank funding costs, which can be found here: <http://www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2014/qb14q4prereleasearticlebankfundingcosts.aspx>.

a) whether or not the term contemplates variations that may favour the consumer as well, and

b) whether the variation can only operate in the consumer's favour. In which case we would not question the fairness of the variation term

The transparency of the variation term

50. The seventh and eighth factors concern the transparency of the variation term. The CJEU considers transparency to be of fundamental importance. Therefore, in drafting a price variation term, firms should consider how to reflect in their terms the elements of transparency highlighted by the CJEU (see for example the extracts quoted at paragraph 29). Also relevant are the circumstances surrounding entry into the contract, including any information supplied to the consumer, especially information that may assist the consumer in comparing the firm's product with other products the consumer could purchase.

51. Depending on whether it is practical in the circumstances, and the consumer's level of understanding, firms could consider providing information that could help the consumer to understand the effect of the variation term. This could include, based on the firm's own knowledge and experience of the market, how the term could be used, and the consequences for the consumer. This information could be given in the contract, or in supporting materials before the contract. It could include, depending on the nature and type of the contract:

a. examples or explanations of variations that could be carried out under their variation terms. While this could include examples of past variations the firm has made, a firm should consider whether the consumer understands that past variations are not necessarily a guide to the future use of the variation term

b. details of any policies operated by the firm, for example in relation to how the firm sets its interest rate. The level of detail in the policy, including the extent to which it sets out what is taken into account when setting interest rates will be relevant. For example, a firm wishing to use a variation term to vary an interest rate because of changes in its cost of funding might provide its customers with its policy for doing so as part of the pre-contractual information

52. Note that including examples or explanations of variations, or providing details of policies in itself will not necessarily achieve fairness. Firms should consider the drafting of their terms as a whole in light of the factors listed in this guidance.

53. Firms should also have regard to other requirements on pre-contractual disclosure and content of contracts that may apply to their products, for example the requirement to provide a European Standardised Information Sheet for a mortgage⁵⁹ or the Standard European Consumer Credit Information⁶⁰ for a consumer credit contract.⁶¹

Notice

54. The ninth factor concerns notice. A provision for notice in the variation term is important because it allows consumers to react to the change and take the action that is most relevant and appropriate for them (i.e. accept the change and continue with the contract, reject the

⁵⁹ See MCOB 5A

⁶⁰ See Consumer Credit (Disclosure of Information) Regulations 2010

⁶¹ To the extent that contract terms reflect mandatory requirements, they are not assessable for fairness (s73 CRA, reg 4(2) UTCCRs).

change and exit the contract, or challenge the firm's contractual entitlement to make the change).

55. Some products are subject to specific rules in relation to notice in the FCA's Handbook or other relevant legislation, which should be reflected in any contractual variation term.⁶² A firm may choose to provide longer notice than is required by an FCA rule or other relevant legislation.
56. Paragraphs 22 and 23 of Schedule 2, Part 2 of the CRA refer both to providing notice 'at the earliest opportunity' and providing 'reasonable notice'. Providing notice to customers before the change is made is more likely to help to establish that the variation term is fair (subject to consideration of all relevant issues), than providing notice that a change has already been made and will be taking effect. **Importantly, providing notice does not compensate for a lack of transparency in the contract.**⁶³
57. The assessment of fairness of a contractual term is determined by 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 or of any other contract on which it depends.'⁶⁴ In considering how to achieve fairness for their variation terms, firms may wish to consider the extent to which their contractual provisions on notice, and particularly any setting out the contents of a notice of variation, may contribute to this. Considering what is practical in the circumstances, firms may wish to include a term in the contract requiring explanations to be given to the consumer during the life of the contract of the reason for any proposed variation and its consequences for the consumer.
58. When deciding what the appropriate amount of notice might be, firms should take into account how long consumers need to shop around and find an appropriate alternative product, if they do not want to accept the change.
59. Personal notice is likely to contribute to fairness as it is most likely to ensure consumers are aware of the variation. However, other forms of notice such as media or branch notification may suffice for minor variations. Firms should look at the FCA's Handbook or other relevant legislation for any rules or guidance on the method of notice for a particular product.
60. Firms are also reminded that they should bear in mind any relevant legislation or rules in the FCA Handbook governing their communications with their customers and in particular the requirement that communications should be clear, fair and not misleading.⁶⁵

Freedom to exit

61. The tenth factor concerns the consumer's freedom to exit the contract. When drafting variation terms, firms should consider consumers' freedom to exit the contract if they do not accept the variation, and how this freedom will be exercised. This should include the financial and practical barriers in the contractual terms which may prevent them from doing so. These may be exit charges, or the consumer being required to give a lengthy period of notice for example.
62. Firms should also consider whether any practical barriers outside the contractual terms might prevent a consumer exiting the contract within any advance notice period or reasonable

⁶² See for example MCOB 7.6.1 in relation to mortgages and CONC 6.7 in relation to credit card and other credit agreements.

⁶³ See C-92/11 RWE Vertrieb at paragraph 55

⁶⁴ s62(5) CRA, reg 6(1) UTCCRs

⁶⁵ Principle 7 of the Principles for Businesses

timeframe. For example, for an insurance contract the consumer might not be able to obtain alternative long-term insurance, or, in a mortgage contract, consumers' circumstances might make it difficult for them to change mortgage providers.

63. There are also relevant cancellation rules regarding particular products within the FCA Handbook and other relevant legislation. For example, the Consumer Credit sourcebook (CONC) states that, if consumers wish to exercise their freedom to exit from a credit card or store card due to an increase to the interest rate, firms should allow them to exit and repay the outstanding balance over a reasonable period.⁶⁶

Striking a fair balance between the legitimate interests of the firm and the consumer

64. As suggested by the eleventh factor, we recommend that a variation term that a firm proposes to include in its contracts with consumers should strike a fair balance between the legitimate interests of the firm and the legitimate interests of the consumer. The impact of a term should be examined broadly and from both sides. Provisions favouring a firm may indirectly serve the interests of the consumer as well when both their rights and obligations are examined under the contract and the benefit to consumers from the contract is considered.⁶⁷ For example a variation term may indirectly serve consumers' interests in circumstances where other restrictions on the firm mean that the ability to flex rates fairly on existing products enables the firm to continue to exist and the customer to continue to receive the product/service in question. On the consumer side, the protection given to the consumer should be considered, in particular any notice provisions, rights the consumer may have to terminate the contract, and the extent to which they are likely to be freely exercisable in practice. Overall, firms should consider whether a firm dealing fairly and equitably with the consumer could reasonably assume that the consumer would have agreed to the variation term had it been negotiated on equal terms.⁶⁸

⁶⁶ See CONC 6.7.13R

⁶⁷ See ParkingEye para 106

⁶⁸ C-415/11 Aziz

Annex 3 – Abbreviations used in this paper

CJEU	The Court of Justice of the European Union
CMA	Competition and Markets Authority
CRA	Consumer Rights Act 2015
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
PRA	Prudential Regulation Authority
SVR	Standard Variable Rate
UNFCOG	Unfair Contract Terms Regulatory Guide
UTCCRs	Unfair Terms in Consumer Contracts Regulations 1999