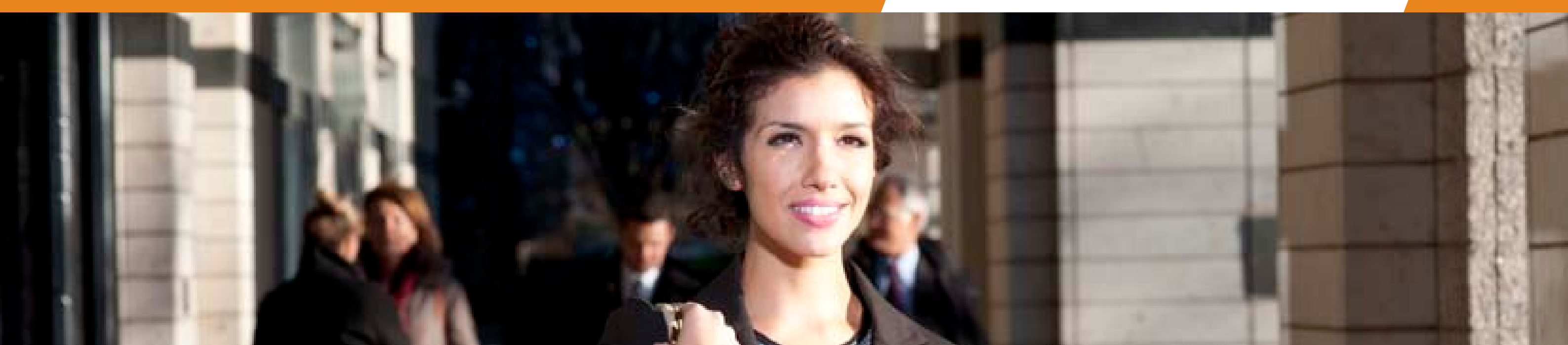
Financial Conduct Authority

Thematic Review TR13/4

Automatic renewal of fixed-term bonds

Identifying and mitigating the risks

July 2013



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Our review

The FCA is currently undertaking thematic work into automatic renewal, considering both:

- consumer contract terms; and
- firms' practices regarding automatic renewal.

We have now completed one aspect of that work, which looked into the automatic renewal of fixed-term bond products. We continue our work into automatic renewal, currently focusing on home and motor insurance policies, but thought it may be helpful to publish our work to date. This is not our final view on this area and we expect to publish our follow-up report in 2014.

1.1 Why did the FCA conduct a review of automatic renewal of fixed-term bonds?

In 2011 our Unfair Contract Terms team received several customer complaints about automatic renewal of fixed-term bonds. Customers were unhappy that firms appeared to be relying on, or introducing during the life of a fixed-term bond contract, automatic renewal terms that they felt were unfair. Customers were finding that, instead of their funds being accessible on maturity, they were locked up in a new bond for a further fixed period.

In 2012, we conducted a thematic review of firms that offer fixed-term bonds, assessing their contract terms and practices regarding automatic renewal. Where we identified concerns, firms reacted positively and made changes to their contract terms and/or practices.

We are conducting some further work into automatic renewal, focusing on home and motor insurance policies. The work will build on this thematic review and provide a basis for the FCA to decide whether to intervene to ensure that customers are treated fairly when their financial products are automatically renewed.

1.2 What are fixed-term bonds?

Fixed-term bonds (also known as fixed-rate bonds, including fixed-rate cash ISAs) are widely used by customers as a low risk type of savings and are offered by most banks and building societies. Customers invest a lump sum for a fixed period and receive a guaranteed rate of interest. Access to that lump sum during the term of the bond is often not permitted or is subject to a penalty (e.g. loss of interest).

The features of a fixed-term bond can vary, such as the interest rate paid, and the minimum and maximum deposits permitted. Typically fixed-term bonds will lock the customer's funds between one and five years, although some firms offer bonds with a shorter or longer duration.

1.3 What is automatic renewal of fixed-term bonds?

Before a fixed-term bond matures, customers are normally invited by their bank or building society to choose how to use their maturing funds (i.e. the original lump sum plus the interest paid upon maturity). Customers can withdraw part or all of the funds, choose a different type of fixed-term bond or investment, or can transfer their funds to an instant access account, either with the same or a different firm.

Many firms operate automatic renewal where a customer does not decide before the maturity date about what should happen to their money. Instead of transferring the customer's funds into an instant access account, the firm reinvests the customer's money into a new fixed-term bond.

Our key findings

2.1 Which firms did we review?

We asked 30 firms that offer fixed-term bonds for details about their contracts and their practices regarding automatic renewal. This sample of firms included the largest retail firms in addition to firms appearing on 'best buy' lists of bonds.

Fourteen firms confirmed that they do not operate automatic renewal. However, we identified concerns about the other 16 firms. These concerns can be split into two categories: 1) the firms' contract terms; and 2) the firms' practices.

We go into further details about each category below.

2.2 Our concerns about the fairness of firms' automatic renewal terms

Our findings were considered under Regulation 5 of the Unfair Terms in Consumer Contracts Regulations 1999.

In our view, automatic renewal terms are likely to be unfair when drafted so that that the interpretation of the term depends on the firm's discretion.[1] For example, a term may give the firm broad scope to determine the terms and conditions of the new bond by stating that the firm may reinvest the customer's funds into whichever bond that it considers 'appropriate'. The potential unfairness arises from the firm being able to interpret what is 'appropriate' in a way that is most favourable to the firm, and reinvest the customer's funds into a new bond, which could have less favourable terms than those of the original bond (e.g. worse access rights or a longer fixed-term etc.).

The firms we identified as having terms likely to be unfair have acted on our feedback and amended the wording of their terms. The amended terms now restrict the firms' discretion when automatically reinvesting a customer's maturing funds, for instance by stating that the new bond will be of similar duration and have the same access rights as the original bond.

1 In our publication entitled 'Unfair contract terms: improving standards in consumer contracts' (January 201, www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg12-02), we stated that:
"…we are concerned about terms which give excessive discretion to firms as to if, when or how they will be able to exercise their contractual powers. In our view, such discretion can cause a term to be unfair.
(…) In addition to our concerns about terms that provide a firm with discretion to exercise contractual powers, we also have concerns about terms which are drafted in a vague way, such that the interpretation of the term is subject to the firm's discretion (whether deliberately or inadvertently).
For example, if a firm writes a term in a way that is vague, there may be ambiguity when interpreting the term. This has the potential to cause detriment to consumers by giving the firm the scope to interpret the term in a way that is most favourable to it and, as a consequence, we consider that such terms have the potential to be unfair under the Regulations."

2.3 Our concerns about the fairness of firms' practices

Our findings concerned the firms' practices when carrying out automatic renewal of fixed-term bonds. These concerns were considered under Principles 6 and 7 of the FCA's Principles for Businesses and related to:

i. *Mid-term variations of fixed-term bond contracts to introduce automatic renewal:* we found that some firms were introducing, or planning to introduce, the feature of automatic renewal during the life of a fixed-term bond contract (i.e. where it was not part of the original terms and conditions).

We told those firms that, in our view, this type of new feature fundamentally changes the nature of the contract that the consumer has entered into, which is not in line with Outcome 5 of the FCA's Treating Customers Fairly Outcomes ("*Consumers are provided with products that perform as firms have led them to expect*").[2]

This is because a customer will generally have taken out a fixed-term bond on the understanding that their funds will be transferred to a nominated account on maturity. We believe that customers would not have expected a mid-term change to their terms and conditions allowing their bond funds instead to be transferred, without their specific permission, to a new bond on maturity. They may therefore be surprised by the automatic renewal and find that, instead of being able to access their funds at any time after maturity as originally agreed, their funds can only be accessed (if after the expiry of a cooling-off period) on payment of an interest penalty, or not accessed at all.

The firms we identified as introducing, or planning to introduce, automatic renewal during the life of a fixed-term bond have agreed not to do so following our feedback.

ii. *Notice periods and cooling-off periods:* we found that some firms were offering short notice periods ahead of maturity in which consumers were expected to make informed decisions about how to use their maturing funds. When considering the adequacy of the notice period provided, we looked at factors such as customers going on holiday and therefore the time left for considering their options upon their return.

We also found that some firms were offering a short cooling-off period, during which the customer could cancel the new bond and withdraw their funds without any penalty, or no cooling-off period at all. When considering the adequacy of the cooling-off period, we looked at factors such as the time customers may take to decide whether they are happy with the reinvestment option taken, allowing them reasonable time to change their minds.

We considered firms' notice and cooling-off periods combined. Where we had concerns, firms have acted on our feedback by agreeing to increase either the length of the notice period or the cooling-off period they offered.

2 www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers

iii. *Opt-out procedures and clarity of communications:* we found that some firms did not make it clear to customers the various options available upon maturity, or how to opt-out of automatic renewal. In some instances, we found that firms had opt-out procedures that were awkward for customers.

Firms have acted on our feedback and have improved the clarity of their communications, for instance by making clearer the relevant terms of the new bond, or in some cases by making it clearer that automatic renewal is not mandatory and customers are entitled to withdraw their maturing funds. Where applicable, firms have simplified their opt-out procedures, for instance by allowing customers to opt-out of automatic renewal in multiple ways.

We are conducting some further work into automatic renewal, focusing on home and motor insurance policies. The work will build on this thematic review and provide a basis for the FCA to decide whether to intervene to ensure that customers are treated fairly when their financial products are automatically renewed.

We expect to publish our follow-up report on automatic renewal in 2014.

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