



Financial Services Authority

Fairness of terms in consumer contracts: a visible factor in firms treating their customers fairly

June 2008

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1 Introduction

Purpose of this report

- 1.1 Firms must have fair terms in their standard consumer contracts to meet their legal and regulatory obligations. Firms' legal obligations include meeting the requirements of the Unfair Terms in Consumer Contracts Regulations 1999 (the Regulations). Firms also have a wider obligation to treat their customers fairly, and we see fair terms in consumer contracts as a key and very visible factor in this.
- 1.2 As well as our principles and rules which require firms to treat their customers fairly, we have powers under the Regulations to challenge firms that use unfair terms in their standard consumer contracts. In the last few months, we have undertaken a project that aimed to:
 - measure awareness of and compliance with the Regulations in the financial services industry;
 - review our use of the Regulations in securing the appropriate level of consumer protection and in firms protecting themselves from prudential, legal and other risks; and
 - explore whether there is more we can do in exercising our powers under the Regulations to promote firms' awareness of their responsibility to treat their customers fairly in relation to their consumer contracts.
- 1.3 This report is to inform firms of our findings and to share examples of good and poor practice in relation to the fairness of terms in consumer contracts. It is aimed primarily at the firms we regulate and for products and services that are within our regulatory scope. We are publishing a separate short summary for smaller firms to help them understand the key messages and key findings of this paper as they apply to them.

Summary of key messages

- We expect all firms to have fair terms in their standard contracts with consumers.
- To have fair terms in their standard consumer contracts, firms need to comply with the requirements of the Regulations and the principle of Treating Customers Fairly (TCF). With the December 2008 TCF deadline rapidly approaching, we remind firms that unfair contract terms can provide evidence that firms are failing to treat their customers fairly.
- We expect firms to proactively review their contract terms. For example, when a firm gives us an undertaking, we expect it to assess whether the concerns identified in the undertaking also apply to the same terms or terms with similar effect in any of the firm's other standard consumer contracts. Similarly, we encourage all firms to review other firms' published undertakings and amend their own contracts in line with them, where appropriate.
- We have published a large amount of information¹ to help firms understand the requirement to have fair contract terms. Our findings show that many of the firms whose contracts we reviewed still have unfair terms in their contracts. This suggests firms need to do more and we encourage them to use the information we provide to help them ensure their contract terms are drafted fairly.
- To lead to the outcome of firms having fair terms in their standard consumer contracts, we encourage firms to:
 1. be aware of the Regulations; and
 2. have systems and controls in place to ensure the fairness of their consumer contracts, for example:
 - (a) to comply with their own undertakings;
 - (b) to apply the underlying reasons for their own undertakings to their other regulated contracts;
 - (c) to use undertakings given by other firms to help them ensure their contract terms are fairly drafted – reviewing undertakings obtained by both the Financial Services Authority (FSA) and the Office of Fair Trading (OFT), as set out in the guidance in The Unfair Contract Terms Regulatory Guide (UNFCOG) in the FSA Handbook; and
 - (d) to use other FSA material on unfair terms such as publications, thematic project findings and speeches to help them ensure they have fair contract terms.

1 Listed at Annex 1 of this report.

2 Why fair contract terms matter

Our powers

- 2.1 We have powers under the Regulations to challenge firms that use unfair terms in their standard consumer contracts.² The OFT is the lead enforcer of the Regulations and we are designated as a qualifying body responsible for enforcing the Regulations. We have an agreement with the OFT³ that we will apply the Regulations to financial services contracts issued by authorised and regulated firms or appointed representatives for carrying on any regulated activity.⁴
- 2.2 The Regulations apply only to standard consumer contracts – they do not apply to contracts which are individually negotiated. There is an imbalance of bargaining power between a firm and its consumers with regard to standard contract terms and the Regulations operate to guard against unfair imbalances to the detriment of consumers. Unfair terms are not binding on consumers, so it is important that firms have fair terms in their standard consumer contracts.
- 2.3 Under the Regulations, we have a statutory duty to consider all complaints⁵ made to us about unfair contract terms. These act as a valuable form of intelligence for us and we have dealt with more than 320 cases so far. We receive complaints from a range of sources including directly from consumers, or referred from the OFT, Citizens Advice Bureaux and Trading Standards Services. Nearly two-thirds of complaints to us about unfair terms come directly from consumers. We also use our own internal intelligence, including from supervisory departments.

2 The Unfair Terms in Consumer Contracts Regulations 1994 came into force on 1 July 1995 and were revoked and replaced by the Unfair Terms in Consumer Contracts Regulations 1999 on 1 October 1999 – the FSA has had powers under the Regulations since 2001.

3 www.fsa.gov.uk/pubs/other/concordat_fsa_ofi.pdf

4 As specified in Part II of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and subsequent amending legislation.

5 The term ‘complaint’ is used in the Regulations at Regulation 10(1) about whether ‘any contract term drawn up for general use is unfair’. Its meaning within the Regulations therefore differs from the formal Financial Services and Markets Act 2000 (FSMA) definition of complaint being ‘any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a person about the provision of, or failure to provide, a financial service...’. In this report, ‘complaint’ refers to the meaning used in the Regulations.

- 2.4 In line with our risk-based, proportionate approach to regulation, we take forward those cases where there is an issue that affects a considerable number of consumers with a particular contract, and where we consider there is a significant probability of actual or potential consumer detriment. We therefore aim to protect consumers in general by preventing firms from using or recommending terms that we regard as unfair.
- 2.5 We do not resolve individual disputes or provide compensation. That is the role of the firm in the first instance and, if necessary, the Financial Ombudsman Service and ultimately the courts may become involved. In addition, only a court can conclusively determine whether a term is unfair. When we state our views, these are our views on whether we think the courts would deem a term to be unfair.
- 2.6 Where we decide to take forward a case and seek the amendment of an unfair contract term, we will ask the firm to provide an agreement (known under the Regulations as an ‘undertaking’) to either delete the unfair term, or to change the unfair term to make it fair under the Regulations. We also expect firms to agree to treat their existing consumers as though the fairly drafted term was included in existing contracts. In addition, we require firms to treat their customers fairly and, as a result, take appropriate steps to tell their existing consumers of the change, for example where there is potential detriment if the consumer remains unaware of the change to their contract.
- 2.7 Due to requirements under the Regulations⁶, undertakings become public knowledge and, as such, our policy is to publish the details of undertakings on our website. This does not amount to a public censure of firms. Undertakings are agreements between us and firms, and firms usually work with us to help ensure their contracts reflect their wider aspiration to treat their customers fairly.
- 2.8 So far we have published 23 undertakings from firms agreeing to delete or amend specified unfair terms to make them fairer under the Regulations, and agreeing not to rely on the unfair terms in contracts with existing consumers. We will publish more undertakings in the near future.
- 2.9 Undertakings are also useful tools to help firms understand their obligations under the Regulations and in treating their customers fairly. As such, we encourage firms to remain alert to published undertakings to help them understand their obligations in terms of the Regulations⁷ and our TCF initiative.
- 2.10 Sometimes we proactively launch our own review of contracts in a specific financial sector if we believe that a particular issue raises industry-wide concerns. This type of project work may come about from receiving a large number of individual complaints about an unfair term or from our own internal intelligence or in response to concerns raised by other bodies such as the Financial Ombudsman Service. As with undertakings, we publish the outcomes of such project work on our website. Recently the profile of the Regulations has increased considerably, for example through our work relating to so-called ‘nil refund’ terms in single premium payment protection insurance contracts and on mortgage exit administration fees (MEAFs).

6 Regulation 15(1).

7 UNFCOG 1.5.1G(3).

- 2.11 This is only a summary of how we use the Regulations in practice. Our full policy on how we use our powers is set out in The Unfair Contract Terms Regulatory Guide (UNFCOG) in the FSA Handbook.

Risks to firms

- 2.12 Firms face significant risks if their consumer contracts contain unfair terms. There is the legal risk of not being able to enforce a particular contract term because it has been deemed to be unfair.⁸ Similarly, unfair terms give rise to prudential risks. For example, unfair terms relating to the variation of charges could result in those terms being unenforceable leaving firms exposed to unexpected costs. Then there is the operational risk of spending management time in redrafting contract terms and providing consumers with new contracts. Finally, there is the reputational risk of consumers not trusting firms and therefore not wanting to do business with them.

Treating Customers Fairly obligations

- 2.13 As part of our day-to-day work, we see many examples of unfair terms in consumer contracts. A consumer contract is a document that crystallises the relationship between the firm and the consumer, so if a contract contains unfair contract terms, it can provide evidence that a firm is failing to treat its customers fairly.
- 2.14 By the end of December 2008, all firms are expected to be able to demonstrate to themselves and to us that they are consistently treating their customers fairly. Unfair terms pose a threat to this, and firms should consider the implications of having unfair terms in their consumer contracts more widely than as simply breaches of the Regulations.

⁸ Regulation 8(1) 'An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer'.

3 What we expect and what we found

Background

- 3.1 We expect firms to have fair terms in their standard contracts with consumers. To do this, they need to have effective systems and controls in place. Without these, it is difficult to envisage how firms can ensure they are meeting the legal requirements of the Regulations and are treating their customers fairly. For example, if firms are unaware of developments in law and regulation, or do not frequently review our web pages on unfair terms, they may be more at risk of having unfair terms in their consumer contracts.

(i) External survey of firms' awareness and systems and controls

- 3.2 To give an indication of firms' awareness of the Regulations and the systems and controls firms already have in place in relation to unfair terms, we commissioned GfK NOP, an independent research company, to carry out an anonymous survey across a sample of firms about the fairness of their consumer contracts.
- 3.3 The survey covered a sample of 120 firms across the range of FSA-regulated firms. Regulated firms are divided into three broad types: large high-impact firms that are supervised in the Major Retail Groups Division; medium-sized firms that are allocated FSA relationship managers in the Retail Firms Division; and lower-impact smaller firms that are monitored through the Small Firms and Contact Division. The full set of survey findings from GfK NOP has been published separately at www.fsa.gov.uk/pubs/consumer-research/crpr66.pdf. This report draws on elements of the survey in reporting on the broader outcomes from the review.
- 3.4 In addition to providing an analysis of the results of our findings, extracts from the responses given by firms are included in speech bubbles throughout the report to provide examples of good and poor practice.

(ii) FSA review of firms' contracts to assess outcomes

3.5 As well as reviewing the systems and controls firms have in place to ensure they have fair contract terms, we proactively reviewed a number of published standard consumer contracts to see whether firms' systems and controls are resulting in the expected outcome of fairly drafted contract terms:

- The first review was to assess how effective our regulatory tool of obtaining undertakings from firms is. We assessed whether firms that had given us undertakings have amended the contract in question. We also looked at whether they have amended any of their other standard consumer contracts that contain the same terms or terms with a similar effect.
- The second review was to assess the extent to which firms are engaging with our guidance in UNFCOG, which encourages them, as part of their risk management, to review other firms' undertakings and amend their own contracts in line with them, where necessary. We looked at whether firms had fair variation terms in their contracts to give us an indication of whether they were reviewing undertakings obtained by us on unfair terms against their own contracts, as suggested by UNFCOG. We focused our review on variation terms as we have published a considerable amount of information about them.
- We also reviewed how often the FSA corporate web pages on unfair contract terms were viewed last year to give us an indication of awareness levels among firms.

Some of our key findings:

Summary

- **We have published a large amount of information to help firms understand the requirement to have fair contract terms. Our findings show that many of the firms whose contracts we reviewed still have unfair terms in their contracts. This suggests that firms need to do more and we encourage them to use the information we provide to help them ensure their contract terms are fairly drafted.**

Awareness of the Regulations

- Most of the firms questioned reported that they were aware of the requirements of the Regulations.
- Several smaller firms questioned in the survey appeared to be unaware the Regulations applied to them. Some smaller firms believed the Regulations did not apply to them because they are intermediaries. Standard contracts between firms and consumers, such as terms of business that set out how intermediary services will be provided, fall within the scope of the Regulations.

Systems and controls to ensure the fairness of their consumer contracts

- All but one firm questioned in the survey reported that they had some systems and controls in place to review the fairness of their standard consumer contracts.
- In our review of contracts, firms had made the amendments required in the undertakings they had given to us in all cases. However, we found two firms that had given us undertakings that had the same unfair terms in their other regulated contracts with consumers.
- Most firms reported that they have some systems in place to monitor and act on undertakings secured under the Regulations by the FSA. Around half of firms reported that they monitor and act on undertakings obtained by the OFT.
- The majority of medium-sized and large firms told us that they have some systems in place to monitor and act on outcomes of FSA's thematic projects under the Regulations, compared to around half of smaller firms.
- Our corporate web pages on unfair contract terms received 32,608 hits last year. We encourage firms to use the web pages regularly as a source of information when drafting and reviewing their contract terms.

Fairness of terms in consumer contracts

- Over half of the sample of contracts we reviewed contained at least one variation term which was, in our view, clearly unfair under the Regulations.
- However, while the results from this review are disappointing, we do not think the failings found are difficult to remedy. Much of the information we have already published deals with variation terms so should help firms with this.

Firms being aware of the Regulations

Expectations

- 3.6 Regulation 5 provides the overarching test of fairness. Firms should not have a term in their standard consumer contracts which ‘contrary to the requirement of good faith, causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer...’⁹
- 3.7 We do not expect firms to focus only on the strict letter of the law – we expect them to embrace the spirit of it in the context of treating their customers fairly. For example, although Schedule 2 to the Regulations sets out an indicative and non-exhaustive list of terms which may be regarded as unfair, this does not mean a term that does not offend any of the terms listed in Schedule 2 to the Regulations is therefore fair. Firms need to assess whether terms are unfair using the Regulations as a whole, taking into account the particular product or service provided.

Findings

- 3.8 Most of the firms questioned in the survey reported that they were aware of the requirements of the Regulations. All large firms said they were aware of the requirements of the Regulations as did the vast majority of medium-sized firms. Awareness of the Regulations was lowest among smaller firms at just under two-thirds of firms.
- 3.9 We are concerned that several of the smaller firms questioned in the survey appeared to be unaware that the Regulations applied to them. Some smaller firms believed the Regulations did not apply to them because they are intermediaries. While intermediaries may not be ultimately responsible for the terms of the contracts for the products they offer, they are likely to have terms of business between themselves and their consumers that set out how they will provide their intermediary services to the consumer. Such standard terms of business between a firm and its consumers fall within the scope of the Regulations.

‘There’s not a lot the FSA can do because understanding consumer contracts is basic.’
Smaller firm

‘The Regulations you were talking about earlier, I wasn’t particularly aware of them, and I think they [the FSA] could do a bit more to make sure I was aware of what the requirements are.’
Medium-sized firm

⁹ Regulation 5(1).

Firms having systems and controls in place to ensure the fairness of their consumer contracts

(i) Overview

Expectations

- 3.10 Having effective systems and controls around consumer contracts is important for firms in ensuring that they are meeting the legal requirements of the Regulations and their wider obligations to treat their customers fairly.

Findings

- 3.11 All but one firm questioned in the survey reported that they had some systems and controls in place to review the fairness of their standard consumer contracts. It is interesting that while nearly all firms said they review the fairness of their consumer contracts, some were not aware of the specific requirements of the Regulations.
- 3.12 The survey showed that firms who we had previously contacted about the fairness of their contract terms were more aware of regulatory requirements and had sought more information about them. However, by the time firms are contacted by us about potentially unfair terms, the risk of having an unfair term has often already crystallised. We take the view that firms should be proactive and not wait for us (or indeed consumers) to tell them about potential concerns with their standard consumer contracts.
- 3.13 Similarly, firms with fair contract terms will find that they benefit from a regulatory dividend, as it may be one of a number of factors which evidences that a firm is treating its customers fairly.

'We have a routine review process as part of our TCF walk through. Checking the policy matches the product literature and the advertisements.' *Medium-sized firm*

'Recognising the fact the FSA had issued guidance on legislation we thought it was time to review the conditions we had to make sure they are compliant.' *Medium-sized firm*

'Contracts are reviewed from time to time by external legal advisers and regularly reviewed by our in house team...To make sure we were fair to both parties and to make sure there weren't any unfair terms.' *Medium-sized firm*

'We have a product review process whereby we review all of our existing products and documentation which will include a review for the fairness as well. It was part of the early work we did on TCF when we first did a gap analysis of our business for TCF and we identified we were not doing enough.' *Large firm*

Good and poor practice examples that we have observed:

Examples of good practice

- Frequent reviews of all consumer contracts for fairness
- Reviewing standard consumer contracts to ensure they comply with the Regulations
- Assessing contracts as part of regular reviews of all product documentation
- Assessing contracts as part of regular product reviews throughout the product life cycle for compliance with the TCF initiative
- Additionally reviewing contracts when receive complaints, cancellations or evidence that terms may be unfair
- Monitoring updates and emails from the FSA
- Reviewing undertakings obtained by the FSA against terms in own consumer contracts
- Reviewing other FSA information on unfair terms, eg thematic work and speeches
- Monitoring updates about the TCF initiative
- Monitoring the OFT website for updates on the fairness of terms in consumer contracts
- Reviewing undertakings obtained by the OFT against terms in own standard 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 bodies
- Checking new legislation as and when 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
- Firms being passive and relying on external publications being brought to their attention through monthly emails
- Only reviewing external publications and updates at time of annual review of consumer contracts
- Not assessing contracts for fairness, frequently resulting in contracts containing out-of-date material – for example a contract which had reference to millennium bug concerns from 2000 was still being supplied to consumers eight years later
- Sole reliance on external compliance firms working on their behalf with no checking or questioning of work conducted

(ii) Firms complying with their own undertakings

Expectations

- 3.14 We expect that when a firm gives us an undertaking, it complies with that undertaking by making the agreed changes to its contract terms. If a firm is in breach of its undertaking, this could lead us to apply for an injunction against the firm.¹⁰

Findings

- 3.15 We carried out a review of the contracts relating to undertakings given to us to check whether the agreed amendments had been made to each firm's current contract (where available). The amendments required had been made in all cases where the contract was available for review.

(iii) Firms applying underlying reasons for their own undertakings to their other regulated contracts

Expectations

- 3.16 As well as complying with an undertaking given for a contract for a particular financial product or service, we expect firms to take a principles-based approach by assessing whether the concerns identified in that undertaking also apply to their other regulated contracts and, if so, removing the same unfair terms or terms with similar effects from those contracts as well. This is because although an undertaking reflects our concerns with the terms in a certain contract for a particular financial product or service, it may provide a useful steer as to our views generally on the fairness of terms in standard consumer contracts. While a term may not necessarily be unfair in every type of consumer contract, firms will need to satisfy themselves that all of their contracts contain fair terms.

Findings

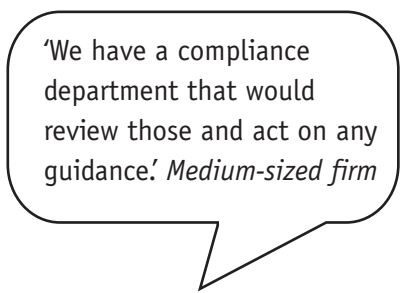
- 3.17 For each firm that has given us an undertaking, we also reviewed three of that firm's other regulated standard consumer contracts (where available). Of the seven firms that had other contracts available for us to review, we found two firms that had the same unfair terms in their other regulated contracts with consumers.
- 3.18 We were particularly disappointed that one of these firms had amended its general contract terms to specifically state that the unfair term applied to all products other than the product the undertaking was provided for. We believe this is unacceptable and not in the spirit of treating customers fairly so have referred these concerns to the two firms' supervisory teams to take follow-up action.

¹⁰ Regulation 12(1).

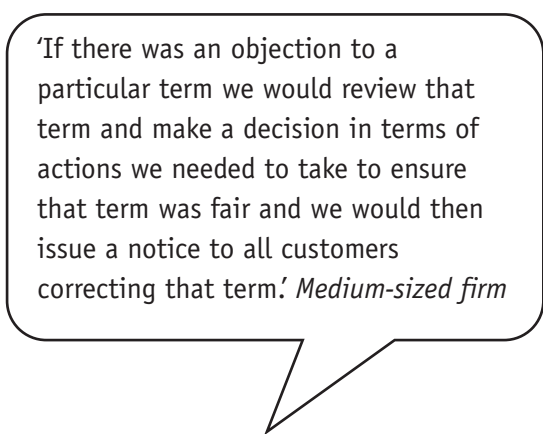
(iv) Firms using undertakings given by other firms to help them ensure they have fair contract terms

Using undertakings as a useful tool

- 3.19 Guidance in UNFCOG sets out how we use our powers under the Regulations. For example, we publish details of undertakings so all firms can see those terms that have been amended, and how. While an undertaking reflects our concerns with the terms in a certain contract for a particular product or service, it may provide a useful steer as to our views generally on the fairness of terms, so can potentially relate to contracts for other regulated financial products. For example, if we publish an undertaking about an unfair variation term in a life insurance contract, the key messages from that undertaking might also apply to mortgage contracts and investment contracts, as well as other life insurance contracts.
- 3.20 This is why in UNFCOG we state that, as part of their risk management, firms that have not themselves given an undertaking should remain alert to undertakings about other firms obtained by the FSA and the OFT, since these will be of potential value in indicating the likely attitude of the courts, the FSA, the OFT or other qualifying bodies to similar terms or to terms with similar effects.¹¹



'We have a compliance department that would review those and act on any guidance.' *Medium-sized firm*



'If there was an objection to a particular term we would review that term and make a decision in terms of actions we needed to take to ensure that term was fair and we would then issue a notice to all customers correcting that term.' *Medium-sized firm*

Findings – undertakings obtained by the FSA

- 3.21 During the survey, firms were asked if they had systems and controls in place to monitor and act on undertakings secured under the Regulations by the FSA. Most firms reported that they have systems in place to do this. Large and medium-sized firms tended to report that undertakings published by us were generally monitored or reviewed by their legal or compliance teams.
- 3.22 Some smaller firms reported that such monitoring or reviewing was done on their behalf by external consultants. While an external perspective can be helpful and some firms may choose to seek external input to help them review the fairness of their consumer contracts, it is not a necessity to use external consultants in order to do this. There is a wide range of information available to firms about the fairness of terms in consumer contracts, and some of these sources are included at Annex 1.

11 UNFCOG 1.5.1G Risk Management

- 3.23 Around twice as many of the firms who reported that they were aware of the requirements of the Regulations – compared to those who reported that they were not aware – reported they had systems in place to monitor undertakings obtained by us. This suggests awareness leads to action as firms that are aware of the Regulations recognise the potential risks in relation to having unfair terms in their consumer contracts.

Example

We have received several consumer complaints about firms using unfair terms where the matter has already been addressed in an undertaking given to us by another firm. On two occasions, it was the consumer making the complaint who spotted that the firm was in breach of another firm's undertaking.

This suggests that some firms do not have adequate systems and controls in place to ensure fair outcomes for consumers.

If consumers are able to review the undertakings we publish, and identify where other firms have the same or similar unfair terms, we see no reason why firms cannot do it too. Firms not doing so, and taking appropriate action to ensure the fairness of their contract terms, face legal, regulatory and reputational risks.

Findings – undertakings obtained by the OFT

- 3.24 Being the lead enforcer of the Regulations, the OFT also publishes undertakings and court decisions about unfair contract terms.¹² As these can also be useful and relevant to financial services firms, our guidance in UNFCOG encourages firms to review this material to check whether the concerns raised may also apply to their regulated contracts.
- 3.25 The survey looked at whether firms have systems and controls in place to monitor and act on undertakings secured under the Regulations by the OFT. While most firms asked reported they monitor undertakings obtained by us, only around half of firms said they monitor undertakings obtained by the OFT. This may be due to firms not being aware that the OFT also have powers under the Regulations and publish undertakings.
- 3.26 However, of the firms that said they monitor undertakings obtained by us, most also reported that they monitor undertakings obtained by the OFT. Many financial services firms that we regulate also hold a consumer credit licence, so are regulated by the OFT. As such, it is not surprising that firms who monitor undertakings obtained by us would also monitor those obtained by the OFT.
- 3.27 There were also a minority of firms who reported that they did not monitor undertakings obtained by either the FSA or the OFT at all. These firms would appear to be less aware of their regulators' concerns about specific unfair terms and may face legal, regulatory and prudential risks as a result of having unfair terms in their standard consumer contracts.

12 www.ofc.gov.uk/advice_and_resources/resource_base/consumer-regulations/undertakings-court-action/

Example

The OFT has obtained several undertakings and published guidance on 'statutory rights' terms.¹³ Terms that just state a person's statutory rights will not be affected may not be plain and intelligible. This is because it is likely that consumers may not know what their 'statutory rights' are. In an undertaking obtained by the OFT on this issue, the firm agreed to say where consumers could find more information about their statutory rights, for example through their local authority Trading Standards Service or Citizens Advice Bureau.

Nevertheless, we understand that statutory rights terms that do not say where consumers could find more information are still common in terms and conditions across different sectors. If firms had been looking at the OFT's website, they would have been aware of this issue before we published material about it on our web pages in September 2007.¹⁴

'We have general procedures in terms of dealing with any authority notices issued by external organisations and external bodies.' *Medium-sized firm*

'Anything that gets put on the FSA website, including unfair terms, I will look at and then consider how it impacts on us. We did one of that a year or so ago when an undertaking was put on the FSA website about unfair terms...We'd review what is said in the FSA undertaking and then review our terms and conditions against what is being said on that undertaking.' *Medium sized firm*

'Monitor exactly what the FSA publishes, review whatever has been produced. We'd look to see if it applies specifically to products of the type that we sell or if there are some underlying principles relevant to what we do.' *Medium-sized firm*

'It's not a system, its part of our job.' *Large firm*

13 www.of.gov.uk/advice_and_resources/resource_base/consumer-regulations/traders/707/1/

14 www.fsa.gov.uk/pages/About/What/thematic/retail_risks/thematic_project/index.shtml#rights

(v) Firms using other FSA material to help them ensure they have fair contract terms

Using other FSA material as a useful tool

- 3.28 To help firms meet the regulatory and legal requirements to have fair consumer contracts, we have published a variety of material about unfair contract terms on our website.¹⁵ These include:
- publications on unfair terms;
 - speeches delivered to the industry;
 - thematic work under the Regulations – including our Statement of Good Practice on MEAFs, refund terms in single premium payment protection insurance, early repayment charges in mortgages and improving the clarity of terms about consumers' statutory rights.
- 3.29 We encourage firms to monitor and act on the information on fair contract terms we provide regularly to inform themselves about recent undertakings and speeches, and to find out about the latest updates on our work.

Findings

- 3.30 During the survey, firms were asked if they have systems and controls in place to monitor and act on outcomes of FSA's thematic projects under the Regulations. Most medium-sized and large firms reported that they do have some systems in place, compared with around half of smaller firms. When questioned, the majority of the large firms reported that they were more likely to monitor the outcomes of projects than undertakings.

'The basic system is the FSA's website and rules, which we refer to. As a backup to that we are also a member of two trade bodies to whom we refer. We also have legal contacts....They were originally put into place several years ago and the reason for putting them into place then was to protect us legally.' *Smaller firm*

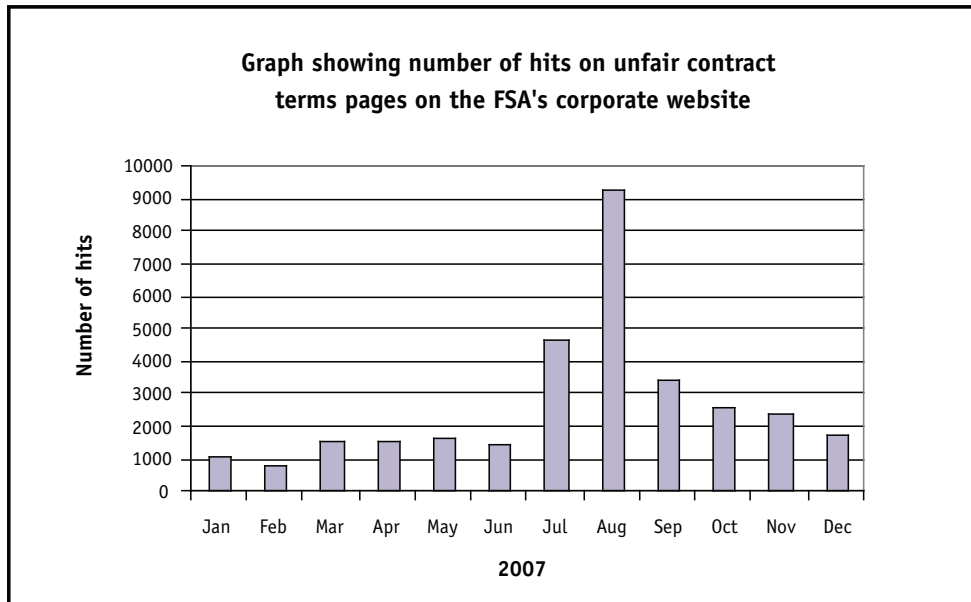
'The FSA email me once a month with all the information which I would check as the Compliance Officer and then I would take appropriate action.' *Smaller firm*

'Regular communications from the FSA directly, constantly checking the FSA small business website and regular communications from [external compliance consultants] and always reading the trade press. Put into place June 2004 to make sure we are ahead of the game and exceed requirements.' *Smaller firm*

'They have a good website for TCF issues and it might be worth a similar set up for unfair contracts.' *Medium-sized firm*

15 www.fsa.gov.uk/Pages/Doing/Regulated/consumer/relevant/index.shtml

- 3.31 To assess whether firms are viewing our web pages, we reviewed the number of ‘hits’ made to our corporate web pages to identify trends within the data that would indicate whether our work has made an impact on firms. A ‘hit’ is recorded every time a webpage is loaded, so it shows the number of times the pages have been viewed and not the number of individual people looking at the pages.
- 3.32 There was a total of 32,608 visits to our corporate web pages in 2007. The average monthly number of hits was 2717.



- 3.33 The chart shows that the number of hits on the unfair contract terms corporate pages increased by over 500% between June and August reaching a high of 9358 hits. The number of visits then fell back throughout the rest of the year. The trend suggests one or more particular incidents generated interest in our pages in July and August. There were several events that happened during that time relating to unfair contract terms:
- on 26 July 2007 the OFT announced the high court test case on the application of the law on unauthorised bank charges and our decision to issue a waiver to banks allowing them to suspend processing complaints on this subject;
 - our update on how firms were applying the Statement of Good Practice on MEAFs; and
 - two undertakings we published in August that were the subject of press coverage.

Any or all of these could explain the increase in the number of visits to our web pages during July and August.

- 3.34 We are pleased to know that the web pages on unfair contract terms are visited. However, over a third of these hits occurred in August alone and we encourage firms to use the web pages regularly as a source of information when drafting and reviewing their contract terms, rather than as a result of particular incidents.

Firms having fair terms in their consumer contracts

Expectations

- 3.35 A further aspect of our review of firms' consumer contracts was assessing the extent to which firms deliver the outcome of fair contract terms. We focused our review on variation terms. These are terms that give a firm the power to impose a change in the contract that the consumer has not explicitly agreed to in advance and that does not require the consumer's agreement at the time the change is made. We have already published a considerable amount of information about unfair variation terms – in our Statement of Good Practice on the Fairness of Terms in Consumer Contracts published in May 2005; in 9 out of 23 of the undertakings we have received; and in the Statement of Good Practice on MEAFs published last year. We feel we have provided sufficient information to help firms understand and meet their obligations to have fair terms and, in particular, to have fair variation terms.
- 3.36 We reviewed 20 mortgage contracts, 20 critical illness contracts and 20 child trust fund contracts as a small sample of the mortgage, insurance and investment markets to give us an indication of whether firms still have unfairly drafted variation terms in their contracts.¹⁶

Findings

- 3.37 The following table sets out our findings as to the number of contracts that contained at least one variation term that we thought was clearly unfair under the Regulations.

Contract type	Number of contracts reviewed	Number of contracts with at least one variation term which we thought was clearly unfair under the Regulations
Stand-alone critical illness	20	7
Mortgage	20	15
Child trust fund	20	10
Overall total	60	32

- 3.38 Overall, we found that out of the 60 contracts we reviewed, 32 contracts contained at least one variation term that we thought was clearly unfair. We are disappointed that more than half of the contracts we reviewed had potentially unfair terms. This means that many of the firms whose contracts were selected for review are not complying with the requirements of the Regulations.

¹⁶ We reviewed mortgage contracts using contracts provided by firms as part of our work on MEAFs. As a result, many of the variation terms in mortgage contracts listed as being unfair in our view have been or will be amended shortly. As such, the results for the mortgage contracts reflect mortgage contracts in use as at July 2007. The contracts for critical illness and child trust funds were the contracts available from November 2007 to January 2008.

- 3.39 We did not look at how a term is applied in practice as under the Regulations we can only review the way a term is drafted. As such, this does not mean the 32 unfair variation terms we found were necessarily being applied to consumers in an unfair way.
- 3.40 As discussed in paragraph 2.12, firms with unfair terms in their contracts face substantial risks, including whether they can demonstrate they are consistently treating their customers fairly. We have referred these concerns to the firms' supervisory teams to follow-up on.
- 3.41 Mortgage, general insurance and child trust fund products have become subject to FSA regulation in recent years. This means the contract terms for these products should have been drafted recently – after the Regulations came into force in 1995¹⁷ – so there is no reason why these contracts should contain unfair terms.
- 3.42 As always, during our review we assessed whether a term is fair using the Regulations as a whole and in the context of the particular product or service. We considered whether, contrary to good faith, the term gives rise to a significant imbalance in the rights and obligations of the firm and consumer.
- 3.43 In the child trust fund contracts we reviewed, we found that 10 out of the 20 contracts contained, in our view, at least one clearly unfair variation term. The variation terms we considered to be clearly unfair were those that gave firms a unilateral discretion to vary the terms of the contract which, in our view, caused a significant imbalance to the detriment of consumers.
- 3.44 Schedule 2 of the Regulations indicates that where the consumer is not free to exit the contract, a variation term is less likely to be unfair if a valid reason for the change is specified in the contract. In our view, consumers often do not have freedom to exit a mortgage or a critical illness contract. Some of the mortgage and critical illness contracts we reviewed included terms that allowed the firms to vary either without a valid reason specified in the contract or for a specified reason which is, in our view, invalid. In our view, reasons such as 'for any other valid reason' or 'for any other fair and reasonable reason' are not valid because they are not clear and unambiguous.
- 3.45 We have previously voiced our disappointment in the context of MEAFs that some firms are not considering whether and how the law and principles we set out in our Statement on MEAFs could also apply to terms that vary other charges.¹⁸ Similarly, we expressed concerns that some firms are interpreting certain aspects of the Statement on MEAFs too narrowly and are including terms in their contracts that may be unfair for similar reasons.
- 3.46 We have published a large amount of information to help firms understand the requirement to have fair contract terms. Our findings show that many of the firms whose contracts we reviewed still have unfair terms in their contracts. This suggests that firms need to do more and we encourage them to use the information we provide to help them ensure their contract terms are drafted fairly.

17 Council Directive 93/13/EEC was implemented into UK law by the Unfair Terms in Consumer Contracts Regulations 1994, which came into force on 1 July 1995.

18 www.fsa.gov.uk/pages/Doing/Regulated/consumer/tackle/meafs/fct/index.shtml

- 3.47 In addition to finding terms that we thought were clearly unfair, we found a number of terms that we considered to be potentially unfair under the Regulations as, for example, the valid reasons provided may have given firms excessive discretion as to how they varied the contract. Examples of these are included in the information box on the following page.
- 3.48 While the results from this review are disappointing, we do not think the concerns relating to the unfair variation terms are difficult to remedy. The information box on the following page is a summary of our published views on variation terms. We also encourage firms to review the sources of information in Annex 1 of this publication for more information about variation terms.¹⁹
- 3.49 From our review of variation terms, it is clear that as well as firms having unfair terms in their consumer contracts and therefore not meeting the requirements of the Regulations, they are also not engaging with the guidance in UNFCOG. If firms were reviewing our publications on unfair terms against their own contracts, as suggested by UNFCOG, we believe our assessment of variation terms would have found fewer unfair terms.

¹⁹ Of particular relevance to the fairness of variation terms are the undertakings, the Statement of Good Practice on the Fairness of Terms in Consumer Contracts and the Statement of Good Practice on MEAFs.

Summary of our published views on variation terms

We have published a large amount of information setting out our views on the fairness of variation terms. This box reiterates our position on the fairness of variation terms compiled from published undertakings, the Statement of Good Practice on the Fairness of Terms in Consumer Contracts and the Statement of Good Practice on MEAFs. In our view, this information does not place any new obligations on firms. Instead this gives firms an indication as to how they may avoid the risk of variation terms which are unfair. As with all potentially unfair terms, only a court can ultimately determine whether a term is unfair.

Schedule 2 suggests that terms which allow a firm to unilaterally vary its contract terms are less likely to be unfair if:

(i) the term enables the firm to change a contract variable only with a **valid reason that is specified in the contract**²⁰; or

(ii) the term permits a change in the rate of interest or other charges for financial services under the contract and there is a **valid reason (that is not specified in the contract)** for that change and the contract provides for the firm to give the consumer **notice at the earliest opportunity** thereafter (rather than in advance) and the consumer is **free to dissolve the contract** immediately²¹; or

(iii) if, in a contract of indeterminate duration, the contract provides for the firm to give the consumer **reasonable notice in advance** of making the change and the consumer is **free to dissolve the contract**.²²

NB: The fact that a variation clause does not offend any of the terms listed in Schedule 2 to the Regulations may not, of itself, remove the risk of unfairness altogether. We expect firms to consider the terms of the contract as a whole and in the context of a specific product or service provided and their overall aim to treat their customers fairly.

Valid reasons

Where the term specifies valid reasons, in our view, the valid reasons should be clear and fair. In our review we found a number of unfair, unclear or vague reasons.

In our view, a term that allows a firm to vary its charges 'to reflect unexpected changes in costs', is not an example of a firm specifying a valid reason, but is, instead, that firm leaving its options open. We would expect a 'valid reason' to be, among other things, clearly and unambiguously defined.

Terms that give firms the power to vary interest rates are not inherently unfair. However, we think terms that allow firms to alter the interest rate 'to reflect changes in the rate of interest charged by others' may be unclear. Firms should not draft terms that allow them to take unfair advantage of the consumer. It is likely to contribute to the fairness of a term if it sets out if, when and how the interest rate may be changed.

20 Paragraph 1(j) of Schedule 2.

21 First sub-paragraph of 2(b) of Schedule 2.

22 Second sub-paragraph of 2(b) of Schedule 2.

Some questions for firms to consider:

- **Do you have robust systems and controls in place to ensure your consumer contracts are fair? For example:**
 - Do you have adequately-skilled people drafting your consumer contracts?
 - Do you ensure someone with the appropriate expertise signs them off?
 - Do you have adequate systems around checking that contracts comply with any developments in law and regulations? For example, reviewing undertakings from other regulated firms published on our web pages, other FSA publications about unfair terms, and undertakings obtained by the OFT?
 - Do you have adequate systems and controls around ensuring terms are applied fairly in practice?
- **Does your senior management:**
 - receive and use appropriate Management Information to measure the effectiveness of systems and controls around unfair terms; and
 - use such information to identify emerging risks to the firm's ability to treat its customers fairly and to take remedial action?
- **For the consumer contracts themselves:**
 - Is the information and its presentation appropriate for the target audience?
 - Is the content of the consumer contracts clear, fair and not misleading?
 - How is the TCF initiative taken into account?

'Every time a contract is written, or as and when an issue arises, then all the existing contracts will be reviewed...by the compliance department and the legal department.' *Medium-sized firm*

'I suppose there probably is something on their (the FSA) website, because there is masses of stuff on their website. Maybe when I come off this I'll go on there and see exactly what they've got to say about unfair terms.' *Smaller firm*

'The fact that we reviewed our documentation back in 2004 against Treating Customers Fairly also applying it to the unfair terms and conditions or unfair contracts act. We reformatted the documentation, we changed some of the legal agreements to make them clearer and we took steps to ensure that customer terms are more clearly defined.' *Medium-sized firm*

4 Going forward

The FSA

- 4.1 We will continue to consider individual complaints under the Regulations about specific firms and use this information to help us decide where to focus our resource.
- 4.2 In addition to our casework, we will remain alert to using project work to deal with industry-wide issues. In doing so, we will act in a risk-based, proportionate way to agree industry-wide solutions by being fully aware of our responsibilities to consumers and firms and by seeking to operate in a manner that both includes and consults with firms.
- 4.3 Liaising with the relevant industry trade bodies has recently become a more common feature of our work, from individual undertakings to the larger-scale project work. For example, once an individual undertaking is agreed with a firm, we now routinely tell the relevant trade bodies, who we have found to be very helpful in notifying their members of relevant undertakings. We are also pleased with the level of engagement and understanding that many of our external stakeholders now have of the Regulations and how they fit within our wider retail agenda. We will continue to liaise with the industry to help maximise the impact and effectiveness of our work under the Regulations.
- 4.4 Our survey results found that many firms rely on email newsletters we send to firms as a source of information about our work on unfair terms. So we will ensure that we include undertakings, projects and other publications on unfair contract terms in these emails.

Firms

- 4.5 However, we also encourage firms to be more proactive and look at our web pages on unfair terms regularly. We publish information on undertakings in two formats: first, on our corporate website and, second, a simplified version on our consumer web pages at www.moneymadeclear.fsa.gov.uk. We have also recently changed the format of new undertakings published on the corporate website to make them clearer and easier to read.

- 4.6 Firms need to satisfy themselves that their contract terms are fair, and that they have adequate systems and controls in place around them. We encourage firms to review the good and poor practice provided in this report to establish whether there is anything more they can do to make sure their systems and controls are providing the intended outcome of fair terms in their standard consumer contracts. We also encourage firms to ask themselves the questions listed on page 24.
- 4.7 Firms need to engage with the requirements of the Regulations alongside their obligations to treat their customers fairly. In particular, unfair terms pose a threat to whether firms are able to demonstrate to themselves and to us that they are consistently treating their customers fairly by the end of December 2008.
- 4.8 We will review the feedback from the survey of firms to assess what other communications from us would be helpful to firms in ensuring they have fair terms in their consumer contracts. We will provide details of these in due course. We welcome comments from firms and trade bodies on this or any other aspect of our work. Please e-mail them to: unfair.terms@fsa.gov.uk

List of useful sources of information about unfair contract terms

Published as at June 2008

Undertakings	
Trading sector – Banking	
Restricted legal rights – Skipton Building Society www.fsa.gov.uk/pubs/other/undertaking_skipton.pdf	November 2003
Trading sector – Insurance	
Travel – UK Underwriting Limited www.fsa.gov.uk/pubs/other/undertaking_ukunderwriting.pdf	May 2008
Motor – Devitt Services Limited and Screentrade www.fsa.gov.uk/pubs/other/undertaking_devitt.pdf	May 2008
Medical – HSA/Simplyhealth Access www.fsa.gov.uk/pubs/other/undertaking_hsa.pdf	November 2006
Legal expenses – DAS Legal Expenses Insurance Company Limited www.fsa.gov.uk/pubs/other/undertaking_das.pdf	July 2006
Deposit – Consumer Protection Association Limited www.fsa.gov.uk/pubs/other/undertaking_cpa.pdf	July 2006
Payment protection – Norwich Union Insurance Limited www.fsa.gov.uk/pubs/other/undertaking_norwich.pdf	June 2006
Payment protection – Amtrust International Underwriters Limited www.fsa.gov.uk/pubs/other/undertaking_amtrust.pdf	June 2006
Cash-back – AXA Insurance Limited www.fsa.gov.uk/pubs/other/axa_undertaking.pdf	March 2004

Critical illness & life plans – PPP lifetime care Plc, part of the AXA group of insurers www.fsa.gov.uk/pubs/other/undertaking_ppp.pdf	March 2004
Critical illness & life plans – Prudential International Assurance Plc www.fsa.gov.uk/pubs/other/undertaking_pru.pdf	December 2004
Trading sector – Investment	
Asset management – Absolute Assigned Policies Limited www.fsa.gov.uk/pubs/other/aap.pdf	December 2006
Pensions – Skandia Life Assurance Company Limited www.fsa.gov.uk/pubs/other/skandia_life.pdf	November 2006
With-profits – Britannic Assurance plc www.fsa.gov.uk/pubs/other/undertaking_britannic.pdf	November 2006
With-profits – Tunbridge Wells Equitable Friendly Society Ltd www.fsa.gov.uk/pubs/other/undertaking_tunbridge.pdf	March 2006
Pensions – Sippdeal Ltd www.fsa.gov.uk/pubs/other/undertaking_sippdeal.pdf	March 2006
Spread betting – London Capital Group Ltd www.fsa.gov.uk/pubs/other/undertaking_londoncap.pdf	Januray 2005
Trading sector – Mortgages	
Variations – Barclays Bank plc, trading under the name of Woolwich (Barclays Bank plc) www.fsa.gov.uk/pubs/other/barclays.pdf	August 2007
Mortgages – London Scottish Bank Plc www.fsa.gov.uk/pubs/other/undertaking_ls.pdf	October 2006
Early repayment charges – Blemain Finance Ltd www.fsa.gov.uk/pubs/other/undertaking_blemain.pdf	October 2006
Exit administration charges – Intelligent Finance www.fsa.gov.uk/pubs/other/undertaking_intelligent.pdf	October 2006
Lifetime mortgages – Scottish Widows www.fsa.gov.uk/pubs/other/undertaking_sw.pdf	September 2006
Trading Sector – Retail Intermediaries	
Independent financial advice – Hayburn Rock Associates Ltd www.fsa.gov.uk/pubs/other/undertaking_hayburnrock.pdf	August 2007

Statements	
Statement of Good Practice on the Fairness of Terms in Consumer Contracts www.fsa.gov.uk/pubs/other/good_practice.pdf	May 2005
Statement of Good Practice on Mortgage Exit Administration Fees www.fsa.gov.uk/pubs/other/meaf_goodpractice.pdf	January 2007
Project work	
Mortgage exit administration fees www.fsa.gov.uk/pages/Doing/Regulated/consumer/tackle/meafs/index.shtml	August 2007
www.fsa.gov.uk/pages/Doing/Regulated/consumer/tackle/meafs/fct/index.shtml	November 2007
Mortgage early repayment charges www.fsa.gov.uk/pages/About/What/thematic/retail_risks/thematic_project/index.shtml#merc	March 2007
Single premium payment protection insurance refunds www.fsa.gov.uk/pages/Doing/Regulated/consumer/tackle/ppi.shtml	March 2007
Statutory rights www.fsa.gov.uk/pages/About/What/thematic/retail_risks/thematic_project/index.shtml#rights	September 2007
Speeches on unfair contract terms	
Speech to Council of Mortgage Lenders www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0718_kw.shtml	July 2007
Speech to Building Societies' Association Legal Forum www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0511_kw.shtml	May 2007
The Unfair Terms in Consumer Contracts Regulations 1999	
The Regulations www.opsi.gov.uk/si/si1999/19992083.htm	
The Unfair Contract Terms Regulatory Guide (UNFCOG) in the FSA Handbook	
UNFCOG http://fsahandbook.info/FSA/html/handbook/UNFCOG	
FSA web pages on unfair contract terms	
Corporate web pages www.fsa.gov.uk/Pages/Doing/Regulated/consumer/index.shtml	
Consumer web pages www.moneymadeclear.fsa.gov.uk/about_the_fsa/unfair_contracts/unfair_contract_terms.html	

OFT website on unfair contract terms	
OFT consumer regulations website www.ofc.gov.uk/advice_and_resources/resource_base/consumer-regulations	
Other external sources of information	
OFT/FSA concordat www.fsa.gov.uk/pubs/other/concordat_fsa_ofc.pdf	July 2006
FOS rulings www.financial-ombudsman.org.uk/publications/ombudsman.htm	

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