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Dear Tina,

**FCA PRACTITIONER PANEL RESPONSE TO GC 18/2 – CONSUMER CONTRACTS**

The FCA Practitioner Panel has some concerns about the proposals in Guidance Consultation GC18/2, relating to consumer contracts. It's important that updated guidance doesn't lead to any unintended consequences or restrictions on legitimate business practices. The Panel has discussed the proposals and between Panel members there has been a range of views as to their likely impact. We therefore suggest that the FCA should revisit the wording to make its intentions clearer. As drafted, there is a view that the guidance could cause several major problems. First, an unrealistic expectation for consumers to understand how prices might vary in the future (e.g. by explaining the constituent parts of the costs of funds and how they could change). Second, it could be viewed that it would not be possible to change pricing simply to remain competitive, or to protect financial sustainability. We also have comments on changes in customer circumstances and the interaction of the Guidance with the Senior Managers' Regime.

We set out our specific concerns in the attached response and would be happy to discuss further if required.

Kind regards,

Anne Richards  
*FCA Practitioner Panel Chair*

## **GC 18/12 - Fairness of variation terms in financial services consumer contracts – Practitioner Panel comments**

The FCA's decision to issue Guidance Consultation GC18/2 regarding "Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015" on 21 May 2018 is to be welcomed as it presents a real opportunity to deliver greater clarity for all concerned on the FCA's views on how to assess the fairness of variation terms.

Much of the paper appears clear and helpful. There are however a couple of areas where early engagement and further explanation by the FCA of what lies behind the points made will enable firms to respond in a way that takes full and proper account of the FCA's thinking and underlying intentions.

The Panel's particular concerns are the following (where paragraph and page numbers refer to GC18/2):

### **1. Future Price Variation**

With reference to:

*- Factors 8.1. and 8.2. (page 23 of 30): "Will a 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? and*

*- the related comment at para. 2.6 (page 4 of 30) that in assessing the fairness of a unilateral variation clause, regard will be had to the 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."*

In deciding to vary the price and, in so doing, rely upon a variation term, firms will have regard to a number of drivers, including base rates, cost of funding, risk based pricing and the need to operate on the basis of a sustainable business model (which includes remaining competitive in the market place, in which pricing plays a clear role).

The concern that arises from the GC18/2 extracts above is the extent to which it is being suggested that firms must draft and thereby be able to rely upon variation terms that go into a level of detail designed to enable consumers at the time of entering into the contract to understand the actual methodology of any future price variation (whether up or down) and assess the financial impact upon them.

There would seem to be any number of serious challenges with this. For example, the combination of: (i) the lifetime of certain financial products (including products of indeterminate duration); and (ii) the uncertainty of how base rates and the cost of funds and the levels of impairment (impacting risk based pricing), amongst other things, will move in the future, would seem to make this extremely difficult. Further, drafting a clause of proportionate length that seeks to explain in relatively plain English to an average consumer what those various drivers to price variation are and how they operate and may interplay with each other in the future would again seem to be extremely difficult.

Further, any suggestion that firms might achieve 'fairness' in a variation term by disclosing, at the time of entering into a contract with a consumer, internal policies on such matters as how interest rates will be set in the future would seem to face similar challenges. For example, to the extent such policies exist in a form that might be applied to the 'life' of a product (including those of indeterminate length), rendering such policies intelligible to an average consumer would seem to be extremely difficult. Further, challenges would likely be faced with the commercial sensitivity and potential competition implications of disclosing such policies to

consumers and, therefore, to the world at large. If it is the FCA's intention that no more is required than the information already supplied about how firms set their SVR, this needs to be clarified.

Given these collective challenges, further clarity on the FCA's expectations of firms would be welcome. In particular, in assessing the fairness of a variation term, will a clear and straightforward articulation for the consumer of the factors that a firm will take into account when looking to vary price (up or down) and a clear statement that this may have very real financial consequences for the consumer suffice? Or is the FCA looking for more and, if so, what (taking into account the sorts of challenges articulated)?

## **2. Pricing with the aim of maintaining competitiveness**

Paragraph 46 of Chapter 3 "Variation Terms" (page 26 of 30) refers to the view that firms may not change pricing for reasons associated with remaining competitive.

As alluded to in point 1 above, it would help if the FCA would provide further explanation of the purpose and intent that underpins this view. The sustainability of a business model (which includes the competitiveness of the products sold in the relevant marketplace) is a factor that will play in decisions to vary prices (up or down). Does the FCA consider such factors to be legitimate considerations in price variation decisions? If not, would clearly spelling such factors out in variation terms have any impact on this view? At an extreme, does this view mean that a price increase to protect the financial sustainability of a firm would not – on its own – be seen as a valid basis for such a price increase? It would be helpful to clarify if the FCA is specifically referring to measures to protect financial sustainability of the firm rather than to remain competitive.

## **3. Changes in price**

Factor 6.1 (page 23 of 30) states: "*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 (e.g. price decreases as well as increases)?*"

It would be surprising if variation terms were drafted in such a way that prices could only increase (and not decrease). It seems, therefore, that this Factor has less to do with how best to word a variation term and more to do with how a variation term should be operated. We are aware from discussions with other firms via UK Finance that the Financial Ombudsman Service is dealing with complaints involving the fairness of variation terms in the first and second charge mortgage market and how those terms have been operated when, for example, base rates have moved up and down. Without expressing any view on the merits of any such complaints, there would appear to be a growing risk that products that include variation terms, and allow for legitimate price variation by reference to a range of factors that go beyond base rate alone, are nevertheless expected to behave as 'tracker products'. Furthermore, there is a risk that when they do not behave as 'tracker products', consumers will look to complain and expect to receive compensation. Given the contagion risk of any such development from the mortgage market into a wide variety of other financial products, the potential ramifications (both in terms of consumer product choice and the prudential impact on the industry) merit careful attention by all concerned.

## **4. Reasons for varying the contract**

In paragraph 48 the consultation suggests that a firm could give consumers a non-exhaustive list of reasons why it could vary their contract without first seeking their consent, but only so long as that 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*".

If the intention is to state that this kind of term could be permissible, but only if on the *exercise* of that term, the consumer is left no worse off than if the firm terminated the entire contract and offered to replace it, this should be clarified. Otherwise it is not clear how the drafting of the term itself could guarantee this in advance, particularly if it is deliberately open-ended.

## **5. Change in customer circumstances**

The right of customers to cancel a contract if they are unwilling to accept a variation of terms is an important aspect of considering whether a variation is fair and is noted in the list of factors to be considered. This enables the customer to exercise their own judgement in determining whether the variation impacts them in a way which means the contract does not continue to meet their needs. However, for long term contracts where a customer's circumstances have changed since contract inception, this may impact their ability to find equivalent alternative arrangements with another provider. This should be an important part of the consideration of whether the contract variation is in the 'legitimate interests of the customer', and may warrant specific reference in the guidance.

## **5. Senior Managers' Regime**

There is a statement in the second paragraph of the draft guidance: *'In line with the principles of accountability from the senior managers' regime (SMR), 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'*.

The allocation of this responsibility is not explicitly included within the senior managers' regime. If it is an FCA requirement that responsibility is formally allocated, then this should form part of that regime, perhaps as a prescribed responsibility, or alternatively should be captured within SYSC, such that all FCA apportionment of responsibility requirements are brought together in the same part of the FCA's Handbook, rather than this requirement being located only in a Guidance document.