FCA Guidance on Variation Terms

January 2019

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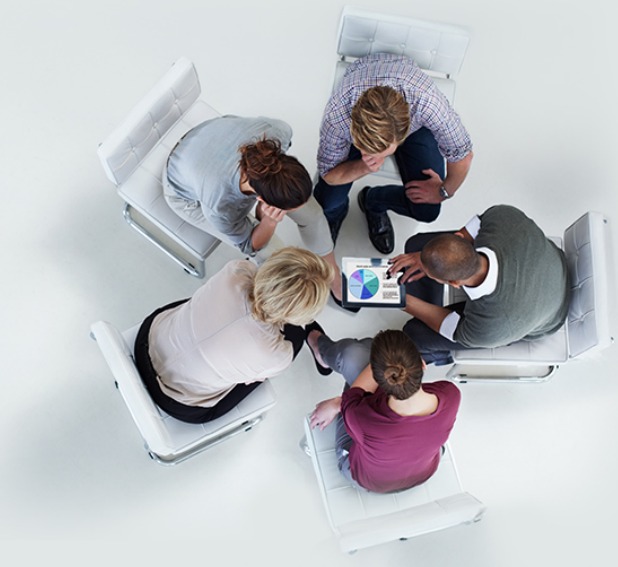
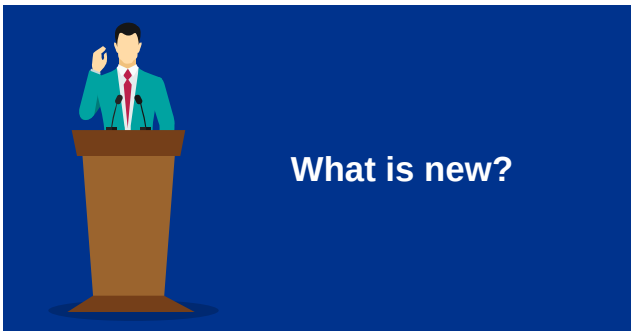
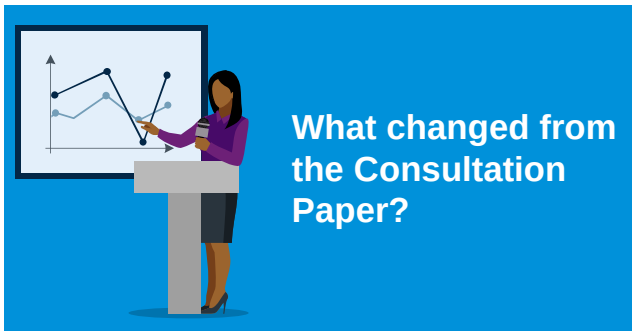


On 19 December 2018, the FCA published its finalised guidance on the fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 ("CRA"). The guidance, which followed a consultation paper published in May 2018, had been highly awaited by the financial services industry. Firstly, due to the delay since the FCA had last issued any guidance on the subject of unfair terms (the last having been issued in January 2012 but subsequently withdrawn in March 2015). Secondly, due to the fact that it is the first guidance on the subject since the coming into force of the CRA (which replaced the Unfair Terms in Consumer Contracts Regulations 1999 – "UTCCRs").





The guidance does not bring any ground breaking new views on the subject of unfair terms. The content mainly elaborates on views previously expressed by the FCA, incorporating some more recent nuances such as:

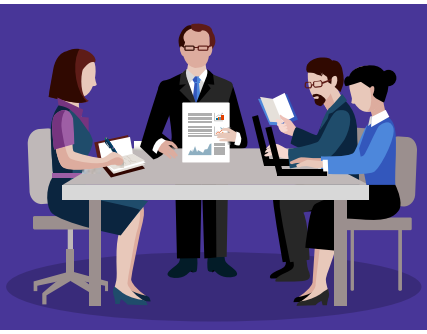
— References to the Senior Managers and Certification Regime, and the FCA's expectation that responsibility for fair consumer contracts are clearly allocated to a Senior Manager within firms' Statements of Responsibilities;

— References to judgments of the Court of Justice of the European Union ("CJEU"), in particular the CJEU reference to transparency being of "fundamental importance", as well as what transparency entails.

— The FCA took account of some feedback received in respect of its original consultation that a firm may wish to disclose its policies on interest rate setting as a means of achieving transparency. It has now recognised that disclosing such policies may amount to disclosing commercially sensitive information and breaching competition law. This is a welcome change, given that the original suggestion was of significant concern to lenders and trade bodies;

— In terms of financial and practical barriers for a customer to exercise their freedom to exit the contract, following the variation of a term, the FCA recognised that practical barriers that were not known or were unlikely to exist at the time the contract was entered into should therefore not affect the assessment of fairness of a term. This is again a welcome change, especially in the context of contracts of longer duration such as mortgages or loans;

— The FCA recognised that the circumstances to be taken into account for the assessment of fairness a contract term should be those at the time of entering into the contract, and not at a later date. Again, this clarification is welcome and in line with the practical challenges of contracts of longer duration such as mortgages or loans.

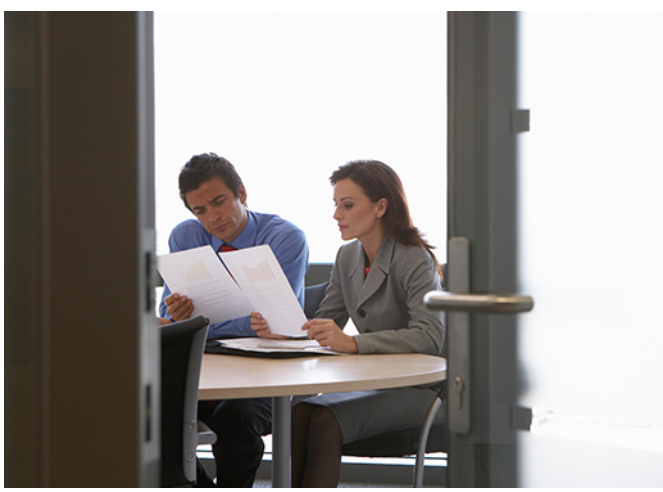


What did not change from the Consultation Paper?

— The FCA rejected the industry's views that the new guidance should be forward-looking (i.e. only applicable to contracts entered into after its issue). It justified this position by explaining that the guidance interprets the previous and current law (UTCRRs and CRA) and CJEU judgments, combined with the fact that it is not proposing to conduct a proactive review of firms' contract terms. In essence it leaves unanswered the question that was raised via the consultation feedback: why new guidance should be applicable to existing contracts that were entered into when firms did not have the benefit of the FCA's current views?

— The FCA did not recognise in its guidance that some of the quoted CJEU judgments were unrelated to financial services. It argued that the principles behind the CJEU judgments are widely applicable, for example the factors that should be taken into account for an assessment of fairness, as well as the elements that comprise 'transparency'. While referring to factors from the CJEU judgments may be justifiable generally, the guidance did not recognise that the consequences of those factors may differ when applied in the context of financial services. Financial services have a unique nature, so much so that there are special provisions referring to such services in the so called 'grey list' in the CRA and the UTCCRs. It is that unique nature that prevents the simple "borrowing" by analogy of factors applied by the CJEU in different contexts. This may be a missed opportunity for the FCA to make the position clear for the industry it regulates.

— The FCA did not explore further the context of potentially unfair terms which are applied fairly in practice. The FCA referred to the "good practice" of regularly reviewing contracts, both new and existing, but again failed to recognise that in some instances this is impossible in practice. The classic example being of existing mortgage or loan contracts, which in many instances (depending on the nature of the change) cannot just be reviewed without the issuing of a new contract, or new customer-facing documentation, which in turns sometimes requires new underwriting and affordability assessments etc. This is further aggravated in the context of closed-book lenders. Yet the guidance did not recognise that, where the actual review of the wording of contract terms is prevented by legal or regulatory requirements, the fair application of those unfair terms may well be the only solution available. The FCA failed to explore these scenarios, despite its current work being undertaking alongside the mortgage industry in relation to 'mortgage prisoners'. Once again, a missed opportunity.



What are the possible issues arising from the new guidance?

While the views set out by the FCA are not exactly new, the guidance may nevertheless present a new opportunity for claims management companies ("CMCs") to pursue new arguments against regulated firms. Historic trends raised by CMCs, which are likely to be reignited, relate to lenders' reliance on allegedly unfair variation terms so to:

- Increase a lender's Standard Variable Rate;
- Increase a lender's margin level above base rate;
- Increase a lender's interest rate cap;
- Increase or set a lender's fees and charges applicable to customers' accounts; and
- Prevent an interest rate decrease when the base rate falls below a particular level.

The other possible issue arising from the new guidance is the possibility of the FCA taking action in respect of existing contract terms. As mentioned above, the FCA has refused to recognise that the guidance is forward-looking, yet the FCA makes the point that firms should regularly review their contract terms. This brings into question how firms can best deal with their historical books and contracts, looking to avoid a possible unenforcement scenario arising from terms being found to be unfair. This is certainly a matter that deserves careful consideration for assessment of risks and possible actions where appropriate.

What next?

Although the FCA has stated that it does not intend to proactively review firms' contract terms for fairness, as it found no evidence to suggest that this is required at present, firms should nevertheless look to digest the new guidance in the context of its business operation and contract terms.

While the FCA has not, to date, sought an injunction in court against firms in relation to unfair terms, the publicity it could attract from seeking an undertaking is always unwelcome damage to any firm's reputation.

In particular given the new regulatory landscape brought by Senior Managers and Certification Regime, this may be a sensible time for firms to review their contract terms and practices in light of the new guidance.

What is clear is that, with the new guidance now officially out, the FCA will be looking for opportunities to seek undertakings from firms to widen the awareness of its new views and its expectations.

If you have any questions about unfair terms and the FCA new guidance, please contact the KPMG expert
team below.

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