

## Finalised guidance

# FG18 / 7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015

### Chapter 1: Introduction

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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, references 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. This guidance also reflects UK and EU case law developments. It sets out our understanding of the CRA's provisions and recent case law developments in respect of unilateral variation terms.
2. We expect firms to consider this guidance when they review their existing contracts and when they draft new ones. Firms should ensure that variation terms in their contracts are transparent and not unfair.
3. This guidance is not a full legal explanation of the CRA. It does not set out an exhaustive list of all the factors that are relevant to the determination of whether or not a variation term is fair. Ultimately, only a court can determine the fairness of a term and we cannot approve terms for these purposes. Firms are responsible for ensuring their terms meet the CRA's requirements. This guidance aims to raise awareness. It gives our view on the factors that firms should consider when thinking about fairness issues under the CRA when they draft and review unilateral variation terms in their consumer contracts.
4. In line with the principles of accountability from the Senior Managers Regime, we expect responsibility for fair consumer contracts to be clear from Statements of Responsibilities (SoRs). We expect firms to which the overall responsibility requirement applies to reflect responsibilities for products, including associated contracts, in appropriate SoRs. Firms that do not yet come under the Senior Managers and Certification Regime should continue to

refer to the current rules and guidance in this area, including (but not limited to) the Principles for Businesses and SYSC.<sup>1</sup>

### 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 accept an undertaking instead. We also have the power under the CRA to seek an undertaking or an injunction from firms where their 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.

### 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 our Memorandum of Understanding with the CMA, we will consider the fairness of terms under the CRA in consumer contracts issued by the firms we regulate and their appointed representatives. The Memorandum of Understanding does not stop the CMA considering the fairness of a term issued by a firm we regulate 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 when taking action in the courts, making complaints to firms and referring them to the Financial Ombudsman Service.

### Scope of this guidance

11. This guidance is *general guidance* under section 139A of the Financial Services and Markets Act 2000.
12. This guidance applies to FCA authorised persons<sup>2</sup> (and their appointed representatives), electronic money issuers and payment service providers in relation to any consumer contracts which contain variation terms. This guidance uses 'firm' to refer to all such persons.

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<sup>1</sup> The senior managers regime came into force on 7 March 2016 for deposit-taking firms and came into force for dual-regulated insurers on 10 December 2018. The Economic Secretary to the Treasury has announced that commencement of the regime for solo-regulated firms will be 9 December 2019.  
<https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-07-03/HCWS823/>.

<sup>2</sup> This includes both solo-regulated (only regulated by the FCA) and dual-regulated (regulated by both the FCA and the Prudential Regulatory Authority) firms

## Other rules and guidance

13. The FCA Handbook contains other rules and guidance that apply to terms in consumer contracts.<sup>3</sup> Firms should consider both this guidance and any other rules that apply when they draft and use variation terms in their consumer contracts, to ensure they have complied with all applicable requirements.
14. We remind firms that the Principles for Businesses are also relevant when drafting and operating consumer contracts.<sup>4</sup> Principles 6 and 7 are particularly relevant in the context of contract terms:
  - a. Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.
  - b. 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.

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<sup>3</sup> 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 2017 for example.

<sup>4</sup> <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

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### The Directive, the CRA and the UTCCRs

15. 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 summarises 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.
16. 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.<sup>5</sup> Although the rest of this guidance will discuss unfair terms in the context of the CRA, it applies equally to factors that firms should consider to achieve fairness under the UTCCRs<sup>6</sup>, under which the test of fairness is essentially the same.
17. The CRA applies to both standard terms and terms that are individually negotiated between a firm and a consumer.<sup>7</sup> Under the CRA, terms should be both fair (subject to the core exemption we explain 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 test of fairness in the Unfair Terms legislation does not apply to terms that have been individually negotiated. However, all written terms, including any that have been individually negotiated, must be in plain, intelligible language.
- A consumer enters into a standard-form contract with a firm in April 2014 – the Unfair Terms in Consumer Contracts Regulations 1999 apply.

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<sup>5</sup> 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.

<sup>6</sup> And under the Unfair Terms in Consumer Contracts Regulations 1994 (see footnote 5).

<sup>7</sup> It may also apply to terms in other contracts if these terms fall within the scope of section 72 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 June 2017 – the Consumer Rights Act 2015 applies.
- A consumer enters into an individually negotiated contract with a firm in August 2017 – the test of fairness in the Consumer Rights Act 2015 applies as the test of fairness is no longer limited to terms which have not been individually negotiated.
- 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.<sup>8</sup>

### The fairness test

18. 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.<sup>9</sup> 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 is not on the grey list does not necessarily mean that it is fair. It simply means that there is no indication of unfairness and the term remains to be assessed for fairness applying the statutory test.
19. The fairness test has two key elements – good faith and significant imbalance. The fairness assessment is a holistic assessment and these two elements may overlap in the way they apply to any particular set of facts.<sup>10</sup> 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.
20. The Directive recognises the importance of striking a fair balance between the legitimate interests of both the supplier and consumer. It states that 'Whereas the assessment ...of the unfair character of terms...must be supplemented by a means of making **an overall evaluation of the different interests involved**; ... the requirement of good faith may be satisfied by the seller or supplier where he deals fairly and equitably with the other party **whose legitimate interests he has to take into account**' (our emphasis).<sup>11</sup> The CJEU's guidance also reflects the importance of the legitimate interests of both parties. It states that, when determining whether a significant imbalance in the rights and obligations of the parties under the contract arises 'contrary to the requirement of good faith', the court must assess whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.<sup>12</sup>
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).<sup>13</sup>

<sup>8</sup> Business to business contracts are governed by the Unfair Contract Terms Act 1977.

<sup>9</sup> See Section 62(4) CRA and regulation 5(1) UTCCRs.

<sup>10</sup> See *Director General of Fair Trading v First National Bank plc* [2002] 1 AC 481, [2001] UKHL 52 at paragraph 37 (Lord Steyn).

<sup>11</sup> See 16<sup>th</sup> recital to the Directive.

<sup>12</sup> *C-415/11 Aziz* at paragraph 69.

<sup>13</sup> See section 62(5) CRA and regulation 6(1) 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.

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, and any other material provided by the firm to the consumer.
23. Although the fairness of a term must be judged as at the date when the contract is made, account may properly be taken of the likely effect of the term when the contract is put into effect.<sup>14</sup> The assessment of the term should take account of all the circumstances which the firm could have reasonably known, or reasonably foreseen, at the time the contract was agreed (having regard to the firm's expertise and knowledge) and which could affect the future performance of the contract.<sup>15</sup>
24. The meaning of unfairness was considered by:
- the House of Lords in *Director General of Fair Trading v First National Bank plc*, and
  - the Supreme Court in *ParkingEye Ltd v Beavis*<sup>16</sup>, which draws on the CJEU case of *C-415/11 Aziz*.

The CMA's guidance published in July 2015 provides further guidance on the fairness test, although this predates the Supreme Court's decision in *ParkingEye v Beavis*. We are not providing 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.

### The core exemption

25. A term will be exempt from the fairness test to the extent that:
- it specifies the main subject matter of the contract, or
  - the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it.<sup>17</sup>

However, terms must be transparent and prominent before they can fall within this exemption, which is commonly called the 'core exemption'.<sup>18</sup>

### Transparency as a requirement under the CRA

26. The CRA requires that terms are transparent.<sup>19</sup> 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) with the consequence that it is not binding on the consumer. However, a lack of transparency on its own may also have consequences:

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<sup>14</sup> See Lord Hope at paragraph 45 and Lord Bingham at paragraph 13 in *Director General of Fair Trading v First National Bank plc*.

<sup>15</sup> See C-186/16 *Andriuc* at paragraph 54.

<sup>16</sup> [2015] UKSC 67, [2015] 3 WLR 1373.

<sup>17</sup> 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.

<sup>18</sup> 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 paragraph 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."

<sup>19</sup> Section 68(1) CRA. Regulation 7(1) UTCCRs has a similar requirement.

- The FCA may seek an undertaking from the firm or an injunction, and/or
- if 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 consumer<sup>20</sup>.

27. The CRA states that a term is transparent for this purpose if it is in plain and intelligible language and is legible.<sup>21</sup> 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.'<sup>22</sup>

'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.'<sup>23</sup>

### The relevance of transparency to the fairness test

28. Recent CJEU case law has emphasised the importance of the transparency of a term as part of an assessment of whether a term is fair or not. In paragraph 41 of Chapter 3, we give 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 has said (our 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 paragraph 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 paragraph 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, to determine whether the loan agreement sets out transparently the reasons for**

<sup>20</sup> 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.

<sup>21</sup> Section 64(3) CRA.

<sup>22</sup> C-92/11 *RWE Vertrieb* at paragraph 44. See also C-26/13 *Kasler* at paragraphs 69-71.

<sup>23</sup> C-26/13 *Kasler* at paragraph 71.



**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 paragraph 74<sup>24</sup>)

### Case law on what transparency requires

30. Regarding transparency more generally, the CJEU has stated (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 paragraphs 40-41)<sup>25</sup>

**'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 paragraph 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 paragraph 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 *Andriuc* at paragraph 51)<sup>26</sup>

### The consumer by reference to whom the test of fairness is to be applied

31. Where the fairness of a term is raised in proceedings between a seller or supplier and an individual consumer, the fairness test must be applied to the term in the contract between the parties. So where consumer X challenges the fairness of a term in a contract with firm Y, the term will be found to be 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 X. The particular circumstances of X may be relevant to the assessment of fairness of the term.<sup>27</sup> When assessing the fairness of a term in the context of a collective

<sup>24</sup> See also C-26/13 *Kasler* at paragraph 73.

<sup>25</sup> *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 paragraphs 60-75.

<sup>26</sup> See also C-51/17 *Ilyes & Kiss* at paragraph 74.

<sup>27</sup> See for example *Director General of Fair Trading v First National Bank* [2002] 1 AC 481 at paragraph 17 per Lord Bingham and *Tew v BoS and others* [2010] EWHC 203 at paragraphs 25 to 27 per Mann J.



challenge brought by a regulator on behalf of consumers, it is necessary to consider the position of typical parties when the contract is made and to take into account the effects of contemplated or typical relationships between contracting parties.<sup>28</sup>

32. Whether or not a term is transparent<sup>29</sup> is determined from the perspective of the 'average consumer' who is 'reasonably well-informed and reasonably observant and circumspect'.<sup>30</sup>

33. In considering whether the firm, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to the particular term in individual contract negotiations (see paragraph 20 above), the question in an individual challenge is not whether the particular consumer would have agreed to the term, but whether a reasonable consumer in the position of the consumer would have done so.<sup>31</sup> In a collective challenge, regard would be had to the reasonable consumer in the position of typical consumers.

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<sup>28</sup> See *Director General of Fair Trading v First National Bank* [2002] 1 AC 481 at paragraph 20 per Lord Bingham and at paragraph 33 per Lord Steyn.

<sup>29</sup> Sections 68(1) and 64(3) CRA and regulations 6(2) and 7(1) UTCCRs.

<sup>30</sup> See for example C-26/13 *Kasler* at paragraph 74 and C-186/16 *Andriuc* at paragraph 47.

<sup>31</sup> In *ParkingEye*, Lord Neuberger and Lord Sumption stated at paragraph 108: "Could ParkingEye, 'dealing fairly and equitably with the consumer, ... reasonably assume that the consumer would have agreed to such a term in individual contract negotiations'? The concept of a negotiated agreement to enter a car park is somewhat artificial, but it is perfectly workable provided that one bear in mind that the test ... is objective. The question is not whether Mr Beavis himself would in fact have agreed to the term impose the £85 charge in a negotiation, but whether a reasonable motorist in his position would have done so."

## Chapter 3: Variation terms in financial services consumer contracts

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### Variation terms

34. Unilateral variation terms are common in financial services consumer contracts. This is particularly the case for contracts 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 over their lifetime, making them more available to consumers. For example, being able to change variable-rate contracts allows firms to offer competitively-priced products that do not just track base rate, so offering consumers greater choice. This is because firms know that they can vary the interest rates they charge to reflect changes in circumstances, particularly in their own costs of funding (see paragraph 50). However, these terms need to be drafted appropriately, as an unfair variation term is not binding on the consumer and also risks causing consumer harm if firms use it unfairly.
35. Firms might legitimately need to make changes to their contracts in certain circumstances. However, they should always consider whether a unilateral variation term is necessary or appropriate, taking into account the legitimate interests of both parties to a contract before including it. Such terms may not be appropriate in every consumer contract. This is particularly true for contracts that have a defined, short duration where the consumer's expectation is that the terms of the contract are usually fixed.
36. We briefly explained the meaning of the core exemption at paragraph 25. A variation term cannot benefit from the core exemption under the CRA and can therefore be assessed for fairness.<sup>32</sup>

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

37. As noted above, Part 1 of Schedule 2 to the CRA contains an indicative and non-exhaustive list of terms that may be regarded as unfair. This list is known as the grey list and it covers the types of variation terms (or terms similar to 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 contract<sup>33</sup>

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 product<sup>34</sup>

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

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<sup>32</sup> See C-472/10 *Invitel* at paragraph 23. See also C-143/13 *Matei* at paragraph 58.

<sup>33</sup> Also, Schedule 2 paragraph 1(j) UTCCRs.

<sup>34</sup> 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 agreed.<sup>35</sup>

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

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

Qualification in respect of financial services - Paragraph 11 does not include a term where 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 immediately.<sup>36</sup>

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 contract.<sup>37</sup>

40. Where a term falls within one of these qualifications, it does not make the term fair. The term will still be assessable for fairness<sup>38</sup>. 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)<sup>39</sup> 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<sup>40</sup>. In our view, the same would apply to the qualification for variation terms in financial services contracts<sup>41</sup>.

### **An overview of factors relevant to determining whether or not a variation term is fair**

41. 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). The table below and the explanatory paragraphs that follow are not intended to be 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, we consider

<sup>35</sup> Schedule 2 paragraph 1(l) UTCCRs.

<sup>36</sup> CRA Schedule 2 paragraph 22, UTCCRs Schedule 2 paragraph 2(b) first indent.

<sup>37</sup> CRA Schedule 2 paragraph 23, UTCCRs Schedule 2 paragraph 2(b) second indent.

<sup>38</sup> 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 paragraphs 48-51.

<sup>39</sup> CRA Schedule 2 paragraph 23, UTCCRs Schedule 2 paragraph 2(b) second indent.

<sup>40</sup> For example, Case C-92/11 *RWE* at paragraph 52.

<sup>41</sup> 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 Case C-26/13 *Kasler* at paragraph 73, C-143/13 *Matei* at paragraph 74 and C-96/14 *Van Hove* at paragraphs 40-41.

that the factors listed in the table are relevant when assessing the fairness of variation terms. There may be other factors to consider, and 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. The weight to be given to the factors will depend on all the circumstances relevant to the assessment of the fairness of the particular term.

## Table

| <b>Factors relevant to determining whether or not a variation term is fair</b>  |   |   |
|---|---|---|
| Note: references to 'the reasons' are references to reasons that entitle the firm to vary the contract, using the variation term. |   |   |
| The firm's purpose in including a variation term  | 1 | Has the firm included the variation term to achieve a legitimate purpose?   |
| The scope of the variation term   | 2 | Are the reasons no wider than is reasonably necessary to achieve a legitimate purpose?  |
|   | 3 | Is the extent of the change permitted by the variation term no wider than is reasonably necessary to achieve a legitimate purpose?  |
|   | 4 | Are the reasons objective?  |
|   | 5 | Would it be possible for the firm to demonstrate whether or not the reasons have arisen (in other words, whether or not the firm is entitled to vary the contract when it invokes the variation term)?  |
| Whether or not the term can operate in the consumer's favour  | 6 | Does the variation term allow for:<br><br>(a) 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), or<br><br>(b) variations in only the consumer's favour?  |
| The transparency of the variation term  | 7 | Are the reasons clearly expressed?  |
|   | 8 | Will the average consumer <sup>42</sup> understand, at the time the contract is concluded, the consequences that a change to the terms might have for them in the future? In particular, for a variation term that entitles the firm to vary the price:<br><br>(a) if practicable, does the contract (or other information provided to the consumer before the contract is concluded) explain in general terms the method for determining the new |

<sup>42</sup> A consumer who is reasonably well informed and reasonably observant and circumspect: see paragraph 32.

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|---|----|--|
|   |    | price (in other words how the new price will be determined), and<br><br>(b) will the average consumer understand the economic consequences for them of the variation term? |
| Notice  | 9  | What, if any, notice of any variation does the contract require the firm to give the consumer?   |
| Freedom to Exit   | 10 | Does the contract give the consumer the right to terminate the contract before or shortly after any variation takes effect?  |
|   | 11 | Judged at the time when the contract is concluded, is it likely that the consumer would be able to exercise the right in practice?   |
| Striking a fair balance overall between the legitimate interests of the firm and the consumer | 12 | Does the term strike a fair balance overall between the legitimate interests of the firm and the legitimate interests of the consumer?                                     |

42. We remind firms 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). We 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.

**Factor 1: The firm’s purpose in including a variation term**

43. The first factor concerns the firm’s purpose in having the right to vary the terms of the contract.<sup>43</sup> As noted in paragraph 35, firms should consider whether a variation term is necessary or appropriate for the contract, taking into account the legitimate interests of both parties.

**Factors 2 - 5: The scope of the variation term**

44. The second to fifth factors concern the scope of the variation term, and are also related to factors seven and eight, i.e. the transparency of the variation term.<sup>44</sup> Variation terms should not be wider than reasonably necessary to achieve a legitimate purpose. They should also not give a firm unreasonably wide discretion to make changes to the contract, both in relation to the reasons for a change 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.<sup>45</sup>

45. When drafting a variation term, firms should carefully consider what, if any, changes might be reasonably necessary during the contract’s duration. This consideration should include

<sup>43</sup> See *ParkingEye* at paragraphs 105(3) and 108; C-415/11 *Aziz* paragraph 74.

<sup>44</sup> See for example C-472/10 *Invitel* at paragraphs 24-28, *RWE Vertrieb* see C-92/11 at paragraphs 42-49.

<sup>45</sup> 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 paragraphs 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.

both the reasons for a change and what that change might be. Firms should also bear in mind the reasons that may make such changes necessary, taking account of the legitimate interests of both the firm and the consumer, and make appropriate provision for making any changes. Firms should ensure that each reason permitted by the contract for varying their contract is clear, is considered in the light of other reasons and avoids unnecessary duplication.

46. Reasons are more likely to be valid if they relate to matters that are outside the firm's control. They are less likely to be valid if they pass on risks and costs that the reasonable consumer<sup>46</sup> would expect the firm to bear.

### Examples of reasons used by firms

47. Firms commonly use variation terms in consumer contracts to increase the price of fees and charges, or to make other changes to terms. Below we discuss the likely validity of some examples of reasons that firms commonly rely on. We should not be taken as expressing any view (whether expressly or impliedly) on the likely validity of reasons not covered by the examples.<sup>47</sup> There may also be other valid and invalid reasons. **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

48. A reason which allows the firm to change its charges because it has made changes to its technology or 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 firms use this type of reason in a number of different product contracts such as credit cards and pensions. Relevant factors when considering the validity of this reason are likely to include the length of the contract, the type of changes to systems that could trigger the change and what costs can be passed on to the consumer under the term. Firms should consider whether the costs that can be passed on actually belong to the product. If costs are common to a number of products then firms should apply only those costs that can be fairly allocated to the product. As noted in paragraph 45, firms should take account of the legitimate interests of the firm and of the consumer.

#### (b) Regulatory requirements/legislative changes/court or relevant ombudsman decisions<sup>48</sup>

49. A reason which allows the firm to make changes to reflect changes to legislation, changes in regulatory requirements (including prudential requirements) or to reflect case law, is generally likely to be a valid reason. This is because it is in the interest of the consumer that firms comply with the law.<sup>49</sup> This is particularly true if the firm's ability to make changes applies only to those changes directly required to meet the new legislation or requirement.<sup>50</sup>

This would include:

<sup>46</sup> See paragraph 33 above regarding the relevance of the reasonable consumer.

<sup>47</sup> 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.

<sup>48</sup> For example, the Financial Ombudsman Service.

<sup>49</sup> In our view, regulatory requirements would encompass Supervisory Statements issued by (or contained in formal correspondence from) the Prudential Regulatory Authority. In addition, guidance issued and supervisory views expressed by a firm's regulator will be relevant when considering what is necessary for compliance with regulatory/legislation requirements.

<sup>50</sup> It should also be noted that the relevant legislation does not apply to terms that reflect mandatory statutory or regulatory provisions (see section 73 CRA, regulation 4(2) UTCCRs).

- changing charges to reflect increased costs arising from new legislation or requirements in relation to the product, or
- 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 firm's control and resulting cost changes 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. When firms consider whether such a reason is valid the following factors will be relevant: the length of the contract and the nature of the product, particularly whether it is a type of product where the consumer generally understands that these costs will be passed on.

### (c) Changes to cost of funding

50. A reason is generally likely to be valid if it allows a firm to change rates because of:

- changes in its cost of funding in relation to the product, or
- where funding is general rather than product-specific, 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 firm's direct control, as these costs 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 requirements, the cost of capital, the cost of fundraising, the cost of attracting retail deposits, and regulatory changes affecting 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 arising from changes to their cost of funding. Some firms, including those authorised by the PRA, are required by law to manage these risks.<sup>51</sup> The exact approach to managing these risks will vary between firms as different types of firms rely on different types of funding, depending on their [particular business models](#).

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. A cost of funding reason is 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, as well as the general factors in paragraphs 44 to 46, relevant factors include: the length of the contract and the nature of the product, particularly whether consumers would generally understand that these costs will be passed on.

### (d) To remain competitive

51. In our view, this reason is generally 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, it is unlikely to provide an objective, clear and intelligible criterion for varying the terms. Such a term is likely to lack transparency as the consumer is unlikely to understand how a firm might change the contracts in the future to reflect what other firms are doing in the market. The consumer will not be able to make an informed decision about entering a contract allowing variation on this basis as the consumer is unlikely to be able to foresee the consequences of such a term.

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<sup>51</sup> 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.



Firms should carefully consider whether a right to vary for this reason would strike a fair balance between the legitimate interests of the firm and those of the consumer. We make clear at paragraph 54 that we will not question the fairness of a variation term, which would include the reason the firm relied on to make the variation, if 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

52. In contracts of **determinate duration**, a statement that the terms may be varied 'for any other reason' is generally less likely to be valid than variation terms which are limited to specified reasons. This is because it would allow the firm to amend the terms for reasons that do not strike a fair balance between the legitimate interests of the firm and the consumer. For example, it would enable the firm to increase the price simply because it wanted to increase profits. Such terms are likely to lack the required transparency as the consumer 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.

However, we recognise that, depending on the circumstances, terms entitling the firm to vary for any reason may be justified in longer term contracts if, when the contract is made, the firm reasonably considers that it cannot foresee all the circumstances that could justify varying the term. In assessing the fairness of such a wide variation term all the circumstances bearing on the fairness of the term would have to be considered, including terms regarding notice, freedom to exit, practical barriers to termination and the information provided to the consumer about the variation term. Firms should carefully consider whether such a wide variation term strikes a fair balance between the legitimate interests of the firm and the consumer. Firms should also consider how they can satisfy themselves that the consumer has been treated fairly when making changes to contracts of determinate duration.

### **Contracts of indeterminate duration**

53. Different considerations may apply to contracts of **indeterminate duration** particularly if the variation term enables the firm to achieve no more than it could lawfully 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. We recognise that the category of potentially valid reasons may be wider for contracts of indeterminate duration where the firm is entitled to terminate the contract for any reason on giving notice and that, depending on the circumstances, the power to vary for 'any reason' is less likely to be unfair than a term in a similar contract of determinate duration.

However, in assessing the fairness of such a wide variation term, the firm would need to consider all the circumstances affecting the fairness of the term. These would include terms regarding notice, freedom to exit, practical barriers to terminating the contract and the information given to the consumer about the variation term. Firms should carefully consider whether such a wide variation term strikes a fair balance between the legitimate interests of the firm and the consumer. Firms should also consider how they can satisfy themselves that the consumer has been treated fairly when making changes to contracts of indeterminate duration.

### **Factor 6: Whether or not the term can operate in the consumer's favour**

54. Many of the reasons that firms rely on 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:

- whether or not the term permits variations that may favour the consumer as well, and
- whether the variation can only operate in the consumer's favour, as such a term could not be unfair.

### **Factors 7 and 8: The transparency of the variation term**

55. 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 the CJEU highlights (for example, in the extracts quoted at paragraph 30). The circumstances surrounding entry into the contract are also relevant, including any information supplied to the consumer, especially information that may assist the consumer to compare the firm's product with other products the consumer could purchase.
56. Firms should consider whether it is practicable to give the consumer a simple explanation, which the average consumer<sup>52</sup> could understand, of the firm's likely approach to changing prices, and in particular an explanation of (1) the circumstances in which these may change, (2) in general terms how the new price would be determined and (3) the potential size of any price increases. Firms could give this information in the contract, or in supporting materials before the contract. Depending on the nature and type of the contract, this information could include examples or explanations of variations that could be made under their variation terms. While this could include examples of past variations the firm has made, a firm should consider whether the average consumer would understand that past variations are not necessarily a guide to the future use of the variation term. When considering the above, firms should also consider their obligations under competition law, (including not sharing any commercially sensitive information with their competitors).
57. However, including the sort of information outlined above will not necessarily achieve fairness in itself. Firms should consider the drafting of their terms as a whole in light of the factors listed in this guidance.
58. Firms should also consider 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 mortgage<sup>53</sup> or the Standard European Consumer Credit Information<sup>54</sup> for a consumer credit contract.<sup>55 56</sup>

### **Factor 9: Notice**

59. The ninth factor concerns notice. A provision for notice<sup>57</sup> to the consumer in the variation term is important because it allows them to respond to the change and take the most relevant and appropriate action for them. This could include accepting the change and continuing with the contract, rejecting the change and exiting the contract, or challenging the firm's contractual entitlement to make the change.

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<sup>52</sup> The average consumer is assumed to be reasonably well-informed and reasonably observant and circumspect: see paragraph 32.

<sup>53</sup> See MCOB 5A.

<sup>54</sup> See Consumer Credit (Disclosure of Information) Regulations 2010.

<sup>55</sup> To the extent that contract terms reflect mandatory requirements, they are not assessable for fairness (section 73 CRA, regulation 4(2) UTCCRs).

<sup>56</sup> See also C-448/17 *EOS Slovenko v Danko* at paragraph 62.

<sup>57</sup> Such a notice may itself be a consumer notice for the purposes of the CRA and as such a firm will need to consider whether its terms are fair.

60. 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.<sup>58</sup> A firm may choose to provide longer notice than is required by an FCA rule or other relevant legislation.
61. 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 the consumer before the change is made is more likely to help demonstrate 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.
62. 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'.<sup>59</sup> In considering how to achieve fairness for their variation terms, firms may want to consider how far their contractual provisions on notice, and particularly any provisions that set out the contents of a notice of variation, may contribute to this. Considering what is practical in the circumstances, firms may want to include a term in the contract that requires them to explain to the consumer, during the life of the contract, the reason for any proposed variation and its consequences for the consumer.
63. When deciding what the appropriate amount of notice might be, firms should take into account as far as practical how long the consumer may need to shop around and find an appropriate alternative product, if they do not want to accept the change.
64. Personal notice is likely to contribute to fairness as it is most likely to ensure the consumer knows about the variation. However, other forms of notice such as media coverage or website or branch notification may be sufficient for minor variations. Whether the change is to the consumer's advantage is a relevant factor in both the length and the nature of notice to be given. Firms should look at the FCA's Handbook or other relevant legislation for any rules or guidance on the method they should use to give notice for a particular product.
65. Firms should bear in mind any relevant legislation or rules in the FCA Handbook that apply to their client communications and, in particular, the requirement that communications should be clear, fair and not misleading.<sup>60</sup>

### **Factors 10 and 11: Freedom to exit**

66. The tenth and eleventh factors concern the consumer's freedom to exit the contract. When drafting variation terms, firms should consider the consumer's freedom to exit the contract if they do not accept the variation, and how they can actually do so. This should include the financial and practical barriers in the contractual terms which may prevent them from doing so. Examples of barriers could be exit charges or requiring the consumer to give a long period of notice.
67. When drafting variation terms, firms should also consider whether there are likely to be any practical barriers<sup>61</sup> outside the contractual terms that might prevent or hinder the consumer exiting the contract within any advance notice period or reasonable timeframe. With a long-term insurance contract, for example, it may be difficult for the consumer to get alternative

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<sup>58</sup> See for example MCOB 7.6.1 in relation to mortgages and CONC 6.7 in relation to credit card and other credit agreements.

<sup>59</sup> Section 62(5) CRA, regulation 6(1) UTCCRs.

<sup>60</sup> Principle 7 of the Principles for Businesses.

<sup>61</sup> See *Director General of Fair Trading v First National Bank plc* per Lord Bingham at paragraph 13. See also per Lord Steyn at paragraph 33 and Lord Hope at paragraph 45.

equivalent long-term insurance if the terms are later varied. Similar considerations may apply to a mortgage contract.

68. The FCA Handbook and other relevant legislation also contain relevant cancellation rules for particular products. For example, the Consumer Credit sourcebook (CONC) states that, if consumers want to exit from a credit card or store card agreement because the interest rate has increased, firms should allow them to exit and repay the outstanding balance over a reasonable period.<sup>62</sup>

### **Factor 12: Striking a fair balance overall between the legitimate interests of the firm and the consumer**

69. We recommend that any variation term a firm intends to include in its contract should strike a fair balance overall between the legitimate interests of the firm and those of the consumer. The factors already discussed are likely to be relevant to factor 12. The firm should examine the impact of a term broadly and from both sides. Provisions that favour a firm may also indirectly serve the interests of the consumer when both their rights and obligations are examined under the contract and the benefit to the consumer from the contract is considered.<sup>63</sup> For example, a variation term may indirectly serve the consumer's 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 the scope of the variation term, the transparency of the term, any notice provisions, the 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.<sup>64</sup>

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<sup>62</sup> See CONC 6.7.13R.

<sup>63</sup> See *ParkingEye* at paragraph 106.

<sup>64</sup> C-415/11 *Aziz*.