

UNFAIR CONTRACT TERMS REGULATORY GUIDE INSTRUMENT 2007

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

- B. This instrument comes into force on 28 August 2007.

General guidance on Unfair Contract Terms

- C. General guidance on Unfair Contract Terms is made in the form of the Annex to this instrument. This guidance is a Regulatory Guide and does not form part of the Handbook.

Citation

- D. This instrument may be cited as the Unfair Contract Terms Regulatory Guide Instrument 2007.
- E. The Regulatory Guide in the Annex to this instrument may be cited as the Unfair Contract Terms Regulatory Guide (or UNFCOG).

By order of the Board
26 July 2007

Annex

Unfair Contract Terms Regulatory Guide (UNFCOG)

In this Annex, all the text is new and is not underlined.

1.1 Application and purpose

- 1.1.1 G This Guide explains the *FSA's* policy on how it will use its powers under the *Unfair Terms Regulations* (the Regulations)
- 1.1.2 G We have agreed with the Office of Fair Trading ('OFT') that the *FSA* will consider the fairness (within the meaning of the Regulations) of financial services contracts for carrying on any *regulated activity*.
- 1.1.3 G The OFT will consider the fairness of other financial services contracts which involve activities governed by the Consumer Credit Act 1974. This includes second-charge mortgage loans, buy-to-let mortgages, and non-mortgage personal loans (including credit cards). Also, where the firm concerned is not a *firm* or an *appointed representative*, the OFT may take enforcement action under the Regulations in respect of financial services contracts involving the carrying on of *regulated activities* (see *EG* 10.16 and 10.17).
- 1.1.4 G This Guide applies to:
- (1) *firms*;
 - (2) *appointed representatives*; and
 - (3) other *persons*, whether or not a *person* with *permission*, who use, or recommend the use of, contracts to carry on *regulated activities*.
- 1.1.5 G This Guide uses "firm" to refer to all such persons.

1.2 Introduction

- 1.2.1 G This Guide explains the *FSA's* formal powers under the Regulations. It does not contain comprehensive *guidance* on the Regulations themselves, and you should refer to those Regulations for further details.
- 1.2.2 G This Guide also provides *guidance* on the approach we take before considering whether to exercise our formal powers under the Regulations.
- 1.2.3 G The *FSA* has powers as a qualifying body under the Regulations. The Regulations are not made under the *Act*, but, under the Regulations our functions are treated as functions under the *Act*. This:

- (1) makes the *regulatory objectives* relevant to forming policy that governs the discharge of our functions under the Regulations;
- (2) means that any complaints about the *FSA's* activities under the Regulations can be referred to the *Complaints Commissioner*;
- (3) allows the *FSA* to make full use of its information disclosure powers;
- (4) allows the *FSA* to use its power to give *guidance*;
- (5) protects the *FSA* against liability in damages in respect of its activities under the Regulations; and
- (6) allows the *FSA* to raise fees to fund its activities under the Regulations.

- 1.2.4 G
- (1) As such, we publish on our website details of cases that result in a change in the contract terms used by the firm. This may happen through either an undertaking by a firm or injunction obtained from the courts.
 - (2) Under regulation 14 of the Regulations the *FSA* has a duty to pass details of these cases to the OFT.
 - (3) The OFT also publishes details of cases that it, and other qualifying bodies, have dealt with in accordance with the OFT's duties under regulation 15 of the Regulations.

1.3 The Unfair Terms Regulations

Terms to which the Regulations apply

- 1.3.1 G
- (1) The Regulations apply, with certain exceptions, to terms in contracts concluded between a seller or supplier and a *consumer* which have not been individually negotiated.
 - (2) Terms cannot be reviewed for fairness within the meaning of the Regulations if they are terms which reflect:
 - (a) mandatory statutory or regulatory provisions; or
 - (b) the provisions or principles of international conventions to which the *EEA States* or the European Community as a whole are party.
 - (3) Terms written in plain, intelligible language cannot be reviewed for fairness within the meaning of the Regulations if the terms relate to:
 - the definition of the main subject matter of the contract; or
 - the adequacy of the price or remuneration, as against the goods

or services supplied in exchange.

However, we can review terms concerning these matters for fairness within the meaning of the Regulations if they are not written in plain, intelligible language. We do not consider that it is enough that a lawyer could understand the term for it to be excluded from such a review. The term must be plain and intelligible to the *consumer*.

When a term is 'unfair' within the meaning of the Regulations

- 1.3.2 G Terms are regarded as unfair if, contrary to the requirement of good faith, they cause a significant imbalance in the parties' rights and obligations to the detriment of the *consumer*.

The main powers of the courts and qualifying bodies under the Regulations

- 1.3.3 G (1) Under regulation 13 we have the power to request, for certain purposes:
- '(a) a copy of any document which that person has used or recommended for use, [...] as a pre-formulated standard contract in dealings with consumers;
 - (b) information about the use, or recommendation for use, by that person of that document or any other such document in dealings with consumers.'
- 1.3.4 G (1) Unless the case is urgent, we will generally first write to a firm to express our concern about the potential unfairness of a term or terms (within the meaning of the Regulations) and will invite the firm to comment on those concerns. If we still believe that the term is unfair, we will normally ask the firm to stop including the term in new contracts and to stop relying on it in any concluded contracts. If the firm either declines to give an undertaking, or gives an undertaking but fails to follow it, the FSA will consider the need to apply to the courts for an injunction under regulation 12.
- (2) In deciding whether to ask a firm to undertake to stop including a term in new contracts and to stop relying on it in concluded contracts, we will consider the full circumstances of each case. Several factors may be relevant for this purpose and the following list is not exhaustive, but will give some indication of the sorts of things we consider:
- (a) whether we are satisfied that the contract term may properly be regarded as unfair within the meaning of the Regulations;
 - (b) the extent and nature of the detriment to *consumers* resulting from the term or the potential harm which could result from the term;
 - (c) whether the firm has fully cooperated with the FSA in resolving our concerns about the fairness of the particular contract term.

- 1.3.5 G Regulation 12 states that:
- '(1) The [OFT] or [...] any qualifying body may apply for an injunction (including an interim injunction) against any person appearing to them to be using, or recommending the use of, an unfair term drawn up for general use in contracts concluded with consumers'.
 - '(3) The court, on an application under this regulation, may grant an *injunction* on such terms as it thinks fit.'

The *FSA* is a qualifying body for the purposes of regulation 12. Our approach to seeking an injunction under the Regulations is set out in Chapter 10 of *EG*.

- 1.3.6 G Regulation 8 states that an unfair term is not binding on the *consumer* but that the contract will continue to bind the parties if it is capable of continuing in existence without the unfair term. Therefore, if the court finds that the term in question is unfair, the firm would have to stop relying on the unfair term in existing contracts governed by the Regulations.

1.4 The Unfair Terms Regulations: the FSA's role and policy

- 1.4.1 G The *FSA* may consider the fairness of a contract within the meaning of the Regulations following a complaint from a *consumer* or other person or on its own initiative if the contract is within its scope.
- 1.4.2 G There are three main ways in which we might receive a complaint from a *consumer* or other person. These are:
- (1) directly; or
 - (2) from another qualifying body which considers that the *FSA* should deal with the complaint; or
 - (3) from the OFT.
- 1.4.3 G
- (1) The main way in which we would act on our own initiative is to undertake a review of contracts in a particular area of business. This might involve looking at the contract terms used by several firms in a particular sector.
 - (2) We will, for example, consider launching such a review if multiple *consumer* contract complaints or other intelligence lead us to believe that under the Regulations there may be a contractual issue of wider significance to firms and *consumers*.
- 1.4.4 G If, following either a complaint or an own-initiative review, we consider that a term in a contract is unfair, we may challenge firms about their use of that term.

Interaction with the FSA's powers under the Act

- 1.4.5 G (1) The *FSA* will consider using its powers under the Regulations in the context of its wider regulatory powers under the *Act*.
- (2) In some cases, it might be appropriate for us to use other powers to deal with issues identified under the Regulations. The powers available to the *FSA* under the *Act* may vary depending on the *regulated activities* which the firm carries out. For example, the use of the unfair term might involve a breach of a *Principle* or a *rule* in *COB*, *MCOB* or *ICOB*. If so, the *FSA* might also address the issue as a *rule* breach.
- (3) We may, in some circumstances, consider treating the matter under our powers in the *Act* itself and also under the Regulations.
- (4) However, the use of our powers under the *Act* will not be possible in all cases where a firm has used an unfair term. If we consider using an enforcement power under the *Act*, we will do so in accordance with the policy relating to that power as set out in *EG*.

1.5 Risk Management

- 1.5.1 G (1) Where a firm has given an undertaking or a court has ruled the firm's term unfair, then the *FSA* considers it desirable that the firm should promptly notify clients with whom it has already concluded contracts of the effect the undertaking or ruling will have on their contracts.
- (2) The firm should also, as part of its risk management, consider the effect on its own business, including whether there are relevant risks which need mitigation. For example, firms should consider the effect of regulation 8 of the Regulations which provides that an unfair term is not binding on the *consumer*, but that the contract will continue to bind the parties if it is capable of continuing in existence without the unfair term. The mitigation may involve the firm contacting existing customers to ask that they agree to an amended contract, although any such amendment will itself need to avoid unfairness within the meaning of the Regulations and to comply with the law of contract generally.
- (3) As part of their risk management, firms that have not themselves given an undertaking or been subject to a court decision should remain alert to undertakings or court decisions about other firms, 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.

1.6 Redress

- 1.6.1 G (1) The *FSA* does not have the power under the Regulations to grant redress to *consumers* who have suffered loss because of an unfair term. *Consumers* may choose to complain to the firm and to seek redress from it. If the firm does not satisfy the *consumer's* complaint, the *consumer* may choose to refer the complaint to the *Financial Ombudsman Service*, if appropriate.
- (2) If the use of an unfair term also amounts to a *rule* breach, and that breach causes loss to *consumers*, the *FSA* can apply to court for restitution or require restitution. The *FSA* will consider whether to use these powers in accordance with the policy in *EG 11*.

2 Statements of Good Practice on fairness of terms in consumer contracts

- 2.1. G In Annexes 1 and 2 you will find 'Statements of Good Practice' where we have set out our views on the likely application of the Regulations in relation to certain types of clause in standard form *consumer* contracts. We will add further Statements of Good Practice relating to the Regulations as and when they are published. Please note that these Statements of Good Practice do not form general *guidance* on rules under the *Act*.

Annex 1

Fairness of terms in consumer contracts: Statement of Good Practice (May 2005)

[link to this Statement on the FSA website]

Annex 2

Fairness of terms in consumer contracts: Statement of Good Practice on mortgage exit administration fees (January 2007)

[link to this Statement on the FSA website]