

Unfair Contract Terms

Statement regarding the use of commission clawback terms in Terms of Business Agreements

18 January 2010

Unfair Contract Terms

We, the Financial Services Authority (the FSA), consider the fairness of terms in standard form consumer contracts. We do this using our powers under the Unfair Terms in Consumer Contracts Regulations 1999 (the Regulations). The Regulations apply to contracts entered into since 1 July 1995 and make unfair terms unenforceable by the firm against the consumer.

We expect senior management to take responsibility for ensuring their firms treat their customers fairly and this includes the drafting of fair terms in their standard form consumer contracts. The fairness of contract terms is a visible factor in assessing whether firms are treating their customers fairly.

Complaints about commission clawback terms in Terms of Business Agreements

We received some complaints from consumers about the fairness of terms in Terms of Business Agreements regarding the amount of commission that can be reclaimed by a firm. We believed these terms may have been unfair under the Regulations.

In particular, we found two terms in the terms of business letters of two separate independent financial advisers (IFAs) that we thought may be unfair under the Regulations. Both terms allow the firm to reclaim an amount from the consumer if they stop paying premiums and the IFA has to refund commission to the product provider.

We thought the relevant terms may have been unfair under the Regulations as they did not clarify the amount that could be reclaimed from the consumer or the timeframe in which the firm could reclaim this amount. We felt this may be unfair to consumers as it gave too much discretion to the firms to decide what amount could be reclaimed and when to reclaim it.

Action taken under the Regulations

Both firms agreed to amend their terms and we have published two undertakings, which provide more detail in relation to this.

Firms' commission and the Retail Distribution Review (RDR)

While we do not object to a firm reclaiming commission from a customer in certain circumstances, to comply with the Regulations firms must draft terms that clearly state the consumer's rights and obligations. Further, in our view, where the purpose of a term is to reclaim commission from customers, this should be explained in the term.

Under the RDR proposals, product providers will no longer be able to offer advisers commission to secure distribution of their product from the end of 2012. Advisers will need to set their own charges, which will be paid by the customer receiving the advice either directly to the adviser or through additional charges under the product.

We appreciate that many such firms are already making changes to their remuneration structures ahead of the implementation of the Retail Distribution Review in 2012 and therefore the guidance in this statement may not be applicable to some firms. Nevertheless, these undertakings, and the message behind them, are important for other firms in the industry. In particular, we understand that some advisers may have similar commission clawback terms in their current Terms of Business letters, which therefore may need to be amended.

We encourage firms to consider the undertakings we publish or court decisions, when reviewing their terms and conditions. Firms should regularly assess whether their terms and conditions in standard-form consumer contracts may be unfair under the Regulations and consider what steps they need to take to comply with them.