



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to BIS call for evidence

Consumer Rights Directive: Allowing contingent or ancillary charges to be assessed for unfairness

August 2010

Contents

Introduction.....	3
Consultation questions	5
1. Do you agree with the Government premise that because charges are contingent, ancillary or not transparent, or otherwise not part of what a typical consumer would understand as ‘the essential bargain’, competition may not drive down the level of such charges as it ordinarily would?	
2. Should any exclusion from the price exemption provision in the UTCCRs (Paragraph 6(2)) focus on:	
• contingent charges – made only on the occurrence or non-occurrence of a particular event – and/or;	
• ancillary charges which require the consumer to pay additional sums for matters outside the ordinary and expected performance of the contract – and/or;	
• charges that are not transparent to the consumer for reasons going beyond the clarity of the language used, for instance in terms of presentation; or all three of the above?	6
3. Are there matters the Government should consider in terms of the interpretation of concepts such a contingent, ancillary, non-transparent terms or ‘essential bargain’ or other terms which are relevant?.....	7
4. Should all contingent price terms be assessable even where they are likely to be in the forefront of consumer’s minds when contracting, eg estate agency sale fees? If not, what other criteria should be involved?	8
5. Would you support a provision which would simply allow charges to be assessed for unfairness if they were not, from the consumer’s perspective, part of the “essential bargain” between the consumer and the trader? Would further conditions need to be applied?.....	8
6. Do you have any evidence of contingent, ancillary or non-transparent charges arising in other sectors beyond personal current accounts which, in your view, would be assessable for unfairness in relation to the level of the charge if the law was changed? and.....	9
7. If so, do you think any of these charges are unfair and if so, why?.....	9
8. Are there other potential consequences or wider impacts of allowing the assessment of contingent, ancillary or non-transparent charges for fairness?	9

Introduction

The BIS Call for Evidence seeks to revisit the provisions in the draft Consumer Rights Directive providing consumer protection in relation to unfair charges and pricing. The call comes following a Supreme Court judgement which has been widely criticised for entrenching unfairness and diminishing consumer's ability to compare and exercise choice in the financial services market.

'The Supreme Court judgement in the OFT v Abbey National plc case in November 2009 held that charges in relation to unauthorised overdrafts were part of the price for the provision of the whole package of banking services received by a personal current account customer, and thus excluded from assessment under legislation on unfair terms in standard form contracts. As a result there is uncertainty as to how UK legislation on unfair terms in consumer contracts applies to charges that are "contingent", or "ancillary" to the core of the contract. The decision of the Supreme Court has led to calls for the Government to bring forward legislative change, especially to address perceived unfairness in certain bank charges. The Coalition Agreement includes a commitment to "introduce stronger consumer protections, including measures to end unfair bank and financial transaction charges.'

Trust and confidence is undermined when the public perception of fairness is negated by technical obfuscation.

The intent of consumer protection directives cannot be fulfilled when an assessment of the fairness of a transaction depends on a legal interpretation of the drafting of a provision. It is of great concern that a common sense definition of what a consumer believes they are paying for products or services, that which is clear and transparent and able to be quantified at the agreement stage, has not been given effect to.

The market does not operate when complexity of pricing is such that prices cannot be easily compared and where the cost charged bears little relationship to the costs incurred. It is particularly an issue where products and services provided are by their nature utilities or essential services. In these cases an assessment of fairness in pricing should be without exemption. At the very least, any charges not part of the essential bargain, and particularly those that are contingent, should be assessable for fairness.

We welcome this opportunity to put forward our position as to why it is important that the consumer protection objective is served and provisions are drafted in a way that are generally understood and clear so that the intent is supported by legal interpretation.

The call for evidence states:

'The Government believes in principle that an economic case may exist to regulate charges which, from the consumer's perspective, do not form part of the "essential bargain" between the trader and the consumer. If such charges are not actively considered by the consumer when electing to enter into a contract, they will not be subject to normal competitive pressures, even if they are formally referred to in the

contract. It could be argued, therefore, that the level of these charges should be able to be assessed for unfairness under the relevant law¹.

We support this position and recommend narrowing as far as possible any exclusion from an assessment of fairness and adopting a clear definition of what constitutes the essential bargain. The essential bargain should be just that, a bargain; transparent, quantifiable and clearly part of the negotiated price of the goods or services purchased at the time of entering the contract. Markets do not work perfectly and in some areas there is little or no competition. In these cases a discretion to assess all charges for fairness may be appropriate as the onus still remains on the consumer to initiate action in these circumstances.

Given the nature of this inquiry our comments are largely focused on the retail banking market unless specifically stated otherwise.

¹ BIS call for evidence, *Consumer Rights Directive: Allowing Contingent or Ancillary Charges to be Assessed for Unfairness*, July 2010

Consultation questions

1. Do you agree with the Government premise that because charges are contingent, ancillary or not transparent, or otherwise not part of what a typical consumer would understand as ‘the essential bargain’, competition may not drive down the level of such charges as it ordinarily would?

In retail banking, under the prevailing model of so called free banking, charges are hidden and punitive and present barriers to comparison. They are not part of the essential bargain. There is no obligation on financial institutions to provide notice of these charges and therefore if these are not disclosed they should not be taken as part of the price or consideration. Even if they were required to be disclosed, a consumer will not make decisions and cannot make comparisons on the basis that they are likely to encounter financial difficulties or other contingencies. The Office of Fair Trading’s qualitative work shows consumers do not expect to pay these charges and therefore do not include them in assessments of value². Penalty charging is not a fair business model and is difficult for a consumer to predict or manage and therefore make a good choice.

A market investigation by the Competition Commission in 2007 into the Northern Ireland market found that complexity in current account charging structures and lack of clarity of information meant that price offers were less likely to be understood by customers and competitive pressure on banks was likely to be reduced. In general customers are not provided with the necessary information to enable them to have a sufficient understanding of the charges and interest rates that might apply to their current account³. While this is the case consumers are not able to exercise choice and competition ceases to have an impact on value.

Once the bargain has been concluded a bank is in the peculiar position of providing a service and accessing a customer’s account without need for notification or separate permission to levy additional charges for those services. The customer is left to challenge after the event.

The cross-subsidy model, where there is an over reliance on hidden charges, also tends to reinforce the position of existing players as they have the established business from which to switch resources and a combined model which allows for this to happen. The products and services offered, and the terms on which they are offered, may not necessarily reflect cost (at least in the short term) nor be a product of competitive measures. Existing players use introductory offers to lure in customers with the confidence that profits can be made through changes to these offers because it is unlikely a customer will switch, or because of the difficulty of comparing prices and of switching itself⁴.

² OFT, *Personal Current Accounts in the UK*, 2008, p. 70

³ Competition Commission, *Personal Current Account banking services in Northern Ireland market investigation*, May 2007, p. 10–13

⁴ ISA super-complaint, <http://www.consumerfocus.org.uk/campaigns/super-complaint-cash-isas>

Individuals tend to place more value on benefits that are immediate than those that are crystallised over the long term (even if the long-term benefits outweigh those in the short term). Competition in the market for retail financial services therefore tends to be on the basis of a headline characteristic, often its immediate cost. Demand is less responsive to the longer-term product cost, which in many cases is quite difficult to calculate⁵. The Office of Fair Trading found that:

‘A combination of complexity and a lack of transparency means that consumers and competition are focused almost exclusively on more visible fees, and not on the less visible elements such as insufficient funds charges and forgone interest – despite the fact these make up the vast bulk of banks’ revenues’⁶.

Current charging structures do impact on competition. The situation could be improved through product design and more transparency about the longer term costs, performance and effectiveness of financial products⁷.

2. Should any exclusion from the price exemption provision in the UTCCRs (Paragraph 6(2)) focus on:

- contingent charges – made only on the occurrence or non-occurrence of a particular event – and/or;
- ancillary charges which require the consumer to pay additional sums for matters outside the ordinary and expected performance of the contract – and/or;
- charges that are not transparent to the consumer for reasons going beyond the clarity of the language used, for instance in terms of presentation; or all three of the above?

It is preferable to clarify the exemption through a narrow and clear definition rather than introducing exclusions or outlining specific charges that are assessable. The exemption needs to be future-proofed and listing charges specifically will not achieve this.

The exemption should be limited to the essential bargain only and should only apply to quantifiable charges that are disclosed in advance. One way of doing this is contained in the approach in new Australian legislation that limits the exclusion to ‘upfront price’.

‘(2) The upfront price payable under a consumer contract is the consideration that:

(a) is provided, or is to be provided, for the supply, sale or grant under the contract; and

(b) is disclosed at or before the time the contract is entered into;

but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event’⁸.

⁵ John Howard in Consumer Focus, *Rethinking financial services*, June 2010, p. 24

⁶ Office of Fair Trading, *Personal Current accounts in the UK*, 2008, p. 2

⁷ Consumer Focus, *Rethinking financial services*, June 2010

⁸ Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010, s26(2), to come into effect as the Competition and Consumer Law Act on 1 January 2011

3. Are there matters the Government should consider in terms of the interpretation of concepts such as contingent, ancillary, non-transparent terms or 'essential bargain' or other terms which are relevant?

Essential bargain should have its common sense meaning. The Competition Commission has found that 'In general, customers are not provided with the necessary information to enable them to have a sufficient understanding of the charges and interest rates that might apply to their current account' and 'in most cases banks do not know the costs of providing particular current account services'. Profits are implicit through a range of cross-subsidies and the lack of competition which keeps prices hidden, high and uniform.

The customer is told that the current accounts are free when, for a large proportion of customers, this is simply not the case. The essential bargain needs to reflect the total cost to the consumer and that cost should be based on a relationship to actual cost or on a transparent cross-subsidy model. We currently have the worst of both worlds.

Fees and charges also need to be expressed as part of a standard representation of total cost. Anything not notified to a customer in advance of the contract as part of the total cost should not be considered part of the essential bargain and should be left to be determined in a way similar to that proposed in the Mortgage Market Review's approach to arrears charging:

'Firms must be in no doubt that their arrears charges must not reflect more than underlying costs. Charges must reflect a reasonable estimate of the costs of the additional administration undertaken by the firm as a result of a customer being in arrears. Additionally, we expect firms to only include costs that they can objectively justify and that can be identified with reasonable precision'⁹.

In general, in considering fairness of terms, **including** that of the essential bargain, the following matters need to be considered:

- Relative bargaining position
- Whether the consumer was able to understand the documents relating to the supply of goods and services
- Fitness for purpose: whether the product and pricing model was appropriate for the individual consumer
- Undue influence, particularly taking into account relative bargaining position, capability and vulnerability of the consumer
- Restrictive conditions
- Is there a bargain? Standard terms, lack of negotiation over price
- An ability to vary the price without the right of the consumer to terminate the contract
- Transparency – notification of charges in advance and an estimate or basis for calculation or quantification of these
- Lack of competition in the market

⁹ Financial Services Authority, CP10/16: *Mortgage Market Review: Responsible Lending*, July 2010

4. Should all contingent price terms be assessable even where they are likely to be in the forefront of consumer's minds when contracting, eg estate agency sale fees? If not, what other criteria should be involved?

All contingent price terms should be assessable as they are unlikely to be part of the essential bargain and may not be negotiated, nor subject to competitive forces. Assessing charges for fairness is a lot easier than assessing what might be at the forefront of a consumer's mind. These charges are not generally standard and in relation to bank fees, seldom cost related and so difficult for the consumer to assess.

There is the compounding unfairness of product pushing that results from agents fees, incentives and commissions, particularly where these are wrapped up in a credit arrangement so that interest will be paid on this in addition to the purchase amount (eg Payment Protection Insurance products).

It is particularly important that an assessment of fairness is available post-sale, given that the current provisions under Article 31(4) of the draft Consumer Rights Directive may limit member states freedom in prescribing standard disclosure of these charges if there is maximum harmonisation. This provision should be revisited, for example member states may want to prescribe what information should be presented to consumers, when and how it is presented, such as consistent methods of calculating annual percentage rates or a figure representing total cost of the products and services. The Directive should not prevent these transparency measures.

5. Would you support a provision which would simply allow charges to be assessed for unfairness if they were not, from the consumer's perspective, part of the "essential bargain" between the consumer and the trader? Would further conditions need to be applied?

This seems to have been the intent of the original directive and the intent should be reflected and updated in the new directive and domestic regulation. All charges outside the essential bargain from the perspective of the average consumer should be assessable for fairness. The non-negotiable nature of many of these charges, the timing of them and the methods by which they are disclosed put the consumer at a significant disadvantage and this is, after all, a piece of consumer legislation.

There are now strong calls for general assessments of fairness in pricing in retail banking because in reality there is little choice and transparency that would enable consumers to make value decisions. The Canadian commitment in this year's budget is to go further and to prohibit negative option billing, in which goods or services are provided automatically and the customer must either pay for the service or specifically decline it in advance, in the financial sector. It intends to "enact regulations that require financial institutions to offer products and services on an opt-in basis only, where consumers have sufficient disclosures about the terms and conditions before accepting".¹⁰ Disincentives such as these to pricing models that are anti-competitive and unfair are required to restore some balance in the market.

¹⁰ Department of Finance, Budget 2010, Budget Plan, 29.
[HTTP://www.budget.gc.ca/2010/plan/chap3c-eng.html](http://www.budget.gc.ca/2010/plan/chap3c-eng.html)

6. Do you have any evidence of contingent, ancillary or non-transparent charges arising in other sectors beyond personal current accounts which, in your view, would be assessable for unfairness in relation to the level of the charge if the law was changed? and

7. If so, do you think any of these charges are unfair and if so, why?

From a consumer perspective all charges outside the essential bargain should be assessable. There is a proliferation of charges in other areas that are all about making additional money out of contracts in a less than transparent way. For instance in the phone market the add on costs can include: non-Direct Debit charge, late payment charge, payment failure charge, charge to restore service, initial minimum contract period, early termination charge, subsequent minimum contract period, minimum notice period, itemised billing charge and cease charge¹¹. The plethora of charges is not unusual and all need to be assessable for fairness

8. Are there other potential consequences or wider impacts of allowing the assessment of contingent, ancillary or non-transparent charges for fairness?

From a consumer point of view this might allow comparison of products and promote more competition and a functioning market. It may also break down some of the barriers to new entrants.

The current charging system in current accounts is unfair, not transparent and relies on some customers subsidising others. It has contributed to a dysfunctional market place without real competition or choice. Any moves to make charging more transparent and fairer have got to deliver some benefits.

However, the reliance on ancillary, contingent and non-transparent pricing as a business model in some significant areas such as current accounts in banking will mean that greater scrutiny of these charges may lead to a change in the 'free banking' model that is beneficial to certain segments of the population. This may not be a bad thing in itself but requires a more open debate on the cross-subsidy model and who benefits, and the possibility of having both fee and free banking. While this exists in other countries, consolidation in the UK market and domination by major institutions has led to a heavy reliance on one model only. Some of the other barriers to competition will need to be addressed to allow for innovation, better efficiency and choice of products and pricing in the market, but lifting the veil on hidden charges is an important first step.

We have already seen the response to OFT's greater scrutiny of unauthorised overdraft fees, with profits being recouped through dramatic increases in authorised overdraft charges. This cost shifting may not itself be all that transparent and the consumer may not get notice and or get to exercise options. In the interim there will need to be greater scrutiny of charging structures and cost shifting to identify where problems may emerge. Monitoring of this area and greater price intervention will be important in the development stages of new models.

¹¹ <http://stakeholders.ofcom.org.uk/consultations/addcharges>



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