S U M M A R Y

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Standard terms and conditions for financial services

Report in accordance with the 2007 letters of appropriation for Finansinspektionen and Konsumentverket

Report 2007:15

Summary

Finansinspektionen (FI) and Konsumentverket (KOV) received an assignment in their letters of appropriation from the Government to "investigate the existence of standard terms and conditions between consumers and firms in the financial sector". The assignment further entails analysing additional needs for and deficiencies in this area and suggesting or implementing appropriate measures.

"Standard terms and conditions" are terms and conditions *that have not been the object of direct negotiation* between buyers and sellers. Their formulation is significant for a large number of consumers. However, standard terms and conditions can also refer to contracts that are similar, or largely similar, *between different companies* that sell the same type of product. Standard terms and conditions in the latter, broader sense are of interest from a consumer policy perspective in that they increase transparency and comparability for consumers presented with offers from different firms.

The downside of standardising terms and conditions across firms is that it may lead to conformity within both product selection and product design. Industry-wide standard terms and conditions can hinder innovation and create obstacles for new entrants. Even if standardisation would lead to increased competition from a short-term, static perspective due to increased transparency and comparability, it would also decrease competition generated by product renewal. The benefits associated with this type of contract must be weighed against its disadvantages.

Within the framework of this assignment, FI and KOV gathered information about and reviewed standard contracts primarily from the banking sector in order to obtain a general overview of their scope and the extent to which industry-wide contracts exist and are used as well as to determine if the main

content of the contracts is in any way deficient. Primary focus was placed on terms and conditions related to non-liability clauses and fees.

Non-liability clauses
All of the standard contracts that were reviewed contain different types of non-liability clauses. Several of these clauses in all probability can be considered to be unfair, either because they are contrary to legal principles in general or they mislead consumers about their legal rights. This is naturally unacceptable. A more simplified choice of wording would also be helpful in avoiding unnecessary misunderstandings.

Fees
Fees are one of the most important factors for consumers when comparing different services. The size of the fees is also an important means of competition.

Market legislation that regulates the terms and conditions for fees requires that consumers are able to easily identify what the fees are and how large they are. There are wide variations in how fee information is presented. In many cases, the basis of the fees is unclear and consumers often do not receive any information about additional fees. Several of the terms and conditions for fees that were reviewed in all probability can be considered to be unfair, which is unacceptable and requires resolution.

Other reviewed terms and conditions
The review included eleven terms and conditions in addition to clauses and fees. In four of these cases, the terms and conditions of all of the actors were fully consistent with current legislation and general guidelines. In the remaining cases, small deviations and ambiguities were identified.

In general, it should be noted that several of the problems related to the formulation of terms and conditions that were identified by Konsumentverket several years ago to a large extent still exist. This raises cause for concern and requires immediate action by firms and industry organisations.

Industry-wide contracts
Standard contracts that are either totally or primarily used by all active firms on a market for a specific financial product are not prevalent in Sweden. They do not exist at all in the insurance sector, partly because of the risk that they could be perceived as limiting competition. In the banking sector, the Swedish Bankers' Association issued recommendations that are voluntary for firms. While these are applied in some cases, banks generally tend to use the Bankers' Associations' contract models as a starting point and then modify them based on individual needs. The banks' answers during the review indicate that determining whether a firm uses its "own" contract or the Bankers' Association's contract model is to some degree a subjective assessment. There is no follow-up from either the Bankers' Association or government authorities regarding how and to what degree the industry-wide contracts are applied.

Questions about how standard contracts function from a consumer protection or competition perspective, their advantages and disadvantages compared to company-specific agreements and how they potentially could be improved cannot be answered based on practical experiences.

Proposed measures and further investigation
Standard terms and conditions and their degree of relevance for consumers and firms vary. The urgency of implementing changes – excluding those cases where terms and conditions are unfair - can therefore vary significantly depending on the type of the terms and conditions.

The risk that industry-wide contracts would obstruct competition is more tangible for some types of standard contracts than for others. The size of the fees, for example, is an important method of competition for firms, and standardisation would in this case directly limit competition. Non-liability clauses on the other hand do not have the same influence on competition, but are of considerable significance for consumers. An industry standard could therefore be more relevant in this case.

Alternative solutions
KO can issue a prohibitory injunction for individual contract terms that are considered to be unfair. However, in and of itself, this would not be particularly useful if the goal is to relatively quickly and on as wide a front as possible improve the quality of standard contracts or promote greater uniformity. On the other hand, this type of injunction would send a clear signal to the market.

KOV and/or FI could also issue general guidelines for how contract terms should be formulated, whether they are firm specific or industry-wide. One advantage to this is that general guidelines can be written and distributed relatively quickly. A fundamental problem with official regulation of contract terms, however, is that actors on the market can interpret this to mean that the authorities, and not the firms themselves, carry primary responsibility. This should be avoided. One alternative could be to keep the general guidelines at such a general level that they do not identify specific solutions and therefore allow the responsibility for the formulation and application to remain with the firms. However, it would then be difficult to argue that any progress was made toward standardisation or uniformity, if this is also a desired outcome.

A third alternative would be to reach an agreement between authorities and industry actors on a common view of how contract terms should be formulated. FI and/or KOV do not necessarily need to participate in the formulation of terms/contracts, but can leave this task to an industry organisation or a specially appointed mediator, whereupon the authority/authorities are responsible for reviewing and approving the contracts based on pre-determined minimum requirements. If an agreement is reached with an industry organisation, the possibilities for achieving uniformity, clarity and transparency on the market are enhanced. Konsumentverket has considerable experience in

industry agreements from a number of other industries. In industries where agreements concerning standard contracts are common, both firms and consumers have welcomed the agreements. It should be noted, however, that this alternative could also introduce a similar problem with task division as mentioned in the second alternative above, although in a milder and most likely more manageable form.

One variation of this model could be to clearly limit standardisation and coordination to a number of simple, basic products or “base services”. In the majority of cases it is not necessary or desirable to standardise all terms and conditions. By limiting both the products and the types of terms and conditions, the problems related to task and responsibility distribution mentioned above as well as the risk for weakened competition are also limited. This requires a more detailed analysis of which products could be classified as “base products” based on certain defined starting points and which minimum elements such a product would have. It also requires a more detailed analysis of which contract terms and conditions are the most strategic for consumers in different sectors. The general goal should be to achieve as large a positive effect for the consumer as possible with as little market regulation and obstruction to competition as possible. Finally, advantages and disadvantages to the “standard terms and conditions model” should be compared with other conceivable methods that strengthen the consumer’s position.