Payment Protection Insurance: The ‘Root Cause’ of Concern for Providers

The British Bankers Association (BBA) recently lost its challenge by judicial review to new regulatory provisions imposed by the Financial Services Authority regarding complaints about the sale of Payment Protection Insurance (PPI). The ramifications of the decision, not just for banks, but for all providers/sellers of PPI insurance could amount to as much as £2.5bn to £4.2bn. The BBA has until the 10th May 2011 to appeal.

The FSA’s New Rules and Guidance

In August 2010 the Financial Services Authority (FSA) published Policy Statement 10/12 “the Assessment and Redress of Payment Protection Insurance Complaints”. This Policy Statement made various amendments to the rules and guidance issued by the FSA as to how firms involved in the selling of Payment Protection Insurance should handle complaints made by consumers and how the complaints should be decided. The Policy Statement also included an Open Letter setting out what the FSA considers to be the most common failings in the sale of PPI to the general public. The new rules came into effect in December 2010.

The Policy Statement effects various changes to the procedure for the sale of PPI including specifically setting out that a firm is required to explain key features of a PPI policy to a consumer and must be able to prove that it made it clear to the consumer that the PPI policy being offered was optional. These specific changes and many others in themselves are not particularly controversial. The controversial element is how these changes will be applied to firms involved (or previously involved) in the sale of PPI.

The first controversial change initiated by the Policy Statement was that a failing by a firm selling PPI in its sales procedure would be considered a breach of the FSA’s Principles for the selling of insurance products which would then oblige the firm to compensate its customer. Furthermore, the new provisions and guidance set out in the FSA’s Policy Statement effectively applied the new standards to all sales of PPI since January 2005 (i.e. the new rules and guidance would have retrospective effect). In its media press releases, the BBA likened this to having a road with a speed limit of 30mph which was later changed to 20mph and then deciding to hand out speeding tickets to anyone who drove at 30mph before the limit was reduced.

By far the most controversial new measure was the FSA’s guidance on the “root cause analysis”. This new guidance obligated providers and sellers of PPI to look at all previous PPI complaints and identify any major failings (i.e. a root cause), with the potential implication that firms may need to contact consumers that had purchased PPI and pay redress for losses to those consumers even though they had not actually complained.

Judicial Review

The British Bankers Association (BBA) mounted a legal challenge by way of judicial review against the FSA and the Financial Ombudsman Service regarding the new regulatory provisions and guidance as set out in the FSA’s Policy Statement. It has been estimated that the cost of compensating purchases of PPI could exceed £1.3 billion in next 5 years and that the cost of reviewing previous PPI sales and pro-actively contacting customers to offer redress could cost up to £3.2 billion; the banking industry is by far the largest sector hit by complaints regarding the sale of PPI.
The basis of the BBA’s challenge was that:

(i) A consumer does not have a legitimate legal cause of action against a firm for a breach of a principle.

(ii) The sale of Payment Protection Insurance is a regulated activity under the Financial Services and Markets Act 2000 (FSMA 200) which sets out its own specific rules. BBA argued that the only obligation on a firm involved in the selling of a PPI product was to comply with those specific rules and pay compensation for any breach of those specific rules.

(iii) The “root cause analysis” imposed by the FSA was in direct conflict with the provisions of the FSMA 2000 which sets out a specific statutory procedure for any scheme dealing with redress for consumers that have not raised a complaint.

The outcome of the Judicial Review

The Court dismissed all of the arguments raised by the BBA and held that the FSA’s Policy Statement providing the new provisions and guidance on the sale of PPI was entirely lawful. Crucially, Mr Justice Ouseley stated that the new policy guidance was not really different in substance to the rules that had previously been in force – the only real difference was that firms would need to identify systematic failings in their sales procedures and complaints handling and contact PPI consumers that had not complained to offer redress. Having decided on its lawfulness, the decision now affects all those organisations where the policy statement applies, not just to banks and financial institutions.

What does this mean?

The true implication and how this will work in practice is unclear. The present position is clear: the new guidance and rules as set out in the FSA’s Policy Statement 10/12 is entirely legal and all firms involved currently and previously in the sale of PPI will need to follow the new guidance and rules, including undertaking a “root cause analysis” in relation to previous complaints. This opens up those organisations who have previously been involved in the selling of PPI policies to paying large amounts of compensation even if there is no actual complaint.

The major element of uncertainty is whether the BBA will seek to appeal the recent ruling of the High Court and, if so, what firms are to do in the meantime. Most consider that BBA will seek to appeal given the likely dire implications to the banking sector if the FSA’s new guidance and rules are to be strictly followed and enforced; in the year ending 31 March 2009, the FOS upheld 89% of PPI complaints. BBA has until 10 May 2011 to decide whether to request permission to appeal.

In direct conflict with what has been advised previously the FSA, BBA has stated that until a decision is taken on whether to seek leave to appeal, any complaints that are directly affected by the judicial review and cannot be decided now will be placed on hold.

Whilst the vast majority of PPI products were sold by banking institutions, the new provisions and rules apply to all regulated firms that are currently involved in and/or were involved previously in the sale of PPI products. It is expected that most firms will follow the lead of the BBA and wait to see whether an appeal is made before implicating any new procedures or dealing with PPI complaints that are directly affected by the judicial review proceedings. What is certain is if there is no appeal firms will have an obligation to follow the ‘root cause analysis’. On a more positive note a root cause
analysis will only result in compensation being paid if systemic failings are found. Beale and Company is involved in the defence of PPI complaints and is pleased to confirm that we have successfully defended each complaint that has thus far been referred to the Ombudsman.

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May 2011