# PAYMENT PROTECTION INSURANCE JUDICIAL REVIEW

**Lucy Walker and Ross Fentem, Guildhall Chambers**

**Payment Protection Insurance: *R (British Bankers' Association) v FSA***

Mr Justice Ouseley yesterday handed down judgment in *R (on the application of the British Bankers' Association (BBA)) v Financial Services Authority (FSA)* [2011] EWHC 999 (Admin), roundly dismissing the BBA's claim for judicial review of the FSA's December 2010 policy statement on selling Payment Protection Insurance (PPI).

The decision is grave for the banks. PPI sales have been a notorious source of customer complaints for years. In spite of an FSA statement that complaints should continue to be processed despite the proceedings, many hundreds of thousands of PPI complaints were stayed pending the decision. The implication is that complaints about the selling of PPI will now be judged by reference to the new rules and guidance, even if the sale complied with the applicable rules at the date of sale. Moreover, under "root cause analysis" reviews of systemic but historical failings, banks are now being euphemistically "advised" by the FSA to contact customers who may never have made a complaint and to offer them compensation if there is something sufficiently questionable about their PPI policy.

**Background**

The sale of PPI is subject to detailed rules and procedures which are set out in the chapters governing Insurance Conduct of Business (ICOB) contained in the FSA Handbook of Rules and Guidance, (the FSA Handbook). In addition to the detailed rules contained in the FSA Handbook, the handbook also contains high level principles for the conduct of business. In the context of yesterday's judgment this is an important distinction to appreciate.

The FSA has lavished attention and resources on monitoring PPI sales for some years. In August 2010, the FSA published policy statement 10/12 which expressed the FSA's "*serious concerns about widespread weaknesses in previous PPI selling practices*" and proposed a package of measures designed to combat the perceived problems. Those measures included a requirement for sellers to conduct "root cause analysis" which is effectively a mechanism whereby even those have not complained about their PPI policy might be eligible for compensation.

**Grounds of Challenge**

What policy statement 10/12 did, as the BBA saw it, was to treat failings in sales procedures as breaches of the high-level principles contained in the FSA Handbook even if, at the time of sale, the applicable detailed rules contained in ICOB had been adhered to. Breach of the principles would – retrospectively – become a relevant consideration for the Financial Ombudsman Service (FOS) and so could give rise to compensation. Or, as the BBA put it in statements to the press, new standards would be applied to past sales.

The BBA challenged the FSA, as well as FOS, by arguing that policy statement 10/12 was unlawful because:

- It treated the principles, (as opposed to the detailed ICOB rules) contained in the FSA Handbook as giving rise to obligations owed by firms to customers, even though the principles were not actionable at law;
- The FSA had made other, specific and exhaustive rules to govern PPI selling, including those set out in ICOB; and

- The policy statement 10/12, with its guidance on "root cause analysis" of complaints, took up the same ground as (or conflicted with) the statutory procedures contained in s.404 of the Financial Services and Markets Act 2000 (FSMA).

**Non-Actionability**

S.150(1) FSMA provides that a contravention of one of the rules specified in the FSA Handbook is actionable as a breach of statutory duty. However, s.150(2) FSMA allows the FSA to define a rule as non-actionable. The high-level principles contained in the FSA Handbook (PRIN) are designated as rules to which s.150(1) does not apply.

The BBA argued that the non-actionable principles were being made actionable by the FSA, as the effect of policy statement 10/12 was effectively to re-designate the principles as matters to which the banks and the FOS should have regard when determining a PPI complaint. This was a circumvention of s.150 FSMA.

Ouseley J disagreed. In his view, the only relevance of s.150(1) FSMA was whether breach of a particular rule was actionable as a claim in a court. It was clear that the principles were not actionable. But FSMA did not alter the function or purpose of the principles in any other way. Indeed, s.228 FSMA gives a very broad statutory basis to the FOS for reaching its decisions: it must expressly do what is in its opinion fair and reasonable, even if the particular complaint would not be actionable. Perhaps most tellingly, in Ouseley J's view, it would be a breach of statutory duty for the FOS to fail to take the principles into account.

**Conflict with Specific Rules**

ICOB contains detailed rules and guidance on the sale of insurance, including but not limited to PPI. The BBA argued that it was illegitimate for the FSA and the FOS to look to the general principles for the assessment of a customer complaint where the regulated activity was governed by very specific rules: the specific could not be augmented by the general.

The BBA analysis put the issue *"the wrong way round"*, commented Ouseley J. The principles are the overarching framework for FSA regulation, *"the ever-present substrata to which the specific rules are added"* or (mixing his metaphors) the principles *"stand over the specific rules"*. The real question was not whether the general was augmenting the specific, but whether anything specific in ICOB excluded recourse to the general principles. There was nothing. On the contrary, the application of the principles as the FSA saw it did not contradict ICOB, but amplified areas which were not specifically covered.

**S.404 of FSMA**

S.404 FSMA provides a general power, now vesting in the FSA, to make a scheme order affecting all firms in a particular industry where the FSA is satisfied that there has been a widespread or regular failure to comply with rules which has led to consumers suffering loss. Policy statement 10/12 required firms to carry out "root cause analysis" of PPI-related failings under which they would have to take steps themselves to investigate systemic problems in sales practices and to consider proactively offering compensation to customers who had not made a mis-selling complaint.

The banks understandably balked at this, as they were being advised to inform non-complainant customers who may have been perfectly happy with their product that they might be able to obtain compensation. The BBA argued that the very purpose of the new policy was to address a widespread failure to comply with rules, which was the exclusive ambit of s.404 of FSMA: the FSA in essence had no rule-making power to address such a failure except as provided by s.404.

The argument was given short shrift. If it were right, it would mean that the greater the problem, the more limited the FSA's powers. Anyway, as Ouseley J saw it, the new policy guidance was not really different in substance from the rules that had been in force, and unchallenged, until 2010. There was

no more than a change in emphasis. All that had changed was that those firms which identified systematic failings on a "root cause analysis" would be advised to take the further steps of contacting non-complainants and offering redress. This was not a s.404 scheme in disguise, but a realignment of rules that had been in place for a long time.

**Clogging the Courts**

In recent years, thousands of claims alleging PPI mis-selling have been brought before the County (and higher) Courts, often fostered by claims management companies. Frequently, because the vast majority of PPI policies were point of sale products linked to personal credit products regulated by the Consumer Credit Act 1974 (as amended, the CCA), an allegation of PPI mis-selling often goes hand in hand with an allegation that the related credit agreement is defective in some way which contravenes the strict rules of the CCA concerning the form, content and financial information contained in a regulated credit agreement. In addition, it is frequently alleged that the mis-selling of PPI also gave rise to an unfair relationship between lender and borrower under s.140 CCA.

Until yesterday, banks and lenders had enjoyed notable success in defeating claims of this nature in the Courts. Recent decisions in favour of Black Horse Limited and Barclays Bank PLC indicated that in those cases the Court generally preferred the lenders' evidence in terms of ICOB compliance. The High Court decision of HHJ Waksman Q.C. in *Harrison v. Black Horse Ltd* [2010] EWHC 3152 Q.B was significant as it provided authority in lenders' favour that if the Court is satisfied that there was no breach of ICOB, then the same set of circumstances could not give rise to an unfair relationship under the CCA. Yesterday's decision potentially puts several issues back on the table as mis-selling now effectively encompasses a breach of principle and extends beyond a breach of ICOB.

**What Next?**

The BBA has issued a press release saying that all pending complaints should remain on hold until it has decided whether to seek permission to appeal. Both the FSA and FOS disagree and the BBA's stance directly contradicts previous FSA statements to the effect that PPI claims should continue to be processed despite these proceedings. So far as the FSA and FOS are concerned, yesterday's decision is "clear cut" and the pending complaints should be processed "promptly, efficiently and fairly". It is not hard to understand the BBA's nervousness about lifting the stay. As Ouseley J pointed out at paragraph 5 of the decision, the FOS upheld 89% of PPI complaints made to it in the year ending 31st March 2009. It would seem that irrespective of whether claims are pursued via FOS or through the Courts, yesterday's judgment will facilitate the initiation and continuation of thousands of complaints and claims.

**Lucy Walker**
**Ross Fentem**
**Guildhall Chambers**
**21 April 2011**