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Payment Protection Insurance ('PPI') Update; Insurance Coverage Issues – Pensions Mis-selling Revisited?

Publication Date: May 05, 2011

Background

The High Court has dismissed the British Bankers' Association's challenge to the FSA prescribed guidance on the proper investigation and complaints-handling process for the selling of Payment Protection Insurance. Unless it is overturned by the Court of Appeal, the court's decision, and the enforcement of the guidance, will have huge cost consequences for the banking community.

As the dust begins to settle on the latest controversy between the Regulator and its community, it seems clear that whilst the focus may be different, many lessons are to be learned from the recent past. If it is not exactly a case of "*pensions mis-selling all over again*", there are clear parallels.

History shows that the Financial Services Regulator is not afraid to apply a retrospective approach, particularly where it perceives there to have been generic or widespread mis-selling practices. In the mid-1990s, the SIB required pensions providers and financial advisers to conduct a prescribed internal investigation of past selling practices relating to transfers and opt outs from occupational pension schemes and the corresponding investment in private pension plans. In 1994, SIB ordered a review of past sales practices from 1988 onwards, but whilst requiring an assessment of previous practice (and to that extent, a retrospective investigation), it did not apply the benefit of hindsight. Rather, firms were required to assess sales practices by compliance standards and rules applying at the time.

More recently, the FSA's publication of its policy statement PS10/12 on the assessment and redress of PPI complaints, and an open letter identifying common Point of Sale failings of PPI products, produced a highly critical response from the regulated community and the matter will not be finally resolved until after the almost inevitable appeal of the High Court's decision. However, the FSA has made it clear that compliance starts now, irrespective of any appeal.

The Compliance Cost and Insurance Coverage

What is clear is that the requirement to carry out self assessment and internal investigation of past business and the need to make redress in accordance with the guidelines issued by the FSA will once again impose a huge financial burden. However, just as with the cost of the Pensions Mis-selling review, banks should have a legitimate expectation that their Errors and Omissions insurance protection will be available to meet a significant portion of this expense, subject, of course, to a review of policy limits and terms.

Previous experience has provided some valuable lessons to be learned and has already produced a significant volume of legal authority dealing with a range of issues concerning the scope of insurance coverage available for "*generic mis-selling*" practices.

Financial institutions should review carefully the terms and conditions of their available insurance and take advice from their brokers and coverage specialists. History suggests that underwriters will raise a significant number of issues, but many of them will have already been the subject of extensive analysis and interpretation by the courts. An insured can expect these issues to include:

- *Notification* - The FSA's spotlight on the selling practices relating to PPI is not new, although arguably, the rejection of the judicial review presents a development of or a different context within which insureds should consider the need to make further or clarifying notifications to their E&O insurers. Care should be taken to ensure that any prior notification is not prejudiced. The law relating to the proper and sufficient notification of claims and circumstances that may lead to future claims has recently been reviewed by the Court of Appeal, and underwriters can be expected to review very carefully this first stage in the claims process.
- *Has a "claim" been made?* - The FSA requires a self-review of past practices and evaluation of whether customers who purchased PPI are eligible for redress, regardless of whether or not a complaint has been made. This is a coverage issue that has already been considered by the Courts within the context of the pensions mis-selling context and, subject to a review of terms and conditions, an insured can expect that its E&O cover should respond when it is adhering to requirements imposed by the Regulator.
- *Which costs will be covered?* - The costs of an internal past practices investigation and the separate obligation to make redress payments where due, are likely to present a range of coverage issues. Cover should be available for an insured's response to regulatory investigations, and the fact that an obligation to make redress payments results from such an internal investigation, as opposed to an FOS award or court judgment, should not in itself

present an obstacle to recovery. However, the policy may provide for limits, deductibles and/or changes in the scope of coverage, which vary depending on which head of loss is being considered.

- *Aggregation of losses* - It is highly likely that any individual redress payment to a single customer will fall well within the policy deductibles. The pensions mis-selling context has produced a significant volume of authority on the approach towards the difficult question of how losses should be aggregated where they arise from a single cause. It is to be expected that underwriters will look very carefully at the approach taken towards aggregation, and a firm should be aware that its own conclusions of the reasons for and causes of any failings in the sales process might affect the aggregation analysis.
- *Consent* - E&O policies routinely contain a requirement that no admission of liability should be made without insurers' consent. The need to keep underwriters advised of steps being taken by the insured applies equally to an internal investigation as it would to formal court proceedings.

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