

## Is “Payment Protection Insurance” the new “Bank Charges”?

According to Datamonitor, in 2005 twenty-million payment protection policies were sold on the back of consumer credit agreements generating a total income for lenders of approximately £5.7 billion. However, following from the recent run of bank charge litigation attention has now been turned to challenging payment protection insurance (“PPI”) with surprisingly high levels of success. Earlier this year, Alliance and Leicester was fined a record £7 million after it was found to have been mis-selling PPI and this is just one of many cases where settlements have been reached or where insurance premiums have been ordered to be refunded. Consequently, it appears that there is the potential for a significant and increasing volume of challenges to PPI policies in the forthcoming months and years. This article attempts to set out the most common methods presently used by practitioners for challenging PPI policies and attempts to highlight the common mistakes made by lenders and brokers when selling PPI.

### Enforceability

When advising on any regulated consumer credit agreement, regardless of whether or not it contains an element of insurance the starting point is to consider whether or not the agreement is enforceable? To answer this question consideration needs to be given to section 60 of the Consumer Credit Act 1974 (“the 1974 Act”) along with the Consumer Credit (Agreement) Regulations 1983 SI 1983/1553 (“the 1983 Regulations”) which sets out in paragraph 2 and schedules 1 and 2 (Re regulated consumer credit agreements) and paragraph 3 and schedules 3 and 4 (Re regulated consumer hire agreements) what items need to be included within each separate type of regulated agreement. In the event that any of the items which are set out therein are not included in the agreement then it will be deemed improperly executed under section 61 of the 1974 Act and will be unenforceable without leave of the court (section 65 and 127 of the 1974 Act).

For agreements which were entered into prior to 6<sup>th</sup> April 2007<sup>1</sup> the court will only grant an enforcement order following a breach of section 60 & 61 and the regulations thereunder where the agreement contains all of the prescribed terms set out within schedule 6 to the 1983 Regulations. In relation to all agreements entered into after that date the court will grant an enforcement order unless it is unjust to do so having regard to any prejudice caused by the contravention of the regulations and taking account of the court's power to apply conditions to the granting of such order and/or its power to vary the agreement. Consequently, it is envisaged that the days of claiming that agreements are irredeemably unenforceable due to some minor irregularity are numbered.

#### Amount of Credit / Total Charge for Credit

There are two reasons why enforceability is so important in relation to PPI claims. The first is as a result of the distinction which is made in the 1974 Act between the amount of credit and the charge for credit (section 9(4)). The Consumer Credit (Total Charge for Credit) Regulations 1980 SI 1980/51 ("the 1980 Regulations") set out what items form part of the charge for credit (and by inference what items cannot form part of the amount of credit). Paragraph 4 states (amongst other things) that a premium under a contract of insurance which is payable as a condition of making the agreement is to be treated as part of the charge for credit and paragraph 5 states that any other insurance (i.e. optional insurance) is to form part of the amount of credit.

Consequently, where (which appears frequently to be the case) a borrower was told at the time of taking out a loan that the taking of PPI was a condition of the loan or that the loan would not be granted without the inclusion of the PPI, then the PPI would be classed as mandatory insurance under paragraph 4 of the 1980 regulations and should form part of the charge for credit. If in such circumstances the PPI was included in the amount of credit rather than the charge for credit then the agreement will fail to comply with the 1983 Regulations and will be unenforceable and in the case of agreements entered into prior to 6<sup>th</sup> April 2007, as the amount of credit is a prescribed term, the agreement will be irredeemably unenforceable.

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<sup>1</sup> Consumer Credit Act 2006 s.15 & schedule 3 para 11; Consumer Credit Act 2006 (Commencement No. 2 and Transitional Provisions and Savings) Order 2007

The second consideration in relation to the enforceability of regulated agreements in relation to PPI claims flows from section 18 of the 1974 Act which applies to multiple agreements and provides that, where an agreement is a multiple agreement, each separate part shall be treated as a separate agreement and by inference shall comply separately with the provisions of section 60 and 61 of the 1974 Act and with the 1983 Regulations. Multiple agreements are defined at section 18(1) as agreements where part of it is placed in one category of agreements mentioned within the act (i.e. hire purchase agreement) and another part of it within a different category of agreements so mentioned (i.e. fixed sum credit agreement).

The majority of PPI policies within regulated agreements are caught by section 18 in that usually the amount of credit is either a fixed sum unrestricted use credit agreement but the PPI will be a restricted use credit agreement, or as is usually the case, where the policy is provided by a third party the PPI will constitute a restricted use debtor-creditor-supplier agreement. Consequently, the provisions under the 1983 Regulations need to be met in relation to both separate types of agreements and if they are not i.e. the lender has failed to include all items required in a debtor-creditor-supplier agreement then that part of the agreement to which the default relates will be deemed unenforceable under section 65. As an aside, this provision is of significant use in relation to pre-April 07 agreements where the amount of credit is taken over the £25,000 limit by virtue of the PPI and is therefore not a regulated agreement. By being able to separate the agreement into two distinct parts it can be argued that the agreement constitutes two separate regulated agreements rather than one unregulated agreement.

As stated above, the effect of challenging the enforceability of an agreement is becoming more limited and the court is likely under section 127 (as amended) to grant an enforcement order unless it can be demonstrated that the borrower will suffer significant prejudice by such an order and that such prejudice is incapable of remedy by virtue of any condition imposed thereon or variation of the agreement. Further, any challenge to the enforceability of a regulated agreement will not assist anyone who has paid off the sums due under the agreement in full or where there is only a small

amount outstanding as the fact that an agreement is unenforceable will not give the borrower the right to reclaim any sums already paid.

### Extortionate Credit Bargain / Unfair Relationship

In order to circumvent the difficulties where an agreement has been paid in full, one method, where the cost of the PPI is high in comparison to the original loan, is to rely on the extortionate credit provisions (sections 137 to 140 of the 1974 Act) in relation to agreements that were paid off prior to 6<sup>th</sup> April 2008<sup>2</sup> or the unfair relationship provisions (section 140A to 140D of the 1974 Act) in relation to agreements that were either entered into after 6<sup>th</sup> April 2007 or were still live after 6<sup>th</sup> April 2008<sup>3</sup>. The argument is thus: where the PPI had wrongly been included in the amount of credit rather than the charge for credit the agreement would have been unenforceable. However, had the PPI been correctly included in the charge for credit this would have had a profound effect on the APR which would be likely to render the agreement unfair or extortionate under the above mentioned provisions which would in turn have enabled the court to re-open the agreement and order the re-payment of any sums overpaid. Consequently, it could be argued that a lender should not be able to profit by its error in erroneously completing the agreement to its advantage. Although the principles of this argument seem sound there does not appear to be any reported case where it has been run.

Further, it is argued that the new unfair relationship provisions are far wider than the original extortionate credit bargain provisions and extend to allowing a borrower to challenge items which form part of the amount of credit, i.e. where pressure was applied to the borrower at the time of execution of the agreement, making him agree to purchase a policy which is significantly overpriced when compared to other products on the market. Although there is merit in this argument, the effect of it would appear to be contrary to the common law principle that it is not for a court to intervene where a party has simply made a bad bargain. Such effect was unlikely to have been the intention of the draftsmen and so care should be taken when considering advancing such arguments.

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<sup>2</sup> Consumer Credit Act 2006, schedule 3 paragraph 15

<sup>3</sup> Consumer Credit Act 2006, schedule 3 paragraph 14

### Misrepresentation / Undue Influence / Duress

In many cases lenders or brokers of an agreement do not state that PPI is mandatory and so do not invoke the provisions in relation to enforceability. However, there are various reports of borrowers being put under pressure to sign up to a PPI policy which they would not otherwise want and which may not provide them with any cover in any event. Such pressure includes representations by lenders that taking the PPI would increase the chances of the loan being approved and that it may be that without such insurance the application would fail on a credit check. Depending on the circumstances of the individual borrows, the knowledge of such circumstances held by the lender / broker and the exact nature of the pressure applied, such pressure may form the basis of an action in duress or undue influence. Alternatively, if the representations were false then a borrower may be able to found a claim for misrepresentation. Again, care should be taken in pleading misrepresentation as it may be in fact that however undesirable the pressure, the representation may be found to be true, i.e. the existence of PPI may in fact increase the prospects of obtaining approval of the loan (although it's absence may not be fatal).

### FSA Regulations

By virtue of section 150 of the Financial Services and Markets Act 2000 an individual can sue an Authorised Person as therein described for breach of statutory duty where the said authorised person has failed to comply with the rule and regulations as contained within the Financial Services Handbook ("the Handbook").

The Handbook sets out a variety of rules which must be applied and in particular the ICOBS section sets out provisions which must be applied by people selling insurance related products. The Handbook includes (amongst other things) rules that a lender / broker should: (a) ensure that the product is suitable for the needs of the borrower (ICOBS 5); (b) ensure that the borrower is treated fairly (principle 6); and (c) communicate with the borrower in a clear and fair way (ICOBS 2.2.2). Where a policy will provide no benefit for a borrower, i.e. because that borrower is self-employed etc. or where no investigation was made in to the needs or demands of the

borrower then it is likely that the lender will be in breach of its statutory duty and will be liable in damages to the borrower. Such damages are likely to be assessed as the value of the policy plus any interest which has been or will be charged thereon although an deduction may be made representing the true value of the policy to the borrower. It should be noted that a successful claim for damages founded on breach of statutory duty will not render the agreement unenforceable and so the sums due and payable thereunder will still need to be repaid.

### Brokers

Finally a word needs to be said about brokers. Where a broker arranges the loan between the lender and the borrower and also sells the borrower PPI, it is arguable, depending on the circumstances that the borrower owes a fiduciary duty to the borrower. If so, then selling a PPI policy for which the cost is grossly in excess of other products available on the market or selling a product which would be highly unlikely to cover the borrower or only cover him for a limited time may amount to a breach of the fiduciary duty rendering the broker liable to the borrower in damages. Breach of fiduciary duty may also be invoked in the case of a section 18 multiple agreement where the loan is arranged directly with the lender but where the PPI is to be provided by a third party, the lender acting as broker for the purpose of the PPI.

This article is intended only as a starting point to highlight the main areas where PPI is being challenged and is not a definitive list of avenues open to a disgruntled borrower. Depending on the circumstances there may be many more ways in which PPI can be challenged which ultimately is going to lead to another large headache for major banks and lenders.

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