Guidance Note on Payment Protection Insurance Mis-Selling Claims

1. Background

1.1 Payment protection insurance ('PPI') is intended to cover a borrower's unexpected loss of income as a result of redundancy, accident, illness or some other specified event, and a consequent inability to pay loan, mortgage, credit card or other credit repayments. It was sold by many financial institutions as part of a lending package or a credit card deal. It transpires that many of these policies were mis-sold. The Financial Services Authority explains in its guidance to consumers 'How to claim for mis-sold PPI'[1] that the mis-selling arose for a range of reasons including:

- the debtor was pressured into taking out PPI;
- it was not made clear that PPI was optional;
- the debtor was advised to take out PPI but it was not suitable;
- the policy was added to the debtor's loan without their knowledge;

1.2 The purpose of this paper is to provide office holders who are dealing with Individual Voluntary Arrangements (IVAs) or bankruptcy cases guidance about the issues that may arise when the debtor may have been mis-sold PPI.

1.3 This guidance does not constitute legal advice nor does it seek to instruct or direct IPs in the administration of their insolvency cases. The bodies issuing this guide do not accept any liability in respect of actions that IPs may take in accordance with it, as it must be for each IP to be satisfied that his/her conduct meets the legal and professional requirements placed upon office-holders. However, notwithstanding the above, IPs should have regard to the regulatory as well as legal consequences of their actions.

1.4 This guidance is issued jointly by:

- Association of Business Recovery Professionals (R3)
- Insolvency Practitioners Association
- The Institute of Chartered Accountants in England & Wales
- The Association of Chartered Certified Accountants
- RPBs
- The Institute of Chartered Accountants of Scotland
- Chartered Accountants Ireland
- The Law Society
- The Debt Resolution Forum.

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

2. Asset at Commencement of Insolvency or a windfall?

Bankruptcy

2.1 Where a PPI policy has been sold to a bankrupt prior to the date of the bankruptcy the mis-selling claim vests in the trustee in bankruptcy[2] because the mis-selling took place prior to bankruptcy. Discharge makes no difference.

Individual Voluntary Arrangements

2.2 In broad terms there are two main types of IVA proposal:

1. "All asset" IVAs which state that all the debtor's assets are subject to the IVA terms except those specifically excluded in accordance with rule 5.3(2)(a)(iii) Insolvency Rules 1986. An IVA governed by R3 Standard Conditions, or Protocol Standard Conditions with an "all assets clause", are examples of such cases. Where such terms apply a mis-selling claim is an asset of the IVA estate.

2. "Defined asset" IVAs, which as the name suggests, specify the assets to be included within the IVA. Unless the IVA terms specify that the PPI mis-selling claims form part of the IVA estate they are not included as an asset (but see 2.5 and 2.6 below). An IVA governed by Protocol Standard Conditions may be an example of such a case.

2.3 In IVAs it is vital that supervisors check the terms of the proposal in each and every case before instituting PPI misselling claims or demanding the proceeds of such claims.

2.4 It has been argued by some that the proceeds of such claims would be available as 'after acquired assets' (sometimes referred to as 'windfalls'). The terms of the 'after acquired assets' clause in the R3 and Protocol Standard Conditions however, refer to assets that are acquired during the course of the arrangement. It would be difficult to argue that PPI misselling claims existing prior to the commencement of the IVA fall into this category.

2.5 Where the proceeds of a PPI mis-selling claim are not caught by the terms of the IVA as an asset they might be captured by clauses dealing with additional income in the hands of the debtor. This will depend upon the precise terms of the IVA proposal. There is nothing to stop the debtor who is entitled to

receive the proceeds choosing to utilise those funds as contributions to the IVA or in early settlement of the IVA, although office holders should take care when negotiating such settlements not to make inappropriate or misleading demands.

2.6 Where the IVA is subject neither to R3 Standard Conditions nor Protocol Standard Conditions, or those conditions are modified, the supervisor must be guided by the terms set out in that particular proposal. If there is any doubt about their effect the supervisor may consider it appropriate to take legal advice.

2.7 In the (rare) event that the mis-selling took place after the commencement of the insolvency but before discharge of the bankrupt or the conclusion of the voluntary arrangement and a payment is made to the debtor, it is likely that after acquired asset provisions would apply.

3. SetOff

3.1 In some cases the lenders who agree to pay compensation seek to apply set-off. Where this happens it is for the office holder to take such steps as he or she deems appropriate to ascertain whether set-off should apply.

3.2 Set off depends upon there being mutuality of dealings. This can be a complex area of law and depends, amongst other things, upon:

- the nature of both the original debt and the mis-sold PPI proceeds;
- the identity of the parties (which might be complicated where the missold
- PPI product and the loan/advance have been provided by
- different companies within or without the lenders' group structures,
- particularly given the prevalence of insolvency debt sales resulting in
- the identity of the debt owner having changed from that of the PPI
- mis-selling party);
- in the case of an IVA, the terms of the IVA.

Office holders may consider it appropriate to seek legal advice when in doubt about whether set off should apply.

3.3 Where the office holder concludes that there have been mutual dealings prior to the commencement of the insolvency process he or she must apply set-off in a bankruptcy or an IVA where R3 Standard Conditions apply (the set-off rules are in similar terms to that used in bankruptcy3) unless the

supervisor is satisfied that the creditor has waived set-off to the benefit of the other creditors.

3.4 Where Protocol Standard Conditions apply clause 17(6) is open to interpretation - possible interpretations (without these examples being intended as definitive or exhaustive or indicative of the correct interpretation of the provision) include:

- a provision for contractual set off (albeit with less precision than
- the mandatory set-off provisions in section 323 of the Insolvency
- Act 1986 and in clause 79 of the R3 Standard Conditions)
- any set-off is conditional on a creditor agreeing to make a
- repayment (with the creditor apparently being entitled to
- withhold such repayment)
- there is a conflict between the operation of set-off and the
- reference in clause 17(6) to any surplus “after the application of
- set-off” being treated as an after-acquired asset
- a creditor is to be taken to agree to make repayment where it is
- legally obliged to make such a payment
- payment of compensation and contractual interest for PPI misselling
- constitutes a "repayment" within the meaning of Clause
- 17(6), whilst statutory interest thereon does not
- neither compensation nor interest thereon constitute a "repayment" within the meaning of Clause 17(6) because neither compensation nor interest thereon is in the nature of "repayment" Consequently, pending such clarification by the Court, office-holders may wish to consider taking legal advice where they feel it would be proportionate to do so, and in any event fully document their decision making processes.

3.5 Strictly to waive set-off would require a variation to the IVA proposal, but in practice this may be unnecessary as it is difficult to imagine any grounds for any other party to raise an objection. Any agreement of this sort should be referred to in the next report to creditors.

3.6 Where neither R3 nor Protocol Standard Conditions are applicable office holders should carefully consider the terms of the proposal taking legal advice if necessary.

3.7 Where set-off is applicable the office holder will need to consider the effect on creditor claim values and upon past and future distributions taking account of the sums involved and the costs of any corrective action. Where there is

certainty about the amounts to be set-off, both R3 and Protocol Standard Conditions give the supervisor general powers which in the view of the RPBs, allows creditor claims to be adjusted to take account of set-off without the need for the creditor to issue a revised claim4.

3.8 Wherever possible, dividends to other creditors should not be withheld pending determination of set-off issues, unless there are reasonable grounds for doing so.

4. Power and Obligation to make PPI misselling claims

Open Cases

4.1 An office holder has a duty to realise the assets of an estate to which he or she has been appointed. This duty is tempered, amongst other reasons, by:

- the extent to which the costs of realisation are likely to absorb the
- proceeds; and
- the availability of funds to pursue a claim. Office holders should be aware however, that some claims companies are prepared to operate on a "no win no fees" basis albeit a "win" for this purpose might constitute a settlement resulting in a set off and reduction in the creditor's claim rather than a cash realisation. An office holder does not have an obligation to pursue a PPI mis-selling claim if there would be no substantial benefit to the estate after accounting for likely costs, but he/she does have an obligation to consider whether or not any potential claims exist and the likely costs of pursing them Depending on what agreement he has made with the Supervisor and whether he holds the PPI claim on trust costs properly incurred by the debtor in connection with a PPI mis-selling claim may well be subject to an indemnity from the estate.

4.2 If at all possible IVAs should not be kept open beyond the planned duration. Where R3 or Protocol Standard Conditions apply the supervisor's powers survive the concluding formalities of the IVA.[5] It follows that where the debtor has provided all the information necessary to pursue a PPI mis-selling claim, the office holder is satisfied that due provision has been made for his fees (see 4.4) and it has been agreed by both the debtor and the financial institution involved that any proceeds of a claim should be paid to the supervisor or the supervisor has secured payment in some other way (e.g. by taking an assignment of the claim), there is no need to delay issuing the

Completion Certificate. Office holders are reminded that any funds received after the Completion Certificate has been issued should be held on a designated client account pending distribution, in accordance with the relevant RPB's Client Money Regulations.

4.3 The formalities of closing an IVA include issuing a Completion Certificate, notifying the Secretary of State, notifying creditors and releasing the practitioner's bond (and such other actions as the proposal may require).

4.4 R3 Standard Conditions provide for the supervisor to charge fees when acting as a trustee. There is no such provision where Protocol Standard conditions apply. Where no provision is made for fees supervisors will either need to seek a variation to the proposal prior to closure of the case, or reach some agreement with individual creditors or the Court, to charge a post-closure fee to those creditors. [See part 8 below for further guidance on recovering fees and costs]

4.5 When seeking variations with a view to facilitating case closure, it is important to ensure that the debtor's agreement is evidenced in writing in each case, and major creditors and/or their representatives are consulted. Variations might cover some or all of the following points:

- powers of the practitioner (the former office holder) in any continuing
- trust;
- on-going co-operation of the debtor;
- provision for fees and costs
- handling of funds (applying Client Money Regulations and Guidance as appropriate);
- treatment of interest & payment of tax thereon;
- treatment of creditors' claims;
- timing of post-completion distributions;
- post-completion reporting

5. Power and Obligation to make PPI misselling claims Closed Cases

5.1 A former supervisor in an IVA does not have a duty to seek out PPI misselling claims in closed cases although, depending on the terms of the IVA, he/she may have the power do so. Where he/she becomes aware of such a claim (e.g. a lending institution requests clearance to pay a sum in compensation to the debtor) and it is one that is commercially viable for the office holder to pursue, then the former supervisor should consider whether the

terms of the IVA are such that the compensation is a trust asset which should be claimed by him/her acting as trustee for the benefit of the IVA creditors.

5.2 A former trustee in bankruptcy has no duty or power to seek out PPI misselling claims. If he/she becomes aware of such a claim he/she should refer the matter to the Official Receiver.

6 Power and Obligation to make PPI misselling claims New Cases

6.1 Debtors should be asked at an early stage about possible claims in connection with PPI mis-selling and appropriate enquiries made. A questionnaire suitable for completion by the debtor is available from the Financial Ombudsman Service.[6]

6.2 IVA proposals or Nominees' reports should explain how potential PPI mis-selling claims are to be dealt with.

7 Taxation

7.1 Compensation for mis-sold PPI usually but not necessarily, comprises a repayment of the premiums, contractual interest thereon, statutory interest and sometimes costs. Any statutory interest is subject to tax at the debtor's marginal rate applicable at the date of receipt of the compensation. This liability to tax is the debtor's but on the principle that the debtor should not be out of pocket, office holders should discharge out of the proceeds of realisation[7] or indemnify the debtor against such liability, if it has not already been deducted by the payor8. Office holders should also notify the debtor of the amounts of interest received and any tax paid directly to HM Revenue & Customs.

7.2 In most cases the marginal tax rate will not be known as it depends upon the debtor's overall taxable income in the relevant fiscal year. In order to make provision for the tax liability arising on the statutory interest it is an acceptable (though not required) practice that tax, if not already deducted, is deducted by the IP and paid to HM Revenue & Customs at the basic rate (currently 20%). The debtor should also be notified of the payment and be asked to inform the supervisor if they are higher rate taxpayers within a specified time period. Where deemed necessary by the office holder, a sum representing any additional higher rate tax can be held pending confirmation of the debtor's marginal rate for the relevant tax year.

7.3 We have not been able to agree a simplified position with HMRC centrally on the practicalities of resolving the tax position. However, office holders may apply to their local inspector for a Unique Tax Reference to use when paying any tax deducted in these circumstances. Payments should be accompanied by a schedule setting out the details of the taxpayers involved.

8 Office holders' Fees and Costs

8.1 In bankruptcy the trustee's ability to charge fees and recover costs will depend upon a creditors' resolution, the provisions of the Act and Rules and SIP 9.

8.2 In IVAs, provision for the supervisor to charge fees and recover costs will be set out in the proposal. In some instances the provision may be inadequate. This may be capable of being remedied by a variation to the proposal (see 4.4).

8.3 In IVA cases where there is no provision for fees to be drawn after the closure of the case, supervisors might reach agreement with individual creditors to charge a fee and recover costs after closure. However, in such cases, only those creditors who have agreed to this should suffer a deduction. A further option is to consider an application to Court.

8.4 Where the basis of the office holders remuneration has been fixed as a percentage of realisations, it is the RPB's view that these fees can only be properly charged on actual receipts into the estate, net of any deductions for set-off. However, it is open to creditors to agree otherwise where they consider there to be a benefit to the estate.

8.5 Some creditor representatives have indicated that modifications introducing caps on total fees and costs may be waived, with their consent, where fees on realisations into the estate at the approved rate would otherwise be limited.

8.6 Where office holders seek to recover the cost of obtaining generic legal advice applicable to a portfolio of their cases, the RPBs would expect office holders to seek creditor consent.

9 Claims Companies

9.1 It is for the office holder to determine whether or not it is appropriate to instruct a claims company to pursue potential PPI mis-selling claims, which fall

within the arrangement. Any reasonable cost arising should not be borne by the debtor but should be treated as an expense of the realisation.

9.2 Where a claims company is instructed it is important that the office holder is satisfied that the procedures adopted result in the debtor being treated in a fair and reasonable manner.

9.3 Where the office holder receives commission for the introduction of a debtor to a PPI mis-selling claims company this should be disclosed and treated as an asset of the estate in accordance with the Code of Ethics for Insolvency Practitioners.

10. Limitation

10.1 Office holders should be aware that it has been argued that claims may be the subject to the effects of the Limitation Act 1980. Arguably at the time of the alleged mi-selling the debtor had all the information to make an informed decision and therefore time runs from that date. It is understood however, that any claim for compensation through the Financial Services Ombudsman is not subject to limitation. If office holders discover that limitation may be an issue it is recommended that they seek legal advice.

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ENDNOTES

1 http://www.fsa.gov.uk/consumerinformation/product_news/insurance/payment_protection_insurance_/claim-back-ppi

2 http://www.bis.gov.uk/insolvency/news/news-stories/2012/Apr/PPI-mis-selling-claims-andbankruptcy

3 S.323 Insolvency Act 1986 and Paragraph 7 R3 Standard Conditions

4 R3 Standard Conditions clause 13(1)(9) and Protocol Standard Conditions 10(4)

5 R3 Standard Conditions clause 14(1) and Protocol Standard Conditions 10(6)

6 http://financial-ombudsman.org.uk/publications/technical_notes/ppi.html

7 R3 Standard Conditions clause 30 and Protocol Standard Conditions clause 27

8 Under section 874 of the Income Tax Act 2007 where a bank or building society makes the payment they are exempt from the duty to deduct basic rate tax at source.

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