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ICOBS and Payment protection insurance

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What is ICOBS

The first question to answer is what exactly is ICOBS? There are probably a number of lawyers who are not quite sure because ICOBS was not around when they first looked at an insurance law text book, because ICOBS does not usually feature in commercial insurance disputes and because it is rarely mentioned in case reports. And how many practitioners have read it from cover to cover?

ICOBS stands for "Insurance: Code of Business Sourcebook." It sets out the non-investment insurance conduct of business requirements which were introduced by the Financial Services Authority ("FSA"). It contains the requirements for marketing, sales, product literature and claims handling for non-investment business. It applies to general insurance contracts such as motor, travel and household insurance and also to pure protection contracts such as critical illness and income protection. It does not apply to long-term care insurance, which is subject instead to the FSA's investment business rules, or to reinsurance. It took effect from 6 January 2008 when it superseded its predecessor, ICOB, (short for "Insurance Conduct of Business") which itself first came into effect on 14 January 2005 following an overhaul by the FSA of the Association of British Insurers ("ABI") and the General Insurance Standards Council ("GISC") codes. The text of ICOBS and ICOB can be found online in the FSA Handbook.[1]

Is ICOBS part of the law?

Technically, ICOBS is not part of the law but sits side by side with it, separately. Some of ICOBS is labelled as rules and other parts as guidance. It sets out good practice with which sales of insurance products and handling of insurance claims should conform and against which the Financial Ombudsman Service ("FOS") and the FSA measure the performance of the insurer or intermediary in question.

The FOS is obliged by s 228 (2) Financial Services and Markets Act 2000 ("FSMA") and its own rules of conduct contained within its Dispute Resolution Sourcebook ("DISP")[2], to make decisions which are fair and reasonable in all the circumstances of the case. This overrides its obligation to decide cases within the law. DISP 3.6.4R specifies that at every decision it must consider not only relevant (a) law and regulations, but also (b) regulators' rules, guidance and standards, (c) codes of practice and (d) where appropriate, what the FOS considers to have been good industry practice at the relevant time. It is telling that DISP 3.6.4R effectively sets out law as being separate to ICOBS. For it impliedly acknowledges that the two might not be the same. ICOBS 8.1.2R is a prime example of where the code is very different to the law.

ICOBS 8.1.2R says, in summary, that it would be considered unreasonable for a consumer's[3] claim to be rejected if there had been an innocent non-disclosure of a material fact, or if a breach of warranty did not cause the loss in question. In contrast, the law would allow avoidance of a policy if there had been any type of material non-disclosure with inducement, or whether or not a breach of a warranty caused the loss. So a consumer's fire claim should be paid under ICOBS even if he was in breach of his burglar alarm warranty, but not according to the strict law. In certain circumstances the FOS may treat a small business as if it were a consumer so as to require a causal connection between its breach of policy and the loss[4].

If ICOBS were part of the law, the FOS would not need to consider the law separately under DISP 3.6.4R and ICOBS would not need to make extra protective provisions for consumers.

ICOBS and its predecessors were not intended to be law. They were meant as self-regulating measures, firstly as part of the deal to exempt insurance contracts from the Unfair Contract Terms Act 1977, and then instead of the primary legislation that was threatened following the Law Commission's 1980 report. It is partly because the Law Commissions do not consider that these measures are sufficient to protect policyholders, particularly consumers, that they submitted a draft Consumer Insurance (Disclosure and Representations) Bill on 15 December 2009. More bills are proposed. The Law Commissions want the law to fall in line with the standards of ICOBS and the policies of the FOS which have become general, but not universal, insurance practice.

The courts are not required to take account of these codes, unless and to the extent that they may set out a custom or perhaps arguably, an implied term. There are very few reported insurance cases which even mention them. The judge in *Lewis* v *Norwich Union Healthcare Ltd*[5] specifically found that the ABI's Statement of Long-Term Insurance Practice ("SLIP") was not incorporated into the policy and was not legally binding. It is of note that the Law Commissions have specifically refrained from requiring courts to take account of any industry guidance, including ICOBS, in the draft consumer insurance bill. At paras. 4.55 and 10.42 of their Final Report dated 15 December 2009, they explain that they did not wish to give the ABI or any other industry bodies the power to bind non-members.

Is ICOBS becoming part of the common law?

Whilst there may be a clear technical division between ICOBS and law, some very recent cases show that the courts are finally beginning to consider ICOBS and may be dragging parts of it into the common law.

Firstly, the courts seem to be suggesting that ICOBS sets out the duties of an intermediary. In *Jones* v *Environcom (No 2)*[6] Mr. Justice David Steel preferred to rely on ICOBS rather than set out copious case law to establish the duties of a broker to ensure that the policy is appropriate for the client's needs and to warn the assured of his duty of disclosure.

Rather than say that ICOBS was part of the law, he seems to be saying that it could be used as a shorthand to express the law when it set out the duties of an intermediary.

In *William McIlroy Swindon Ltd and Rannoch Investments Ltd*[7] v *Quinn Insurance Ltd* Mr. Justice Edwards-Stuart went further. He commented that if there was no specific guidance in ICOB (which applied at the time of the case rather than ICOBS) which would put the insurer under a duty to do something - in this case alert the assured about the time bar in its arbitration clause - then the court would not find that there was a duty. In *Harrison* v *Black Horse Ltd*[8] Mr. Justice Waksman held that the duties of an intermediary giving advice in respect of a single product were set out in so much detail in ICOB that the general law of tort did not impose any further and coterminous duties of care. It can probably be assumed in both cases that the same comments would apply to ICOBS. It is suggested here that the judges in these two cases did not intend to imply that ICOB or ICOBS were included in the common law, but more that they reflected the tortious duties owed by an intermediary and/or an insurer. It is unclear whether their conclusions may be limited to the circumstances of the cases they were deciding.

Whatever the judges intended, they required a breach of ICOB to have caused or contributed to a loss before it would affect the cover. This reflects the position of breaching a tortious duty: to be actionable it requires loss. So in *William McIlroy Swindon*, the judge found that the assured was out of time for bringing an arbitration against the insurer under the policy, but that this was not caused by any breach of ICOB. Firstly, he found that there was no provision in ICOB which required such a clause to be alerted, and especially not to a non-consumer. Secondly, he found that in any case, the loss in the assured not realising the existence and terms of the arbitration was caused by the assured and/or its broker failing to read the policy that they had had for the previous 4 years. It was unrelated to any other breaches of ICOB which might have occurred, such as the insurer failing to make a prompt decision on declinature or relying for a while partly on one unsustainable reason for rejecting the claim.

Similarly in *Harrison,* a case about the alleged unsuitability of a payment protection insurance ("PPI"), the court found that the intermediary had breached ICOB 4.3 2R because the bank had not established that the five year term offered was the desired or sufficient length of the policy. But the judge also concluded that this breach did not cause any loss and so did not affect the claim, because there was no evidence that the claimants who knew of the term would have acted any differently had ICOB not been breached.

Construction of ICOBS by the courts

Whilst the courts are using ICOBS to help define the duties that an insurer or intermediary owes to an insured, they are also beginning to construe parts of the code. Although this may be useful in helping to determine the meaning and extent of a rule, there is a danger that the courts will construe the codes as they would a statute, looking

carefully and strictly at the language. ICOBS rules were not written as a statute, especially in an era where regulation is meant to be veering away from rules and regulators are instead meant to be applying principles. As Gen 2.2.[9] of the FSA Handbook says, every provision in the Handbook must be interpreted in the light of its purpose, and its purpose is to be gathered first and foremost from the text of the provision in question and its context amongst other relevant provisions, with the guidance in the Handbook intended to assist the reader in assessing the purpose of the provision, but not to be taken as a complete or definitive explanation. It is unlikely that the FOS would take a legalistic approach to the interpretation of the codes and there may eventually be a situation where the FOS interprets a code one way and the courts another. There is no mechanism to draw the two together, because they were set up to be separate.

For instance, in *Harrison* the judge construed quite narrowly ICOB 4.3.6R(2) - (the ICOBS equivalent is 5.3.2G[10]) to mean that an intermediary did not have to consider whether the policy was expensive or not, unless the customers volunteered information which showed that it was relevant to their demands and needs, perhaps by volunteering that they were on a budget. That the court concluded that an intermediary is not meant to ask whether the cost of the product is a factor of importance to a prospective customer is perhaps a strange conclusion. The judge continued that even if there had been a duty to consider the product's cost so that ICOB 4.3.6R(2) was engaged, the only duty was to compare it under ICOB 4.3.7G(1) with other contracts on which it could provide advice.[11] In this case, the intermediary was tied to a particular bank and was offering a single product, so there were no other contracts on which it could provide advice. It was therefore not obliged to do a comparative exercise with other products on the market and there was nothing in the rules which required it to consider whether the PPI was unsuitable on non-comparative costs grounds. The figures of the product were made very clear to the Claimants before they purchased it, and in these circumstances, that was enough.

In *William McIlroy Swindon* the judge found that his conclusions about the insurer not having a duty to alert an arbitration clause and its time limit, at least to a non-consumer, were not affected by ICOB 7.3.5R, which was a provision obliging an insurer to give the customer reasonable guidance to help him make a claim, the equivalent of which is ICOBS 8.1.1(2) R (see below). He said firstly, that this obligation did not apply where the insurer had rightly or wrongly rejected a claim, and secondly even if it did apply, giving the customer guidance to help him make a claim under the policy did not include alerting the assured to a time limit for bringing an arbitration under a policy's arbitration clause in case of dispute with the insurer.

Implied terms

If ICOBS is technically not part of the law and is only seeping slowly, if at all, into the common law in places where it is considered to set out the tortious duties of an

intermediary, the next question is whether the duties and obligations it sets out can be viewed as implied terms in contract to most insurance policies.

For instance, ICOBS 8.1.1R obliges a insurers to treat its policyholders fairly:

"An insurer must:

(1) handle claims promptly and fairly;

(2) provide reasonable guidance to help a policyholder make a claim and appropriate information on its progress;

(3) not unreasonably reject a claim (including by terminating or avoiding a policy); and

(4) settle claims promptly once settlement terms are agreed."

It is arguable that these terms at least are implied into all insurance contracts. Given the *Jones* v *Environcom* ruling referred to above which would not view SLIP as incorporated, the argument might be either a stroke of genius or an uphill struggle depending on how the courts received it in the ICOBS context. It is not clear that the argument would work with all parts of ICOBS, but where it could be used, the effect might be far-reaching. An obligation to handle claims promptly and fairly could, for instance, be interpreted to mean that damages for unfair delays in paying a claim should be given in addition to or instead of interest, such as in the infamous *Sprung*[12] situation where late payment meant that the business folded.

s 150 FSMA

Another question which arises is whether the law provides for breaches of ICOBS to be actionable, and if so, whether that brings ICOBS into the law as a code which is required by law to be obeyed. s 150 FSMA 2000 provides as follows:

" (1) A contravention by an authorised person of a rule is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

(2) If rules so provide, subsection (1) does not apply to contravention of a specified provision of those rules.

(3) In prescribed cases, a contravention of a rule which would be actionable at the suit of a private person is actionable at the suit of a person who is not a private person, subject to the defences and other incidents applying to actions for breach of statutory duty.

(4) In subsections (1) and (3) "rule" does not include—

(a) [Part 6 rules]; or

(b) a rule requiring an authorised person to have or maintain financial resources.

(5) "Private person" has such meaning as may be prescribed."

s 150 FSMA 2000 is therefore a tool for private persons who suffer a loss as a result of a breach of a rule, including ICOBS. But it is under-used: the author has found no reported case where it has been referred to and unsurprisingly, it is not mentioned by the FOS. It is also not clear whether the words "loss suffered" require a quantified judgment against the assured in accordance with the law which was harsher than the treatment an assured could have expected under ICOB/S if the rule had not been breached. Or would it suffice for the assured to argue that his loss under s 150 was the refusal of the insurer to pay the claim it should have under ICOBS, with the amount to be quantified in the same action?

Courts tend to deal with ICOBS sorts of issues through the established laws of tort, contract, misrepresentation or the Consumer Credit Act 1974 rather than as a breach of ICOBS rules. Actions under s 150 can only be brought by private persons. Even if the definition of a private person is wider than that of an ICOBS consumer[13], and even if most complainants about a breach of ICOBS would be private persons in practice, there are still categories of claimants who would not be able to use this section, notably companies. As such, it provides a limited statutory redress in case of breach of ICOBS so it cannot be said that it brings ICOBS generally into the law. If ICOBS were part of the law through this section, then it would be possible to action all breaches, not just those brought by private persons. Where a particular rule in ICOBS applies to all types of customers, not just private persons, it would be strange if s 150 could bring the same rule into the law in the context of a consumer, but not in the context of a business.

The FSA

It was originally intended that breaches of ICOBS would be dealt with by the FSA, as industry regulator. It remains the only body which can deal with breaches of ICOB/S whether or not there has been a loss. This confirms ICOBS as part of the regulatory system, not the legal system, at least technically. It was never intended that the regulatory system would be part of the law, and Parliament chose to keep the functions of the FSA and the FOS separate from the courts and from each other. ICOBS rules are no more law than the FSA's Principles also to be found in its Handbook.

But it has been suggested that the FSA does not have a brilliant track record in dealing with serious industry-wide problems where ICOBS (or other FSA codes appropriate to the industry in question) is being breached[14]. The FOS has had more of an impact in filling the vacuum and policing the codes case by case, which is not its function. The recent PPI debacle is a case in point where there have been widespread breaches of ICOBS in the selling of these policies, with the customers' demands and needs not being established and unsuitable policies being supplied. Some cases also involve misrepresentations or misunderstandings as to whether or not a policy is compulsory with the loan in question and non-disclosure of the amount of commission received by the brokers.

Although it may be said that the FSA was not effective at stemming the source of the PPI sales problem at the outset, it has now taken some substantial steps following the FOS wider implication referral in July 2008. From 29 May 2009, the FSA banned the sale of single premium payment protection insurance sold alongside unsecured loans which were the cause of most of the complaints that the FOS was seeing.[15] The FSA has also published two consultation papers[16] in response to the FOS referral resulting in Policy Statement 10/12[17] with an Open Letter attached at Appendix 4 (which sets out a non-exhaustive list of "Common Failings,") a clarification of that letter[18] and a new DISP 1.4.6G and a new DISP Appendix 3 which regulate how the FOS should function in this respect. This was followed by another letter[19] to all firms selling non-investment insurance protection products, setting out ICOBS sales requirements, and telling the firms to review within six months their PPI sales procedure to ensure that it complies with ICOBS. The FSA has also punished various large companies for breaches of ICOBS on a massive scale, imposing huge fines and requiring them to pay compensation and undo some PPI arrangements and conduct comprehensive customer contact programmes to investigate whether there are others which should be undone, for instance if there were complaints which they should not have rejected.

The FSA also introduced on 28 May 2010 a temporary suspension of the six-month time limit for bringing a complaint to the FOS for consumers who received a final response letter between 28 November 2009 and 28 April 2010 inclusive. For those consumers the six-month time period was treated as not running between 28 May 2010 and 27 October 2010. This was to allow these consumers more time to bring their complaint while the FSA worked to resolve a long-term solution to ensure the consistent and fair treatment of customers buying or complaining about the sale of a PPI policy.

Payment Protection Insurance claims

The courts have not as yet had a major impact on these claims, presumably because these are usually consumer claims small enough to be within the jurisdiction of the FOS. In the year ending 5 April 2010, the FOS dealt with 49,196 PPI complaints, which represented 71% of all insurance complaints and 30% of all complaints received. In July, August and September 2010, 45% of all complaints received related to PPI. The number had increased from only 1,832 in 2006/7 to 10,652 in 2007/8 and 31,066 in 2008/9. The FOS Plans and Budget 2011/2012 expect a 7% increase in claims generally, but a 40% increase in PPI complaints. Shockingly, 89% of these PPI complaints in both 2008/9 and 2009/10 were upheld, whereas the average uphold rate for other types of complaint is 40%.

Of course, the FOS can only deal with the issue on a case by case basis, and indeed, is continuing to do so despite the British Bankers Association judicial review challenge against both the FSA and FOS regarding their approach to PPI complaints handling. The challenge was launched on 8 October 2010 and the hearing began on 25 January 2011.

The outcome may have significant consequences on both PPI complaints and the way that ICOBS and other rules are regarded by the courts.

Conclusion

Technically, ICOBS is and was intended to be separate to the law. It may also be different to the law, particularly in its treatment of consumers. But as law reform is delayed and ICOBS begins more and more to reflect the general practice of the market, it may be creeping bit by bit into the common law through the courts beginning to adopt and interpret parts of it, although they have not yet made many relevant rulings. It was intended as a regulatory tool and the recent FSA and FOS action in respect of PPI complaints shows how it works in this context.

Although ICOBS is not technically part of the law, insurers and intermediaries ignore it at their peril as there are many ways as set out above that a court might still conclude that they have committed an actionable breach. In any case, their industry regulator may take action against them, and the FOS will regard ICOBS equally with law in every individual complaint.

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Endnotes

1 Accessed via the FSA's website at www.fsa.gov.uk

2 DISP 3.6.1R and 3.6.2G which can be found in the FSA handbook

3 A consumer is defined by ICOBS 2.1.1(3)G as "any natural person who is acting for purposes which are outside his trade or profession."

4 See further at paras 14.15 et seq of the author's book entitled Insurance Law and the Financial Ombudsman Service.

5 [2009] EW Misc 2 (EWCC)

6 [2010] EWHC 759 (Comm).

7 [2010] EWHC 2488 (TCC)

8 [2010] EWHC 3152 (QB)

9 http://fsahandbook.info/FSA/html/handbook/GEN/2/2

10 ICOBS 5.3.2G "a firm should...(2) take reasonable care to ensure that a policy is suitable for the customer's demands and needs, taking into account its level of cover and cost, and relevant exclusions, excesses, limitations and conditions."

11 The nearest equivalent duty under ICOBS is 5.3.3R. This talks of how widely the firm must analyse other available contracts if it informs a customer that it is giving advice on the basis of a fair analysis.

12 [1999] 1 Lloyd's Rep IR 111

13 See the definition in the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2000

[14] See The Super Complaint made by the Citizens Advice Bureau to the Office of Fair Trading as long ago as September 2005 about PPI and the criticisms of the FSA made thereafter by Teresa Perchard, Director of Policy for Citizens Advice in its Press Release dated 19 October 2006. See also "The FSA has made a dog's dinner of PPI, Financial Adviser October 08, 2009. Further, the mass claims made to the FOS can be seen as evidence of general FSA failings, for instance, from 2000/1 to date, more than 300,000 endowment mortgage complaints went through the FOS, and over 46,000 unauthorised overdraft charges complaints. The FOS comments that if there is a large number of claims about the same sort of thing from a particular firm, that usually indicates that there is something wrong in that firm's processes. The implication is that they should have been spotted and dealt with by the regulator. See further the Written Evidence submitted by the FOS to the Treasury Committee on 13 October 2010 and 18 November 2010 at http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/financialreg/m08.htm and m42.htm and the Treasury Committee's Seventh Report of 2010/11 dated 27 January 2011 which responds to the Government's initial proposals for radical change to economic policy-making and the way in which financial services are regulated in the UK following the recent banking crisis.

[15] See also the further measures unveiled by the FSA on 29 September 2009 to protect PPI consumers, to be found on the FSA website, document FSA/PN/129/2009 and the agreement for refunds etc reached between the FSA and Mortgage Payment Protection Insurance firms dated 7 October 2009, to be found on the FSA website, document FSA/PN/135/2009.

[16] CP09/23 in September 2009 and CP10/6 in March 2010.

[17] August 2010, to be found at www.fsa.gov.uk/pubs/policy/ps10_12.pdf

[18] FSA Statement dated 24 November 2010

[19] 29 November 2010