

News flash

“Slap it on the Plastic and Worry About it Later” Credit Cards and Broker Liability

The interaction of the Consumer Credit Act 1974 and ordinary Merchant Credit Agreements can give rise to a surprising source of liability for brokers. Joanne Staphnill provides an overview of financial and professional indemnity problems, some of which have only recently come to light, for brokers who accept credit card payments, and for their insurers.

Brokers could potentially be liable to repay client premiums, regardless of whether the premiums have been passed on to the Insurer. The potential liability has been highlighted by the collapse of Independent Insurance Company Limited. Whilst the repayment of premiums can only occur if the client made the original payment by Credit Card (as opposed to debit card), brokers could face financing entire premiums should another insurer fail at any time, and in some circumstances, this liability could amount to millions of pounds.

How does the potential liability arise?

In order to protect consumers, Section 75 of the Consumer Credit Act 1974 (CCA) provides that a customer who finds that the goods/services he has purchased with a credit card are faulty (for example) can get his money back from his credit-card issuer (“the bank”). The bank is jointly and severally liable with the shop that was in breach of contract by selling faulty goods, and the CCA provides that the bank can recover its money from the “supplier”, in this case the shop.

In order for any business to be able to take credit card payments, it has to enter into a “Merchant Credit

Agreement” (“MCA”) with a bank. Such agreements are usually on standard terms, and provide that the bank can “chargeback” any sums which it has to repay to the credit card holder. This means that the bank can make the business immediately liable to repay those sums.

For brokers, problems arise because whilst they are the “merchant” who has entered into an MCA with the bank, they do not themselves provide the insurance cover that the client is purchasing with his credit card. The mere fact of taking the credit card payment means that the broker could be liable to repay the premium amount to the bank (if the client requested a refund from the bank) in the event that the insurer breached the insurance contract. In the event that an insurer goes into liquidation, as the Independent Insurance Company Limited did, there could potentially be a very large volume of policy holders seeking to recover their premium payments.

In a case which analysed the interaction between a MCA and the CCA, *The Governor and Company of the Bank of Scotland v Alfred Truman (a firm)* [2005] EWHC] 583 (QB) (17 March 2005) (unreported), the comments of the judge strongly suggested that ▶

▶ a broker would be held to be a “supplier” for the purposes of the CCA despite the fact that it does not itself provide insurance cover. Further, the terms of the MCA might operate to impose liability to repay sums to the bank regardless of whether the broker is a “supplier” or not.

How the liability could operate in practice

To show how devastating the liability could be, we can take the example of a (fictitious) specialist personal lines broker, called Cover 4 You. Cover 4 You has clients that are almost all private individuals, who therefore are given the protection of the CCA. Cover 4 You’s clients regularly use their credit cards to purchase their cover. Further, it places the insurance with one or two insurers with whom it has built up a relationship and its business. One of the insurers goes into liquidation. All of those clients who have purchased insurance with their credit cards are now entitled to get their premium monies back from the bank, which will, in turn, make Cover 4 You immediately liable to repay those sums.

Knowing that it is about to take a big ‘hit’, Cover 4 You tries to work out what its maximum potential liability is. It finds that it does not keep statistics on how much client money is taken by credit card as opposed to debit card or other methods of payment. Accordingly, Cover 4 You has no way of knowing what its ‘worst case scenario’ is.

Deeply concerned, Cover 4 You checks the wording of its own professional indemnity cover. It discovers that it is not clear whether the firm is covered for the “chargeback” repayments, as the potential liability arises out of the MCA with the bank rather than work for its clients, and there is no question of it having been negligent. Further, Cover 4 You is not sure whether the policy will allow all the claims to be aggregated, or whether it will have to pay the whole amount because each individual payment will fall below the policy deductible.

Cover 4 You, who has acted entirely properly throughout, now finds itself facing an unknown number of claims for an unknown total amount, without being sure that it has insurance cover in

relation to the sums it stands to lose. This also means that it cannot be sure how long it will be able to trade, because it does not know the period of time it can continue to comply with the FSA rules on solvency.

The final insult is that in some circumstances a broker can be held to be negligent for allowing policies to be taken out with insurers whose financial health is not good. Accordingly, there is a danger that Cover 4 You could face a ‘double whammy’ of having to repay premiums through “chargeback” and also face allegations of negligence.

Steps brokers and their insurers can take to protect themselves

Firstly, brokers should take legal advice as to what potential payments the terms of their MCA exposes them to. Secondly, both brokers and their insurers need to take legal advice as to the terms of the broker’s indemnity policy, and especially the aggregation clause. They should ascertain whether the broker is insured for “chargebacks” and how the aggregation clause operates in a chargeback situation. The results of the advice will determine whether the broker should consider negotiating for such cover at next renewal, depending on their exposure. Insurers need to decide whether this is an exposure that insurers wish to cover and consider reviewing wording for renewal, if appropriate.

Conclusion

This potential liability may only occur rarely, but could have devastating consequences for a broker. It should be noted that there has been no decided case specifically on brokers liability in this context. Accordingly, in the event that an insurer became insolvent and a broker was subject to a “chargeback” from the banks, there is the potential for litigation to finally determine the existence of the liability, leading to yet more uncertainty for the broker. It is not only clients who will “worry about it later” when they purchase insurance with a credit card.

Should you require any further information please contact:

Joanne Staphnill

T +44 (0)870 839 0885

F +44 (0)870 839 0985

E joanne.staphnill@robinsimonllp.com

We can put together a seminar/talk or panel discussion on either the issue above or any of the issues featured in Inversions to be held at any of our offices, or yours. If you are interested, please contact any one of our lawyers or David Simon at david.simon@robinsimonllp.com.

London

Minster House
42 Mincing Lane
London EC3R 7AE
T +44 (0)870 839 0800
F +44 (0)870 839 0900

www.robinsimonllp.com

Manchester

Arthur House
Chorlton Street
Manchester M1 3FH
T +44 (0)870 839 0800
F +44 (0)870 839 0893

Birmingham

37a Waterloo Street
Birmingham B2 5TJ
T +44 (0)870 839 0950
F +44 (0)870 839 0960

Leeds

2 St David’s Court
David Street
Leeds LS11 5QA
T +44 (0)870 839 0800
F +44 (0)870 839 0891