

## Payment Protection Insurance: the Final Instalment?

September 2009

Issues with the sale of Payment Protection Insurance (PPI) in the UK have been a regular feature in both the financial and consumer press for nearly half a decade. In this article, we summarise the action being taken by the main regulatory bodies overseeing this product and consider whether recently proposed legislation will increase either competition in the market or consumer confidence in the product.

### Background

PPI generally protects insureds from the inability to make repayments on credit products (such as unsecured loans, mortgages, credit cards) if the insured suffers from, for example, accident, sickness, unemployment or death.

As credit markets became more competitive, lenders tried to increase profitability by providing PPI with the main credit product being purchased. This practice became controversial for a variety of reasons but mainly because consumers were not told they were purchasing insurance with their credit product or that the PPI was not a pre-requisite to obtaining the credit. Lenders would also front load the single premium onto the credit, leading in many cases to interest on the premium making up the majority of the cost of the main credit product.

As a result of some of these practices, the consumer body Citizens Advice made a 'super-complaint' to the Office of Fair Trading (OFT) in September 2005. The OFT agreed to undertake a market study into the supply of PPI, which was conducted in 2006. In February 2007, as a result of its finding that features of the PPI market may be anti-competitive, the OFT referred the issue to the Competition Commission (the Commission) for a full investigation. The final Commission report was published in January 2009 and draft legislation, based on the Commission's recommendations, is now under consultation.

It should be noted that the sale of PPI also falls under the remit of the Financial Services Authority (FSA). The view of the FSA throughout the various OFT and Commission investigations has been that whilst it is able to govern and control selling practices and elements of the PPI market that fall under the FSA's principles for business, it is for the Commission to determine whether the market itself is anti-competitive and, if so, to deal with this aspect.

### The Commission Review

#### *The PPI Market*

The Commission reviewed the PPI market and the business models of PPI providers. It found that most PPI was sold at the point of sale of the credit product and there were very few stand-alone PPI providers. Typical commission rates on gross written premium (GWP) for PPI providers were between 40 and 80% depending on the type of risk. Claim rates were generally 11% - 28% of GWP. Providers also often had profit-sharing agreements with underwriters, generally 90% - 100% in favour of the providers. PPI was primarily sold through the same channels as credit products, namely face-to-face contact in branches, over the telephone and on the internet and was paid for either by a single premium or in monthly or annual instalments. The Commission also found that whilst prices for PPI did vary as between different providers, a particular provider generally did not vary the price of its product.

#### *Competition Between Providers*

The Commission found very little competition between PPI providers. This conclusion was based, amongst other things, on the following:

- little variation in PPI prices over time or evidence of PPI providers seeking to win sales from each other by competing on price or non-price factors such as quality, innovation or choice;

- very limited advertising of PPI itself, rather the focus of advertising being on the underlying credit product;
- despite variations in price and quality of PPI products, the low incidence of substitution between PPI policies, or combinations of PPI and credit; and
- providers tending to sell the same PPI products for a considerable period of time and the level of commission being used as a marketing tool by underwriters to attract providers to sell their PPI.

### ***Features of PPI Market Preventing Competition***

The Commission found four main features of the PPI market that prevented competition, resulting in higher prices and less choice for consumers. The features were:

- providers and other intermediaries failed to seek to win customers by using the price or quality of their PPI policies as a competitive variable;
- consumers could not easily compare PPI products. This was largely due to their complexity, the way information on PPI was presented to customers, the bundling of PPI with credit and the limited number of stand-alone PPI providers and policies;
- consumers wishing to switch PPI policies were restricted from doing so as the terms of most PPI products made switching expensive (in the case of single-premium policies) or risked leaving consumers uninsured (eg due to limits on claims during the initial period of a policy or due to the exclusion of medical conditions that became apparent during the term of the current PPI policy). These barriers to switching limited consumer choice. They also, therefore, acted as barriers to expansion for other PPI providers, in particular, providers of stand-alone PPI; and
- the sale of PPI at the point of sale of the credit product further restricted the extent to which other PPI providers could compete effectively.

### ***Commission's Recommendations***

In order to stimulate competition in the PPI market, the Commission made a number of recommendations, including:

- a prohibition on selling PPI at or shortly after the credit point of sale or provision of a PPI quote for a period of seven days (unless the consumer has initiated the PPI transaction and has confirmed that he has seen the personal PPI quote, in which case the prohibition period is reduced to 24 hours);
- all providers and other intermediaries who arrange credit for consumers must provide a personal PPI quote to the consumer and an annual statement for PPI policyholders;
- a requirement on all PPI providers to disclose prominently certain information in any marketing materials, including that PPI is optional and available from other providers;
- all PPI providers must supply comparative data to the FSA, as specified by, and in a format requested by, the FSA and a recommendation to the FSA to use the information for price comparison tables on its "money made clear" website;
- a prohibition on selling single-premium PPI policies;
- premium rebates to be paid to consumers on a pro-rata basis if the consumer terminates the policy during its term; and
- no separate charges to be levied for administration or for the setting-up or early termination of a PPI policy.

Following publication of the Commission's review, Barclays Bank has appealed against certain findings of the Commission to the Competition Appeal Tribunal. Barclays' main objection is to the prohibition on selling PPI at the credit point of sale. The Commission challenged Barclays' appeal and the FSA has also intervened on the Commission's behalf. The appeal is due to be heard in September 2009.

Despite this impending appeal, the Commission consulted on draft legislation to implement its recommendations. Responses were requested by 9 August 2009 and whilst the Commission has not set a date for the implementation of the legislation, the intention is to implement it swiftly if the appeal upholds the Commission's findings.

### **FSA Action**

The focus of the FSA in relation to PPI has been to improve sales practices, taking enforcement action where it has deemed necessary.

The FSA has stated that the sale of PPI is one of the most extensive thematic reviews it has undertaken. As a result of this review, progress has been made in improving sales practices and customer awareness of the issues surrounding PPI.

Notable actions include:

- directions (that have now largely been adhered to) to stop the sale of single premium PPI;
- a number of reviews of sales practices of providers of various types of PPI, including 'mystery shopper' exercises and an escalation in regulatory interventions since October 2008;
- prominent features and advice on PPI on the FSA's "money made clear" website, including a detailed price comparison table of various PPI policies; and
- publication of 20 enforcement cases relating to the sale of PPI, including one of the largest ever fines imposed by the FSA (£7million) on Alliance & Leicester in October 2008.

### **Conclusion**

As can be seen, progress has certainly been made in improving the sales practices of PPI providers and opening up the market, particularly to stand-alone PPI providers. The approach taken by the FSA, namely the implementation of the Commission's key recommendations before they are on the statute book, shows the flexibility and effectiveness of principles-based regulation.

However, problems still remain. Consumer groups claim that PPI providers routinely reject consumers' complaints, leaving the Financial Ombudsman Service to determine these cases (and routinely find in favour of the consumer). As sales practices improve and the market is opened up, these cases are likely to start to decline. However, after over five years of bad publicity, it may take some time before PPI is seen as the important protection it could be in uncertain economic times.