

# Payment protection insurance and its alternatives

## Introduction

1. This paper describes the main characteristics of payment protection insurance (PPI) and presents alternative insurance products that offer similar benefits to PPI but are available to consumers on a stand-alone basis (ie not linked to a particular mortgage, loan or credit card). These products may be divided into the following broad categories:

- Short-term income protection.
- Personal accident insurance.
- Income protection.
- Critical illness insurance.
- Life (whole of life) insurance.
- Term life insurance.
- Decreasing term life insurance.

Within these categories the cover provided by a particular policy and the benefits offered to policyholders will vary, depending on the insurer and the product in question.

## PPI

2. PPI covers repayments on credit products if the borrower is unable to do so due to loss of earnings as a result of accident, sickness, unemployment or death.<sup>1</sup> PPI covers repayments for up to a specified period of time. PPI is typically available for the following credit products: mortgages (first and second charge), personal loans,

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<sup>1</sup>Some PPI policies also offer critical illness cover

credit cards, personal finance (including retail and motor finance) and personal current account overdrafts.<sup>2</sup>

3. The Financial Services Authority (FSA) is currently considering a definition of PPI in the course of its consultation with regard to amendments to the Insurance Conduct of Business (ICOB) rules. At present PPI is described as an insurance contract, the benefits of which enable a policyholder to protect their ability to continue to make payments due to third parties, or can reasonably be expected to be used in this way.

4. The table below sets out the main characteristics of PPI.

Cash flow insured	Repayments of: <ul style="list-style-type: none"><li>• Loan debt.</li><li>• Mortgage debt (first and second charge).</li><li>• Credit card debt.</li><li>• Overdraft debt.</li><li>• (Retail credit debt).</li></ul>
Risks insured	<ul style="list-style-type: none"><li>• Accident, sickness and unemployment;</li><li>• accident and sickness; or</li><li>• unemployment.</li></ul> <p>Most loan, credit cards and overdraft PPI policies also include life insurance and some policies include critical illness insurance.</p> <p>Some policies also include hospitalization, permanent disability cover and carer cover.<sup>3</sup></p>
Type of underwriting	Community rated pricing (ie all customers are charged the same premium). <p>Some underwriters and lenders (eg Genworth, HBOS) told us that they were considering offering risk-based products, the price of which varied according to a set of variables such as age or type of employment.</p>
Payment of premium	PPI for loans: <ul style="list-style-type: none"><li>• Monthly or single premium with premium rate linked to term of the loan.</li></ul> <p>PPI for credit cards:</p> <ul style="list-style-type: none"><li>• Fixed amount per £100 of monthly outstanding balance (eg 79p per £100 of outstanding balance); premium is not paid if there is no outstanding balance on the card.</li></ul> <p>PPI for mortgages:</p> <ul style="list-style-type: none"><li>• Monthly premium (normally as a fixed amount per £100 benefit).</li></ul> <p>PPI for overdraft:</p> <ul style="list-style-type: none"><li>• Fixed amount (eg 70p) per £100 of insured overdraft limit; premium is paid regardless of whether the account is overdrawn or not.</li></ul>
Benefits paid to customers or to dependants <sup>4</sup>	Amount of monthly debt repayment (or in the case of credit cards and overdraft a specified percentage of the outstanding balance, eg 10 per cent) or repayment of the whole debt in the case of life insurance or critical illness insurance. <sup>5</sup>

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<sup>2</sup>PPI is also available to cover store cards, but this is outside the scope of the current investigation.

<sup>3</sup>The cover applies when the policyholder leaves work to look after a member of their immediate family.

<sup>4</sup>Payments can be also made direct to the provider of the credit product sold alongside PPI.

<sup>5</sup>Capital One told us in its response to the issues statements that benefits of PPI include the following:

- PPI protects a customer credit history (negative information on credit record is reverted once a claim has been accepted).
- PPI refunds any fees incurred by customers during the claim process (eg default fees).
- PPI ensures that the customer is never over- or under-insured.

Typical exclusions	<p>Deliberate self-injury, or any injury or pre-existing medical condition of which the applicant had knowledge prior to the application for cover,<sup>6</sup> AIDS-related conditions and conditions due to drug and alcohol abuse or criminal activities.</p> <p>Many policies apply restrictions to payment of claims for conditions related to pregnancy, stress, and backache. These restrictions might include limits to the length of period benefits are paid for and/or a requirement for the applicants to be referred to and under the care of an appropriate specialist.</p> <p>If unemployment cover was selected, customers would not be covered if: at the time of their application, they knew or had reason to believe that they might become unemployed; their work is seasonal or temporary; they accept voluntary unemployment.</p>
Eligibility	<p>Applicants:</p> <ul style="list-style-type: none"> <li>• must be over 18 and under 60 (depending on the cover the maximum age can be higher (eg 65 or 70));</li> <li>• must be employed (typically for at least 16 hours per week);<sup>7</sup> and</li> <li>• must be resident in the UK .</li> </ul> <p>Most policies are available to applicants who are self-employed and have been so continuously for a period prior to the application, although the benefits for the self-employed may differ to those with an employed status.</p>
Benefits period <sup>8</sup>	<p>It depends on the policy.</p> <p>Unemployment benefits: typically 12 months.</p> <p>Accident and sickness: 12–24 months or, with some policies, until the customer returns to work, or in the case of PPI for loans, for the term of the loan.</p> <p>Death and permanent invalidity benefits: some policies would repay the whole of the outstanding debt in case of death or permanent invalidity. Other policies would repay up to a maximum amount or length of time for permanent invalidity benefits (eg Lloyds PaymentCare Gold).</p>

## PPI alternatives

### ***Short-term income protection***<sup>9</sup>

Cash flow insured	Gross income (normally a selected amount subject to a maximum percentage of gross income (eg 50 per cent)) or monthly outgoings (up to a percentage of gross income), for a year. <sup>10</sup>
Risks insured	<ul style="list-style-type: none"> <li>• Accident, sickness and unemployment;</li> <li>• accident and sickness; or</li> <li>• unemployment.</li> </ul>
Type of underwriting	Community rated pricing, although pricing can be risk-based (ie price varies according to a set of variables such as age or type of employment).
Payment of premium	Customers typically pay monthly premiums.
Benefits paid to customers	<ul style="list-style-type: none"> <li>• Fixed monthly amount up to the limit insured.</li> <li>• Benefits can be used for any purpose.</li> </ul>
Typical exclusions	<p>Deliberate self-injury, or any injury or condition of which the applicant had knowledge prior to the application for cover, AIDS-related conditions and conditions due to drug and alcohol abuse or criminal activities.</p> <p>Depending on the policy, restrictions might apply to the payment of claims for conditions related to pregnancy, stress, and backache. These restrictions include limits to the length of period benefits are paid for and/or a requirement for the applicants to be referred to and be under the care of an appropriate specialist.</p> <p>If unemployment cover was selected, customers would not be covered if: at the time of their application, they knew or had reason to believe they might become unemployed; their work is seasonal or temporary; they accept voluntary unemployment.</p>

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<sup>6</sup>Exclusions for pre-existing conditions will be waived if the insured is able to demonstrate a period in which they have not suffered the condition or any of its symptoms.

<sup>7</sup>Employment is not an eligibility criterion for some products or in cases where restricted cover such as hospitalization, disability or life is provided for. For example, Barclays offers life and disability cover to customers who are not in employment.

<sup>8</sup>Length of time benefits will be paid for.

<sup>9</sup>Can be also called accident, sickness and unemployment insurance.

<sup>10</sup>Bill protector policies, a variation of short-term income protection insurance, are offered by some providers. Bill protector policies are designed to cover outgoings for household bills up to a certain amount (eg £300) in case of accident, sickness or unemployment.

Eligibility	Applicants: <ul style="list-style-type: none"> <li>• Must be over 18 and under 60 (depending on the cover the maximum age can be higher (65 or 70)).</li> <li>• Must be employed or self-employed and have been so continuously for at least the previous six months.</li> </ul>
Benefits period <sup>11</sup>	Typically 12 months.

### ***Personal accident insurance***

Cash flow insured	A fixed amount.
Risks insured	Accident which results in permanent loss of limbs or permanent disability within the term of the policy. Some policies include life insurance and hospitalization cover.
Type of underwriting	Community rated pricing.
Payment of premium	Customers typically pay monthly premiums calculated on the basis of the level of benefit required.
Benefits paid to customers	Lump sum.
Typical exclusion	Exclusions include disability due to, or caused by: <ul style="list-style-type: none"> <li>• Attempted suicide.</li> <li>• Misuse of alcohol or drugs.</li> </ul>
Eligibility	Applicants must be over 18. Maximum age depends on the policy.
Benefits period	Not applicable (see cash flow insured).

### ***Income protection***

Cash flow insured	A percentage of gross income (normally up to 65 per cent) for a limited period or up to retirement (if incapacitated).
Risks insured	Accident or sickness which results in loss of earnings within the term of the policy, usually to age 60 or 65.
Type of underwriting	Individually underwritten.
Payment of premium	Customers typically pay monthly premiums calculated on the basis of their occupation, age, state of health and level of benefit required.
Benefits paid to customers	Regular tax-free income which can be used to pay monthly bills or for any other purpose.
Typical exclusions	There are common exclusions on most income protection plans, including disability due to, or caused by: <ul style="list-style-type: none"> <li>• HIV/AIDS.</li> <li>• Normal pregnancy and childbirth.</li> <li>• War.</li> <li>• Self-inflicted injury.</li> <li>• Criminal acts.</li> <li>• Misuse of alcohol or drugs.</li> <li>• Failure to follow medical advice.</li> <li>• Residing outside the UK.</li> </ul> <p>Source: //www.privatehealth.co.uk/.</p>
Eligibility	Applicants must be over 18.
Benefits period	Up to retirement or for remainder of the term of the policy.

### ***Critical illness insurance***

Cash flow insured	Fixed cash amount.
Risks insured	The event of being diagnosed with one of the defined illnesses/conditions within the terms of policy. A list of illnesses that can be covered by critical illness insurance is presented in Annex 1.

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<sup>11</sup>Length of time benefits will be paid for.

Different insurers have different cover and limits. In particular, the 'other conditions' and 'other benefits' listed in Annex 1 are not always included.

Policies usually have a specified survival period from diagnosis that must be exceeded in order for a claim to be considered as a critical illness.<sup>12</sup>

Type of underwriting	Individually underwritten.
Benefits paid to customers	Tax-free lump sum or in some cases monthly payments up to the end of the term of the policy. Benefits can be used for any purpose that the customer wishes.
Payment of premium by customers	Customers typically pay monthly premiums.
Typical exclusions	See risks insured.
Eligibility	Policies are individually underwritten and require the customer's medical history. Minimum age 18. Maximum will depend on individual policy.
Benefits period	Not applicable (see cash flow insured).

### **Life insurance (whole of life)**

Cash flow insured	Fixed cash amount. <sup>13</sup>
Risks insured	Death.  Life policies can have the following optional extras: <ul style="list-style-type: none"> <li>• Waiver of premium: If customer is unable to work in his normal occupation because of illness or injury, the insurance company will pay the premiums to maintain the benefits under the policy.</li> <li>• Critical illness insurance (see above).</li> </ul>
Type of underwriting	Individually underwritten.
Benefits paid to dependants	Cash sum.
Payment of premium by customers	Monthly.
Typical exclusion	It depends on policies. Typical exclusions could include accidental deaths caused by 'act of war' or 'while in active military service', or suicide. <sup>14</sup>
Eligibility	Applicants must be over 18. Maximum age will depend on individual policy.
Benefits period	Not applicable.

### **Term life insurance**

Name of product	Term life.
Cash flow insured	Fixed cash amount.  Term life gives financial protection if the customer dies within a specified period known as 'the term'. This period might be 10, 15 or 20 years although policies can be arranged for cover for periods as short as one month. The benefit is normally fixed and remains level throughout the term of the plan.
Risks insured	Death. Can include critical illness as an optional benefit.
Type of underwriting	Individually underwritten.
Benefits paid to dependants	Cash sum.
Payment of premium by customers	Monthly.
Typical exclusion	It depends on the policy. Typical exclusions include accidental deaths caused by 'act of war' or 'while in active military service', or suicide.
Eligibility	Applicants must be over 18. Maximum age will depend on individual policy.

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<sup>12</sup>Source: HBOS's response to put back.

<sup>13</sup>The policy may have a surrender value if the customer terminates the policy.

<sup>14</sup>This exclusion is in the majority of cases within a specified term, such as the first 12 months of cover.

Benefits period                      If the customer is alive at the end of the term no payment is made and there is no surrender value—that is, if the customer stops paying the premiums the cover ceases and there is no refund of premiums paid.

### ***Decreasing term life insurance***

Cash flow insured	Fixed cash amount.  Gives financial protection if the customer dies within a specified period known as 'the term'. The amount of cover decreases over the term of the policy and is usually designed to tie in with the outstanding amount on the customer's structured capital and interest borrowing (eg mortgage or loan account).
Risks insured	Death.  Can include critical illness as an optional benefit.
Type of underwriting	Individually underwritten.
Benefits paid to dependants	Cash sum based on a predefined schedule or outstanding mortgage balance.
Payment of premium by customers	Monthly premium. As the life cover reduces, the monthly premium remains at a constant level over the term of the policy.
Typical exclusions	It depends on policies. Typical exclusions could include accidental deaths caused by 'act of war' or 'while in active military service', or suicide.
Eligibility	Applicants must be over 18. Maximum will depend on individual policy.
Benefits period	Not applicable.

## List of illnesses

<i>ABI core</i>	<i>Other conditions</i>	<i>Other benefits</i>
Aorta graft surgery	Aids assault	Children's benefit
Benign brain tumour	Aids blood transfusion	Loss of independence
Blindness	Aids occupation	Major medical expenses
Cancer	Alzheimer's Disease	
Coma	Angioplasty	
Coronary artery bypass	Aplastic Anaemia	
Deafness	Bacterial Meningitis	
Heart attack	Cardiomyopathy	
Heart valve replacement	CJD	
Kidney failure	Diabetes	
Loss of limb	Hodgkins Disease	
Loss of speech	Liver failure	
Major organ transplant	Major head trauma	
Motor Neurone Disease	Open heart surgery	
Multiple Sclerosis	Pre-senile dementia	
Paralysis/paraplegia	Progressive Supra-nuclear Palsy	
Parkinson's Disease	Rheumatoid Arthritis	
Stroke	Severe lung disease	
Terminal illness		
Third degree burns		

Source: [www.criticalillness.co.uk](http://www.criticalillness.co.uk).

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