

Payment protection insurance and regulation

Summary

1. This paper outlines the regulatory framework and rules that affect the provision of payment protection insurance (PPI) to consumers.¹ Parts 1 and 2 specifically concentrate on the policy, legal and regulatory framework as it affects the interface with consumers, while Part 3 considers the impact of money received under a PPI policy on eligibility for state benefits.

2. Key points to note include:
 - There are two key regulators responsible for PPI and associated credit products—the Financial Services Authority (FSA) and the Office of Fair Trading (OFT).
 - The FSA and the OFT have different roles and responsibilities but a firm can find itself regulated by both when conducting certain business activities.
 - The regulatory regime specifies that the annual percentage rate (APR) should be the prime comparator used by credit companies.
 - The cost of PPI has to be included in the APR calculation only if the taking out of PPI is a condition of the credit. If a discount on the APR were offered for customers taking out PPI, this would likely be regarded as a policy where PPI was a condition of the credit, and the combined APR for this would need to be quoted.
 - Money received from a PPI policy does not reduce the amount of state benefits payable to the policyholder where the PPI income does not exceed the repayment liability under the credit agreement, and is paid directly to their credit provider.

¹This paper does not cover prudential, accounting or establishment requirements or other general legal provisions that affect the internal corporate operations of insurers and distributors.

Part 1—Background

Regulatory responsibilities

3. The OFT and the FSA are the two lead regulators for both PPI and for the related credit products. According to a recent paper by the OFT,² the OFT and the FSA have complementary regulatory roles for PPI. The OFT has the lead role in considering whether markets are working well in terms of delivering value for consumers, whereas the FSA has the lead role on customer protection. There are additional government departments and independent bodies that have an interest in the regulation of PPI and the related credit products. A summary of policy and regulatory stakeholders is provided at Appendix A.

4. Since 14 January 2005, general insurance and insurance intermediaries have been subject to the FSA's Conduct of Business regulations and to the FSA's Principles for Business/Treating Customers Fairly regulations.³ Together, these provide detailed rules for the sale and administration of general insurance, including product disclosure, claims handling, complaints procedures and holding client money. Under the Financial Services and Markets Act 2000 (FSMA), the FSA has extensive powers of investigation if it suspects that there has been a regulatory infringement, and where breaches of the rules are proved, the FSA has the power to levy unlimited fines,⁴ or prosecute individuals or firms for certain criminal offences. For example, if a firm carries out activities regulated under the FSMA without being authorized or exempt, it can be prosecuted.

5. Most credit products are regulated by the OFT in conjunction with Trading Standards Officers (TSOs) or by the FSA. The OFT is responsible for the credit licensing regime

²*Payment Protection Insurance*, report on the market study and proposed decision to make a market investigation reference, October 2006.

³Before 14 January 2005, complaints about general insurance products—including PPI—bought from firms that signed up to the General Insurance Standards Council (GISC) were dealt with by arrangements set up by the GISC.

⁴The FSA fined a number of firms for mis-selling PPI in 2006 including: loans.co.uk (£455,000); Redcats (£270,000); and Regency Mortgage Corporation (£56,000). Two other cases were also concluded in 2006 where problems relating to PPI featured—Capital Mortgage Connections and Home and County Mortgages.

and the general supervision of the consumer credit market. Along with TSOs, the OFT monitors and enforces compliance with the Consumer Credit Act 1974 (CCA 1974, as amended)⁵ and the licensing regime. The OFT also produces advice for consumers and guidance for businesses. The FSA is responsible for regulating financial services, including authorizing the activities of first-charge mortgage lenders: it is also responsible for checking the capital structure and ongoing viability of financial organizations that fall under its jurisdiction.⁶

6. There is a historical split between deposit-taking investment and insurance organizations (eg banks) which are regulated by the FSA and for which HM Treasury (HMT) leads on high-level policy and primary legislation, and consumer credit (eg hire purchase) which is regulated by the OFT/TSOs and for which policy decisions are made by the Department for Business, Enterprise and Regulatory Reform (BERR, formerly the Department of Trade and Industry (DTI)). This means, for example, that although the OFT/BERR is responsible for credit cards, most credit card companies are also authorized by the FSA, as a credit card company may become a deposit taker if customers overpay their bill. As a result, different divisions of a firm can be regulated by different organizations, and in some cases firms have to comply with two different sets of regulations.⁷

7. Product promotion is one example of an activity in which firms have to deal with different sets of regulations that are overseen by different regulators. The FSA regulates PPI product disclosure and the sales processes (see Insurance Conduct of Business—ICOB—Rules). The FSA's Treating Customers Fairly (TCF) initiative also covers PPI promotions. The CCA 1974 also regulates, through the OFT, the form

⁵Paragraphs 29 to 33 outline the Consumer Credit Regime.

⁶The FSA will check the financial viability of an organization at the level of the business segment it is responsible for and the highest level of consolidated accounts which include that business segment.

⁷By way of example, as at the end of June 2007, around 21,000 firms were jointly regulated in some capacity by the FSA and the OFT. See *Delivering Better Regulatory Outcomes—July 2007 Update: a Joint FSA and OFT Action Plan*, OFT940.

and content of credit advertisements and credit agreements and can affect how PPI is advertised and sold. For example, where PPI is to be financed by the credit on offer, a separate signature box for PPI is required.⁸ Further, a number of general consumer protection rules are relevant to PPI sales practices and contracts. As a result, promotions for PPI may be covered by both by the OFT and FSA regimes and would, in that event, need to comply with both.

TABLE 1 **Who regulates what promotions**

	<i>The FSA regulates financial promotions relating to:</i>	<i>The FSA does not regulate financial promotions relating to:</i>
<i>Product type</i>	<p>Investments—bonds, gilts, futures and other derivatives, collective investment schemes, unregulated collective investment schemes, with-profits funds, etc.</p> <p>Mortgages—all first-charge mortgages and some second-charge mortgages (from those firms also offering first-charge mortgages).</p> <p>General insurance—for instance, PPI motor and household.</p>	<p>Credit—consumer credit, including credit card, store card and unsecured personal loans.</p> <p>Mortgages—second-charge mortgages from firms that are not authorized by the FSA to sell first charge mortgages.</p> <p>Insurance mediation</p>

Source: FSA www.fsa.gov.uk/Pages/Doing/Regulated/Promo/Role/index.shtml.

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8. The FSA also regulates the advice that can be given to customers regarding PPI. Sales can either be made on a non-advised or an advised basis. If they are made on an advised basis then there are a number of procedures that need to be followed, including an assessment for suitability and a review of potential alternative products sold by that supplier. If sales are made on a non-advised basis then firms have to have adequate systems to stop their staff giving advice or providing information that amounted to giving advice (see paragraphs 22 to 25 for a more detailed explanation).

⁸Consumer Credit (Agreements) Regulations 1983 as amended by the 2004 Amendment Regulations and the Consumer Credit (Advertisements) Regulations 2004.

TABLE 2 **Summary of credit and insurance products and related associations**

	<i>Primary policymaker</i>	<i>Primary regulator</i>
Insurance products (including PPI)	HMT	FSA
First-charge mortgages	HMT	FSA† (since 31 October 2004)
Second-charge mortgages*	DTI	OFT/TSO/or the FSA (if loan is from a bank or building society)
Personal loans	DTI	OFT/TSO/or the FSA (if loan is from a bank or building society)
Credit cards	DTI	OFT/TSO

Source: CC.

*The FSA does not regulate where less than 40 per cent of the property on which the loan is secured is used or will be used as a home by the borrower or a member of the borrower's immediate family—these are regulated by the OFT.

†If the mortgage is a second charge on a home it is a 'second-charge mortgage', ie the customer already has another loan secured against the home.

Part 2—The regulatory framework

The Financial Services Authority and its powers

9. The FSA is the independent statutory body that regulates most aspects of the financial services industry in the UK. It has four statutory objectives, which are set out in sections 3 to 6 of the FSMA. The FSMA provided the FSA with its powers and established the overall regulatory framework for the financial services sector. A key provision of the FSMA is a general prohibition on any person carrying on a regulated activity in the UK unless they are either specifically authorized to carry it out or they are covered by one of the exemptions from the general prohibition.

10. All financial institutions authorized by the FSA must always meet FSA 'threshold conditions' set out in Schedule 6 to the FSMA, which include FSA approval of the adequacy of financial resources, management and systems and controls.

11. The FSA has been given a wide range of rule-making, investigatory and enforcement powers to discharge its functions.⁹ In using them, it has regard to the principles of good regulation set out in section 2 of the FSMA. These, for example, encourage the FSA to be efficient in the use of resources and proportionate in its dealings with firms and other regulated entities. The principles of good regulation also require the FSA to have regard to (a) the need to minimize any adverse effects on competition arising from regulation; and (b) the desirability of facilitating competition and innovation. Finally, they recognize the international character of markets and the UK's competitive position. Although the principles of good regulation are not absolute requirements, they guide the FSA's actions and encourage it to consider the impact of its rules on competition. The FSMA does not give the FSA any specific powers concerning competition issues or any responsibilities regarding the fees and prices charged by regulated companies.
12. The FSA Handbook sets out the rules made under the FSMA with which regulated firms are required to comply. The Handbook's Principles for Businesses (the Principles) set out the fundamental obligations of regulated businesses, provide a basic yardstick for firms to order their behaviour by and provide a basis for supervisory and enforcement activity by the FSA itself. The breach of a Principle makes a firm liable to disciplinary sanctions. The Principles provide that a firm must:
- Principle 1:* Conduct its business with integrity.
- Principle 2:* Conduct its business with due skill, care and diligence.
- Principle 3:* Take reasonable care to organize and control its affairs responsibly and effectively, with adequate risk management systems.
- Principle 4:* Maintain adequate financial resources.
- Principle 5:* Observe proper standards of market conduct.

⁹Sections 59 (Approval for particular arrangements); 138 (General rule-making power); 139 (Miscellaneous ancillary matters); 149 (Evidential provisions); 156 (General supplementary powers); 157(1) (Guidance); 214 (General); and 341 (Access to books etc).

- Principle 6:* Pay due regard to the interests of its customers and treat them fairly.
- Principle 7:* Pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
- Principle 8:* Manage conflicts of interest fairly, both between itself and its customers, and between a customer and another client.
- Principle 9:* Take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.
- Principle 10:* Arrange adequate protection for clients' assets when it is responsible for them.
- Principle 11:* Deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

Treating customers fairly and thematic work

13. The FSA's TCF initiative is a core theme in its regulatory work in retail markets. The initiative is based upon the Principles, in particular Principle 6, though other Principles will be informative as to the expectations of firms and to establishing what fair treatment might mean.¹⁰
14. The FSA has defined six consumer outcomes that explain what they want the TCF to achieve for consumers:
- (a) consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture;
 - (b) products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;

¹⁰Principles 1, 2, 3, 7, 8 and 9 are all relevant to the TCF initiative.

- (c) consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
 - (d) where consumers receive advice, the advice is suitable and takes account of their circumstances;
 - (e) consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect; and
 - (f) consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.
15. The FSA required all firms to provide an implementation plan for their TCF programmes by March 2007, and by the end of March 2008 firms are expected to have appropriate management information or measures in place to test whether they are treating their customers fairly. The TCF initiative applies to companies regulated by the FSA.
16. In addition to the TCF initiative, the FSA is carrying out a specific thematic programme on PPI.¹¹ The main elements of the thematic programme include visits to firms, enforcement action where appropriate and information aimed at consumers. The thematic programme has now reached Phase III, as part of which the FSA is testing optionality, eligibility, refunds, product and price disclosure.¹² Where necessary, the FSA will take enforcement action against firms using any of its powers under the FSMA and the Handbook, including the Principles, the ICOB rules or the Unfair Terms in Consumer Contracts Regulations (UTCCRs—see below).

¹¹The FSA has a policy of reviewing major regulatory interventions to ensure that they are effective and are addressing the issues intended. The ICOB review is one such stand-alone post-implementation effectiveness review.

¹²For further information, see www.fsa.gov.uk/pages/Library/Communication/PR/2007/102.shtml.

ICOB

17. As mentioned above, the ICOB provides an extensive set of rules that govern the relationship between insurers (acting as product providers) and insurance intermediaries who arrange insurance for retail customers. The ICOB contains general rules,¹³ which reflect FSA Principles 1 and 6, that require a firm to conduct its business with integrity, to pay due regard to the interests of its customers and to treat them fairly throughout the process (including claims handling). It then contains specific rules in relation to financial promotions, advising and selling standards, product disclosure and cancellation.

Product disclosure, cancellation and claims

18. The ICOB rules relating to product disclosure reinforce the FSA's Principle 7, which requires a firm to pay due regard to the needs of its clients and communicate information to them in a way that is clear, fair and not misleading. The rules make insurers responsible for the content and production of information for the customer, and intermediaries responsible for provision of that information to the customer. The rules require the provision of certain information to customers, including a policy summary, policy document, information about the claims-handling process, cancellation rights and any compensation scheme, and—in good time before the conclusion of the contract—a durable copy of the policy summary and a statement of the price. The customer's attention must be drawn to the importance of reading the summary, especially any sections on significant, unusual exclusions and limitations.
19. Where a contract is concluded by telephone, a retail customer may give explicit consent to receiving only limited information. In that situation, the intermediary may proceed on the basis of the name of the insurance undertaking, type of insurance and cover, significant features and benefits, significant or unusual exclusions or

¹³Chapter 2.

limitations, the total price (or the basis of the calculation), notice of other possible costs, cancellation rights, contact details for any claim and the nature of other information available on request.¹⁴

20. Retail customers who have entered into a non-investment insurance contract will be entitled to a period of reflection during which they can decide whether to proceed with their purchase. Cancellation periods are 30 days for 'pure protection contracts' (life insurance) and 14 days for general insurance contracts (including PPI). The cancellation period begins on the day the customer is informed that the contract has been concluded, or the day on which they receive the terms and conditions and information (whichever is the later).¹⁵
21. The ICOB claims-handling rules reinforce Principles 3 (internal management and systems control), 6 (customer interests) and 8 (conflicts of interest) requiring claims to be handled promptly and fairly, and customers to be given reasonable guidance to help make claims. An insurer must not unreasonably reject a claim or refuse to meet a claim made on certain grounds, including breach of terms in life insurance contracts (unless the circumstances of the claim are connected with the breach).¹⁶

ICOB Chapter 4 and advised sales

22. There is no requirement that companies advise their customers in regard to the purchase of PPI; companies have a choice about whether to sell on an advised or a non-advised basis. The general distinction lies in the making of a personal recommendation: a non-advised sale will just provide facts and figures about the product, whereas an advised sale process results in a recommendation to the customer as to whether the product is suitable for their needs. However, where a

¹⁴Chapter 5.

¹⁵Chapter 6.

¹⁶Chapter 7.

company chooses to provide advice in relation to its sales of insurance it will need to comply with the requirements of Chapter 4 of the ICOB which governs advised sales, specifically matters such as assessment of customer needs and disclosure about exclusions.

23. When providing advice, the adviser is required to take reasonable steps to ensure that any personal recommendation to a customer to buy a contract is suitable for the customer's demands and needs at that time. The ICOB sets out the information the adviser must seek about the customer's needs/demands, including such information about their circumstances and objectives as might reasonably be expected to be relevant in enabling the firm to identify their requirements, including any relevant existing insurance. ICOB guidance suggests, for example, that an intermediary advising on private medical insurance should make it clear to customers that they need to disclose any existing medical condition where relevant. Though the adviser need not take into account any existing cover if the customer is not able to provide information about it, the ICOB requires that where a firm is aware that the existing cover is likely significantly to affect the suitability of any personal recommendation, it must either not make the recommendation until details of the insurance cover are available, or make it clear to the customer that the recommendation may not be suitable because the intermediary has not taken into account full details of the existing cover.
24. An adviser must consider a number of matters including whether the level of cover is sufficient for the risks that the customer wishes to insure, and the relevance of any

exclusions, excesses, limitations or conditions in the contract¹⁷ when providing advice. However, a recommendation need not meet all of the customer's demands and needs, provided that there is no contract within the insurance intermediary's scope which does fulfil that criteria, and that the insurance intermediary identifies that fact to the customer at the point of recommendation. This is done by providing the required statement of demands and needs to the customer.

25. It should be noted that, even where a company has chosen not to conduct an advised sales process, it is still required to ensure that its sales are compliant with the other FSA Principles and other fairness requirements. This means it will still need to ensure that the customer receives sufficient information on the product to enable them to make an informed decision as to whether it meets their own demands and needs.

New ICOB

26. In June 2007 the FSA issued a consultation paper for the reform of ICOB. For general insurance business, such as household, motor or pet policies, this means moving to principles and high-level rules, except where detailed provisions are required by European directives or, in a small number of cases, where they are the only practicable way to protect consumers. The FSA is proposing additional rules for protection products (PPI, critical illness, income protection and term assurance), which are designed to improve selling practices. Some of these new measures will apply to all protection products, for example the new standard to ensure balanced oral disclosure to help consumers make informed purchasing decisions. Others will have particular impact on PPI markets, for example the requirement for firms to

¹⁷The adviser should take into account the cost of the contract when compared with other contracts that cover a similar range of demands/needs *on which the adviser can provide advice/information*. This does not necessarily mean that all the insurance products offered by that company will be considered; it depends on which products the adviser is trained to offer on an advised basis. Also, advisers are not trained to compare their products with products offered by other insurers or distributors. However, as the adviser need not consider (1) alternatives to those contracts or (2) customer needs that are not relevant to the type of contract in which the customer is interested—and PPI sales are generally advised on a single product basis—this requirement would not appear to be relevant here.

provide information on price orally to the customer where a discussion takes place. Some new measures will apply to PPI alone, such as extending the cancellation period from 14 to 30 days.¹⁸

27. The new ICOB will retain the requirement to establish customer demands and needs for advised sales of protection products. In addition, the customer in non-advised sales must be informed that the customer is responsible for ensuring the suitability of the product offered.
28. Under the FSA proposals, for sales under a credit agreement (for example, single premium), firms must provide information on the total policy cost, total interest payments and regular payments in good time to allow an informed decision. Where a sale under a credit agreement has an oral element, this price information will have to be provided orally as well as in writing.¹⁹ Furthermore, all PPI sales (both advised and non-advised) will be subject to a rule requiring a firm to take reasonable steps to ensure that a customer is only sold a policy under which they are eligible to claim benefits. If certain parts of the cover do not apply, the customer must be informed of this so that they can take an informed decision on whether or not to buy the policy. Firms will also be required to draw the customer's attention (orally in sales with an oral element) to the importance of reading documentation before the end of the cancellation period to check that the policy is suitable for them.²⁰

The consumer credit regime

29. The Consumer Credit Act 1974 (CCA 1974) requires most businesses that offer goods or services on credit, or lend money to consumers, to be licensed by the OFT. The CCA 1974 applies to personal loans, credit cards, and mortgages secured by a

¹⁸FSA/PN/077/2007.

¹⁹FSA consultation *Proposed amendments to the Insurance: Conduct of Business Sourcebook*, June 2007 FSA/07/11 paragraph 5.13.

²⁰Paragraph 5.7.

second charge. It does not automatically apply to mortgages secured by a first charge.²¹ At present, the CCA 1974 only covers loans not exceeding £25,000 (though this limit is being removed by the Consumer Credit Act 2006 (CCA 2006)—see below). Licensees must satisfy the OFT that they are fit to carry out the type of business in question.

30. The CCA 1974 is augmented by a number of sets of regulations, orders and notices (the CCA regime). The CCA regime sets out detailed rules covering (among other things): the form and content of agreements; the advertising of credit; the method of calculating the APR of interest charged; procedures to be adopted in the event of default, termination or early settlement; extortionate credit agreements; and individuals' rights of access to credit reference files.

31. As a part of the CCA regime, the Government has made regulations under the CCA 1974 which set out rules in relation to the calculation of credit charges,²² make the APR the prime comparator in advertising consumer credit²³ and require lenders to provide clear pre-contractual information about costs and key terms of loans.²⁴ In 2004, the (then) DTI made further regulations that introduced major changes in consumer credit law. They provide for rules on:
 - (a) advertising consumer credit products;
 - (b) requirements for pre-contract disclosure to consumers;
 - (c) the form and content of agreements; and

²¹There is an overlap between the OFT and the FSA in relation to second-charge mortgages. Where a lender is authorized by the FSA for first-charge mortgages, then the advertising of its second-charge mortgages is also covered by the FSA. However, the FSA does not regulate the products themselves, which are generally regulated under the CCA (although section 16 of the CCA will serve to exempt some).

²²The Consumer Credit (Total Charge for Credit) Regulations 1980.

²³Consumer Credit (Advertisements) Regulations 1989 (repealed).

²⁴Consumer Credit (Agreements) Regulations 1983 (amended).

(d) early settlement.²⁵

32. The first set of regulations covers the information an advertisement must contain and how that information is presented. The aim is to ensure that consumers are given sufficient, fair information about the nature and cost of credit to enable them to compare different products and choose the ones that are best for them. The second set of regulations specifies that information provided to customers should be: easily legible; not interspersed with other information; presented with equal prominence; contained in a separate document from the contract concerned, headed 'pre-contract information'; and capable of being taken away by the consumer to read. The third set of regulations provides that contracts have to be divided into three main sections: key financial information; other financial information; and key information. Specified information has to be included in each section, including certain warnings to consumers. The regulations also contain special provisions for the documentation of agreements where PPI is financed by credit, including a requirement for a separate signature box ('form of consent') with cross-reference to the relevant terms and conditions. The fourth set of regulations entitles the debtor making an early repayment to a rebate and incorporates an actuarial formula to be used in calculating the minimum rebate.
33. Following a three-year review of consumer credit laws, the CCA 2006 was enacted in March 2006. The CCA 2006 amends and updates the CCA 1974 to enhance consumer rights. It enables consumers to challenge unfair credit agreements in court, providing an 'unfair credit relationship' test, concerned not only with the cost of credit but with anything relating to the agreement itself, the way it is sold and any other

²⁵The Consumer Credit (Advertisements) Regulations 2004 (replaced the 1989 Regulations), The Consumer Credit (Agreements) (Amendment) Regulations 2004 and Consumer Credit (Miscellaneous Amendments) Regulations 2004 (amended 1983 Agreements Regulations), Consumer Credit (Disclosure of Information) Regulations 2004 and Consumer Credit (Early Settlement) Regulations 2004.

aspects that a court considers to be unfair. The CCA 2006 entitles consumers to receive more information about the state of their accounts to help them identify problems earlier, requiring lenders to provide consumers with regular information about the state of their credit accounts such as statements about fixed-sum credit agreements, notices of arrears and notices of default sums incurred. It also entitles consumers to take complaints about lenders to a dispute resolution scheme run by the Financial Ombudsman Service, and seeks to strengthen the credit licensing system with enhanced and new powers to address problem traders and practices. It introduces a more robust and flexible licensing system for lenders, gives the OFT more effective powers to tackle issues with lenders quickly and in proportion to the scale of the problem and reforms the appeals system under which lenders may challenge decisions of the OFT. The unfair relationships provisions of the CCA 2006 came into force in April 2007; the licensing reforms and the transparency provisions are due to come into force in April and October 2008 respectively.

PPI and the calculation of annual percentage rates

34. The Consumer Credit (Total Charge for Credit) Regulations 1980 (as amended) provides the basis for calculating APRs. Regulation 4(c), provides that the total charge for credit includes:

A premium under a contract of insurance, payable under the transaction by a debtor or a relative of his, where the making or maintenance of the contract of insurance is required by the creditor:

(a) *as a condition* of making the agreement; *and*

(b) for the sole purpose of ensuring complete or partial repayment of the credit, and complete or partial payment to the creditor of such of those charges included in the total charge for credit as are payable to him under the transaction, in the event of the death, invalidity, illness or unemployment of the debtor. [Emphasis added].

35. As can be seen from the above, the question of whether a PPI premium forms part of the total charge for credit depends on whether the premium is payable under the transaction, and whether the PPI is required as a condition of making the agreement. The APR must be calculated to reflect the cost of the PPI *only* where it is a condition of making the agreement, not where PPI is optional.
36. Where PPI is financed by credit, there will be two separate credit agreements—one for the principal credit and one for the PPI credit. The APR for the principal credit agreement will take into account the cost of PPI only if it is a required condition of that agreement. Where PPI is optional, the PPI credit agreement will have its own APR, based on the charges for credit to finance the PPI, which must be disclosed as part of the agreement documentation (but will not represent a consolidated APR figure, combining the APR for the principal and PPI credits).²⁶
37. Where a lender offers loans with or without PPI, and with an interest rate discount where PPI is taken out, the borrower remains free to decide whether or not to take out a loan with PPI—but the interest rate discount is available only if he does so. As, with the discounted interest rate product, there is a link between the offer of PPI and the offer of credit on alternative terms and conditions (namely a lower rate of interest), and given that the terms and conditions of the credit offered are different, there are two different credit agreements. Under the agreement with the lower rate of interest, the PPI is, in effect, mandatory, and its cost therefore falls to be included in the total charge for credit. The OFT's view is that this effect is consistent with the intention of providing APR as a comparator. Should a distributor calculate an APR figure that takes into account the reduced interest cost of the credit without also

²⁶The typical APR cited in advertising must also take into account the APRs of credit agreements financing PPI, in so far as such agreements are expected to result from the advertisement.

reflecting the additional cost of the PPI, it does not provide a valid means of comparison for the cost of the package as a whole.²⁷

General consumer protection regime

Background—Part 8

38. Part 8 of the Enterprise Act 2002 (the Act) came into force in June 2003 with the aim of improving consumer protection by giving enforcers (TSOs and the OFT) strengthened powers to obtain court orders against traders that breach a range of consumer legislation. This consolidated the previous regime, in which each piece of legislation made specific provision for enforcement by particular bodies, such as TSOs and/or the OFT, or simply through consumers taking action under their contracts, depending upon the piece of legislation concerned. Part 8 does not remove the enforcement provisions in the various pieces of consumer protection legislation; however, it adds a coordination mechanism between enforcers and enables a single Part 8 Enforcement Order to be sought for activities that breach a range of different pieces of legislation, such as misleading advertising, misleading pricing, breaches of contract for goods and services, trade descriptions, unfair terms in consumer contracts, doorstep selling, distance selling, package travel and the consumer credit regime outlined above.

39. There are four types of enforcers specified in Part 8:

- General enforcers, namely the OFT, TSOs and the Department of Enterprise, Trade and Investment in Northern Ireland (DETI).
- Designated enforcers, enforcers designated by the Secretary of State. This list currently includes the FSA,²⁸ Which?,²⁹ the Information Commissioner and the sectoral regulators.³⁰

²⁷*Discounted APRs and PPI*, OFT299, and *Credit Charges and APR*, OFT144.

²⁸See The Enterprise Act 2002 (Part 8) (Designation of the Financial Services Authority as a Designated Enforcer) Order 2004.

²⁹See The Enterprise Act 2002 (Part 8) (Designation of the Consumers' Association) Order 2005.

- Community enforcers.³¹
- CPC enforcers.³²

40. Part 8 gives the OFT a central coordination role to ensure that action is taken by the most appropriate body and is not duplicated.³³ Enforcers who want to apply for an enforcement order must first consult with the OFT as well as with the business against which they want to proceed.³⁴ If more than one enforcer is contemplating bringing proceedings, the OFT may direct which body may bring proceedings, or that only the OFT may do so.³⁵ In considering which is the most appropriate body to act, the OFT will take into account a number of factors, including location of the trader, nature of the activity concerned, number of consumers affected and sectoral expertise of the enforcer.

Relevant general consumer legislation

Unfair Terms in Consumer Contracts Regulations 1999

41. The Unfair Terms in Consumer Contracts Regulations (UTCCRs)³⁶ apply a principle of fairness to terms in contracts which allow for variation. Fairness is assessed 'taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent'.³⁷ Core terms (concerning price or main subject matter) are exempt from the Regulations, provided that they are in plain and intelligible language.

³⁰See The Enterprise Act 2002 (Part 8 Designated Enforcers: Criteria for Designation, Designation of Public Bodies as Designated Enforcers and Transitional Provisions) Order 2003.

³¹'Qualified public entities' listed in the Official Journal in accordance with the Injunctions Directive 1998/27, that can enforce the legislation which implements certain consumer directives.

³²Enforcers authorized under the Consumer Protection Cooperation Regulation EC No 2006/2004 (the CPC).

³³Section 216 of the Act.

³⁴See section 214 of the Act and the CPC.

³⁵Section 216 of the Act.

³⁶That implement the Unfair Terms in Consumer Contracts Directive 93/13/EEC.

³⁷Regulation 6.

42. The UTCCRs provide that a standard term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.³⁸ Good faith embodies a general principle of fair and open dealing. This principle of fairness is not limited to deliberately misleading or detrimental terms but extends to the situation in which the contract was concluded. In general the Court has found that, in accordance with the principle of fairness, 'the consumer in choosing whether to enter into a contract should be put in a position where he can make an informed choice'.³⁹ Transparency is also fundamental to fairness. Regulation 7 says that any written term of a contract must be in plain and intelligible language. The Regulations may apply wherever a term gives powers or safeguards to the supplier which could put the consumer at a disadvantage. If a term is unfair then it will not bind the consumer⁴⁰ and the FSA or the OFT may seek an injunction to prevent the continued use of such terms.⁴¹
43. The FSA considers contract terms that provide for no refund in the event of customer cancellation of single premium PPI contracts to be unfair under the UTCCRs, as they run contrary to the requirement of good faith and could cause a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer. Schedule 2 to the Regulations illustrates the meaning of 'unfairness' with a list of indicative unfair terms. This list includes terms that:
- inappropriately exclude or limit the legal rights of the consumer vis-à-vis the seller or supplier;⁴²
 - permit the supplier to retain sums paid by the consumer where the consumer decides not to conclude or perform the contract;⁴³

³⁸Regulation 5.

³⁹*Director-General of Fair Trading v First National Bank [2002] 1 All ER 97.*

⁴⁰Regulation 8.

⁴¹Action may be taken under Regulation 12 of the UTCCRs or Part 8 of the Act. The OFT and the FSA have an MOU which generally provides that the FSA will take action under the UTCCRs where a firm is FSA regulated (OFT860).

⁴²For example, 'Notice of cancellation must be sent by recorded delivery'. See 'Unfair Standard Terms', OFT143.

⁴³For example, 'In the event of an order being cancelled no refunds can be given', OFT143.

- require a consumer who fails to fulfil an obligation to pay a disproportionately high sum in compensation; and
- limit the supplier's obligation to respect commitments undertaken by agents.⁴⁴

44. In addition to the OFT's Part 8 coordination responsibilities, the OFT and the FSA, who along with Which? may enforce the UTCCRs directly,⁴⁵ have developed a concordat in relation to action under the UTCCRs providing that action will be taken by the body best placed to deliver swift and effective protection of consumers having regard to its expertise, knowledge, and priorities among other matters.⁴⁶

Consumer protection from Unfair Trading Regulations 2007

45. The impending Consumer Protection from Unfair Trading Regulations (CPRs)⁴⁷ will introduce a general duty not to trade unfairly in relation to business-to-consumer transactions. The CPRs implement the Unfair Commercial Practices Directive 2005 (UCPD),⁴⁸ the objectives of which are to harmonize⁴⁹ the consumer protection framework across the EU, and to provide a uniform and robust system of law relating to business-to-consumer commercial practices to enhance consumer and business confidence in the internal market. The UCPD recognizes the competition implications of unfair practices—which comprise an advantage to dishonest traders.⁵⁰

46. The CPRs address commercial practices directly related to influencing consumers' transactional (economic) decisions in relation to products and services. They extend in scope from advertising and in-home selling to post-contractual representations that

⁴⁴For example, 'No employee has authority to make statements inconsistent with these terms', OFT143.

⁴⁵See Schedule 1 of the UTCCRs.

⁴⁶July 2006, www.fsa.gov.uk/pubs/other/concordat_fsa_ofi.pdf.

⁴⁷The CPRs come into force in April 2008.

⁴⁸Directive 2005/29/EC.

⁴⁹With the exceptions of financial services and immovable property, the UCPD is a maximum harmonization directive; member states are prohibited from introducing or retaining laws within the scope of the directive that are inconsistent with its tests. Therefore the UK cannot retain or introduce laws pertaining to business-to-consumer commercial practices that fall below or go beyond the standards in the UCPD.

⁵⁰Recital 8.

might influence a consumer's decision to exercise a contractual right (for example, to switch or claim on a policy).

47. The CPRs contain a general prohibition⁵¹ against conduct:
- contrary to the requirements of professional diligence (an objective test—what would a reasonable person expect of an honest trader in this field); and
 - that causes, or is likely to cause, an average consumer (reasonably well-informed, observant and circumspect), the average member of a targeted group, or a member of a clearly identifiable group of vulnerable consumers, to take a transactional decision that they would not otherwise have taken.
48. They then specifically prohibit practices automatically considered contrary to the requirements of professional diligence: misleading actions, misleading omissions and aggressive practices;⁵² and a list of 31 practices that will be considered unfair in all circumstances—ie there is no requirement to show an effect on the average consumer's transactional decision. This list includes:
- Requiring a consumer who wishes to claim on an insurance policy to produce documents which could not reasonably be considered relevant as to whether the claim was valid, or failing systematically to respond to pertinent correspondence, in order to dissuade a consumer from exercising their contractual rights.
 - Falsely stating that a product will only be available for a very limited time, or that it will only be available on particular terms for a very limited time, in order to elicit an immediate decision and deprive consumers of sufficient opportunity or time to make an informed choice.

⁵¹Regulation 3.

⁵²These practices are defined in Regulations 5 to 7.

49. Subject to a couple of small exceptions, the CPR will make it a criminal offence to engage in most of the practices it prohibits. The criminal offences created by the CPRs will be prosecuted by the OFT, TSOs or DETI, having regard to the most appropriate body to take action in the circumstances. All Part 8 enforcers, including the FSA, will have the ability to seek a Part 8 Enforcement Order in relation to the CPRs. The FSA and the OFT are discussing drawing up a concordat similar to that used for the UTCCRs, to ensure clarity when enforcing the CPRs.⁵³

Part 3—PPI and state benefits

50. Complex sets of rules govern entitlements to state benefits. In many cases, benefits are means tested, and are therefore provided after the recipient's income from other sources has been taken into account. Money received under PPI policies can, in some cases, substitute a portion of income, and the CC has been told that a key difference between PPI and products such as income protection insurance is that PPI does not affect state benefits, whereas income protection does. This section summarizes the impact that money received under a PPI policy can have on state benefits.

51. State benefits fall into two broad categories: allowances and income-related benefits.

Allowances

52. Various allowances are available in specific circumstances, which usually relate to the *health* of the applicant or a person dependent upon the applicant. Specific criteria determine eligibility for each allowance, rather than the applicant's financial means. Allowances not calculated according to the applicant's financial means include:

- Contribution-based Jobseeker's Allowance.
- Disability Living Allowance.

⁵³See *Delivering better regulatory outcomes*, OFT940.

- Attendance Allowance.
- Carer's Allowance.
- Vaccine Damage Payments.

53. Money received under a PPI policy is not taken into account when entitlement to those allowances is calculated. Similarly, it should have no effect on the amount payable under any allowance.

Income-related (or mean-tested) benefits

54. Several Department for Work and Pensions (DWP) benefits are available to applicants whose income *from all sources* is limited. They are designed to 'top-up' the applicant's finances to a minimum level. The aim of these benefits is to ensure that an individual (and any dependants) has no less than the minimum level of income to meet their day-to-day living costs. The amount of benefit payable depends on the applicant's income and savings, and their individual or family circumstances. Each applicant is individually assessed, and the amount of benefit payable—their *applicable amount*—bridges the gap between their total income and the minimum level (as set by Parliament) applicable to their circumstances.

55. Some money received under a PPI policy is taken into account in the assessment of income-related benefits. Although such PPI money does not affect eligibility for income-related benefits, it can affect the amount of benefit to which the applicant is entitled.

56. The three main income-related benefits are:

- (a) *Income-based Jobseeker's Allowance (JSA)*. JSA is payable to people of working age who have not paid sufficient National Insurance contributions to qualify for

contributory JSA, who are unemployed and are available for, and actively seeking, work.

(b) *Income Support (IS)*. IS is payable to people of working age where there is no requirement for them to look for work. The main recipient groups include lone parents, those registered sick or disabled, students who are a lone parent or disabled and carers looking after someone who is sick, disabled or elderly.

(c) *Pension Credit*. This is an entitlement for people aged 60 or over. It guarantees everyone aged 60 or over a minimum weekly income. It is paid in addition to the State Retirement Pension.

Treatment of PPI payments when calculating entitlement to income-related benefits

57. To summarize, money received under a PPI policy affects the amount of benefit payable to an applicant where:

- benefits are income-related;
- money received under the policy exceeds the repayment liability under the covered agreement; and
- the claimant receives the PPI monies direct.

58. Where the claimant directly receives any surplus PPI monies (for example, some MPPI policies allow up to 133 per cent of the monthly mortgage repayment to be insured), that sum will be included as income in the assessment of benefit payable. The amount of benefit payable is likely to be reduced in such circumstances.

TABLE 3 **Income-related benefits**

<i>Benefit type</i>	<i>Paid by</i>	<i>Effect of surplus PPI</i>
IS	DWP	Surplus PPI income is taken into account in the benefit assessment
JSA	DWP	Surplus PPI income is taken into account in the benefit assessment
Pension Credit	DWP	Exception: surplus PPI income is ignored
Housing Benefit	Local authorities	Surplus PPI income is taken into account in the benefit assessment
Council Tax Benefit	Local authorities	Surplus PPI income is taken into account in the benefit assessment

Source: DWP.

59. Where recipients of IS or JSA also claim financial assistance with eligible *housing costs*, money received under a PPI policy which is paid to the:

- *lender* directly, as a condition of the policy, is treated as income and factored into benefit calculations—up to the amount that would be payable for housing costs if there were no PPI. Any excess is ignored, as money not available to the claimant;
- *claimant* directly is (after certain disregards) taken into account as net income in the benefit assessment; and
- *lender voluntarily*—where the claimant *could* receive it directly—is (after disregards) taken into account from the date the claimant might receive that money.

60. Where an IS or JSA claimant has a mortgage, their applicable amount will also include an amount for their mortgage interest only. This is the amount that would be payable to them but for the MPPI. Where there is MPPI in place, the amount payable under the policy will be taken into account as income. For example, if the amount payable as mortgage interest included in the applicable amount is £20 per week and the MPPI is paying £20 per week, it effectively eliminates the mortgage interest included in the benefit assessment. If, however, the MPPI was paying out £30 per week, the £10 excess (if available to the applicant) would be treated as income and therefore reduce the amount of benefit payable.

61. Financial assistance extends to housing costs such as payments under a long lease (more than 21 years), ground rent and certain service charges, but excludes payment of mortgage arrears, monthly premiums for endowment policies or capital repayments. Claimants are expected (with the assistance of lenders) to make provision for short periods when they are unable to meet their mortgage payments.
62. Recipients of Pension Credit receive immediate help with their eligible housing costs.
63. Other claimants are subject to two different 'waiting periods':
- (a) Claimants whose mortgage was taken out after 2 October 1995 receive:
 - (i) no help for the first 39 weeks; and
 - (ii) 100 per cent of eligible mortgage interest from week 40.
 - (b) Claimants whose mortgage pre-dates 2 October 1995 receive:
 - (i) no help for the first eight weeks;
 - (ii) 50 per cent of eligible interest for a further 18 weeks; and
 - (iii) 100 per cent of eligible mortgage interest from week 27.
 - (c) This shorter period also applies to specified groups, including:
 - (i) widow(ers) or people who have been abandoned with responsibility for children;
 - (ii) those with caring responsibilities; and
 - (iii) those who have been refused payments under an insurance policy due to a pre-existing medical condition, HIV or AIDs.

Linked entitlements

64. Anyone who qualifies for IS or JSA after surplus monies received under a PPI policy have been taken into account does not have to satisfy another means test for either Housing Benefit (HB) or Council Tax Benefit (CTB). Receipt of those underlying benefits automatically 'passports' that applicant on to full HB and CTB.

65. The principle explained in paragraph 60 above also applies to other insurance policies. Where a PPI policy pays out more than is required to cover the repayment liability under the covered agreement, any excess directly available to the policyholder will be taken into account as income in their assessment for state benefits.

66. In contrast to PPI, income protection appears to offer income which is not designed specifically to cover certain payments. It would appear that in these circumstances, all the money received from an income protection policy would affect the amount of state benefit payable.

Stakeholder summary

HM Treasury

1. One stated aim of HMT is 'Securing an innovative, fair dealing, competitive and efficient market in financial services, while striking the right balance with regulation in the public interest'. It is also responsible for the UK's financial stability and, as such, has close links with the FSA and the Bank of England.
2. A consultation conducted by HMT led to responsibility for the regulation of general insurance products moving to the FSA, along with the responsibility of enforcing the Insurance Mediation Directive (Directive 2002/92/EC).⁵⁴

Department for Business, Enterprise and Regulatory Reform

3. As part of its remit to protect the rights of customers, BERR is responsible for policy on consumer credit.
4. BERR was responsible for the Consumer Credit Act 2006, for increasing the availability of debt advice to customers and for working with the European Commission on the proposed new EU consumer credit directive.

Financial Services Authority

5. The FSA was given statutory powers by the FSMA. HMT appoints the FSA board, which then sets the FSA's overall policy.
6. The FSA regulates the financial services industry and has four statutory objectives:
 - (a) maintaining confidence in the financial system;
 - (b) promoting public understanding of the financial system;

⁵⁴www.hm-treasury.gov.uk/newsroom_and_speeches/press/2003/press_66_03.cfm.

- (c) securing the appropriate degree of protection for consumers; and
- (d) fighting financial crime, reducing the extent to which it is possible for a business carried on by a regulated person or by a person who should be but is not regulated.

7. Following the Government's decision in 2001 to widen the scope of the FSA, it now regulates over 25,000 firms (including 16,000 general insurance brokers⁵⁵).

Office of Fair Trading

8. The OFT is the licensing authority for consumer credit licensees, including lenders, brokers and debt collectors. It has a duty, along with TSOs, to enforce the CCA 1974, including through enforcement action under Part 8 of the Enterprise Act 2002.⁵⁶
9. In addition, under the CCA 1974, the OFT is charged with keeping the consumer credit market under review, and advising BERR about developments in the market and the operation of the CCA 1974 and the CCA regime regulations. It is also required to disseminate information and advice to the public about consumer credit, and has an active role in consumer education in terms of understanding credit issues.

Trading Standards Officers

10. TSOs are part of the Local Authority Regulatory Services and are funded by local authorities. TSOs advise businesses and customers on consumer protection.
11. TSOs have powers to investigate (among other things) complaints about false or misleading product descriptions or prices as well as consumer credit. As with the

⁵⁵www.fsa.gov.uk/pages/About/Teams/Retail/statistics/insurance/index.shtml.

⁵⁶The OFT, the TSOs and the DETI can apply to the court for an enforcement order under Part 8 of the Enterprise Act 2002 where a person has infringed the 1974 Act or regulations made under it and this harms the collective interests of consumers. They can also accept an undertaking in lieu of an application to the court.

OFT, they also have power to seek enforcement orders under Part 8 of the Enterprise Act 2002 where the legislation is infringed.

Department for Constitutional Affairs, Justice, Rights and Democracy

12. The Department for Constitutional Affairs, Justice, Rights and Democracy (DCA) is responsible for debt collection legislation, data protection legislation and court proceedings. It aims to ensure that, where possible, debt problems and disputes are resolved without court proceedings. It envisages the courts being used in the last resort to resolve genuine legal disputes and enforce judgments against those who will not pay. The DCA has responsibility for data protection legislation as well as being the Government's lead organization for information and advice with regard to debt.

Communities and Local Government (formerly Office of the Deputy Prime Minister)

13. The Home Ownership Task Force was established by the Deputy Prime Minister in March 2003 following the Sustainable Communities Plan. This task force is interested, among other things, in the interaction between MPPI and Income Support for Mortgage Interest.

Department for Work and Pensions

14. The DWP is primarily responsible for pensions and benefits rules. It is also involved in the Home Ownership Task Force.