

## PPI remittal

### HSBC Bank - Response to Provisional Decision

#### 1 Summary

HSBC<sup>1</sup> disagrees with the Provisional Decision reached by the Competition Commission (**CC**) with regard to the sale of mortgage PPI (**MPPI**), personal loan PPI (**PLPPI**) and credit card PPI (**CCPPI**).<sup>2</sup> No comments are made with regard to the impact of the Decision on second charge mortgage PPI or retail PPI, since HSBC does not actively sell protection products to customers who have purchased second charge mortgages or retail credit.

HSBC does not consider that the CC has correctly re-assessed the proportionality of imposing a point-of-sale prohibition (**POSP**) on the sale of MPPI, PLPPI and CCPPI for the following reasons:

- The Accent market research (and the CC's interpretation of it) is flawed. In particular, the finding that customers are willing-to-pay a significant amount in order to delay their purchase of PPI is a counter-intuitive and unreliable conclusion, which is inconsistent with other findings in the Accent survey and the CC's own market analysis.
- This finding plays a major role in the CC's modelling result that the benefits from the remedies package significantly exceed the costs. If the unjustifiable finding is removed from the model, the results are materially different.
- In relying on hypothetical, counter-intuitive and unreliable survey evidence, the CC is too quick to dismiss evidence from "real world" experiments conducted by a number of parties and, in particular, the  $\times$  pilot evidence, which suggest that the loss of convenience associated with a POSP will be significant. If this evidence is taken into account in the CC's modelling, the result is significantly different. The decision to rely on the Accent survey evidence at the expense of a considerable number of "real life" experiments which all suggest a significant reduction in PPI penetration rates when a POSP is implemented appears irrational.

It is submitted that on a correct application of the proportionality test, the imposition of a remedy package including a POSP is disproportionate to the aim it seeks to achieve. HSBC has conducted analysis using the CC's model to demonstrate that this is the case. The CC must therefore give consideration to alternative remedy packages.

#### 2 The Accent market research and the CC's interpretation of it

The CC has published two pieces of consumer market research, namely:

- "Retail PPI Qualitative Research Findings", prepared by GfK NOP, on 30 April 2010; and
- "Consumer Attitudes to Payment Protection Insurance", prepared by Accent, on 7 May 2010.

The analysis in this response relates mainly to the market research undertaken by Accent. It is the quantitative findings from this survey that have been relied on by the CC in its remedies modelling for MPPI, PLPPI and CCPPI. HSBC has asked an independent market research expert, Philip Graves (BSc), to review the Accent survey. His detailed review is included in

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<sup>1</sup>  $\times$

<sup>2</sup> For ease of reference, HSBC has adopted the CC's terminology in this response. As has been made clear on numerous previous occasions, HSBC disagrees with the conclusion that one of its protection products - LifeChoices - constitutes PPI and no admissions with regard to the relevant market for LifeChoices should be implied from the use of this terminology.

Annex 1 to this response. The assessment of the market research and the CC's interpretation of it set out here includes the main points identified by Mr Graves in his review.

The Accent survey comprised both qualitative and quantitative research. The qualitative stage consisted of five mini-focus groups and six face-to-face interviews. The quantitative stage consisted of a pilot survey with 50 interviews and a main survey with 806 interviews. The interviews were conducted by either phone and post, or email and phone.

The questionnaire for the interview covered the following elements:

- details of credit and PPI products (e.g. extent of cover, whether a claim has been made);
- views on the advantages and disadvantages of buying PPI at the point of credit sale; and
- a stated preference element to understand customer priorities and their willingness-to-pay for changes to the product specification.

It is the willingness-to-pay (**WTP**) results that have been used by the CC in its modelling. It is the interpretation of these results that gives rise to the flaws in the CC's analysis.

The WTP results are based on a stated preference technique known as conjoint analysis. Respondents were asked (informed by Accent's qualitative research) to compare different pairs of hypothetical options, which varied in the extent of cover, the duration of cover, the monthly premium, and the timing of purchase.<sup>3</sup> Conjoint analysis considers multiple results of these individual paired choices and generates statistical estimates of customers' valuation of the individual components in the product specification.

The WTP results in the Accent survey indicate that a proportion of customers place a significant value on the delay in purchase of the PPI product. The research finds that 31% of personal loan customers surveyed would have preferred to buy PPI after the credit POS. These customers would be "willing to pay" £25.20 per month to delay their PPI purchase by seven days, with the provider contacting the customer, or £19.00 per month for a 24-hour delay, with the customer contacting the provider (see Table 11 in the Accent report). These values can be compared with the median monthly PPI payments of £20.<sup>4</sup> Similar estimates were calculated for mortgage customers (see Table 10 of the Accent report).

The WTP results have been used by the CC as a key input in its modelling of the remedy package. However, these results are not robust for the following reasons:

- loss of convenience is difficult to capture in a WTP study;
- there is no obvious economic interpretation for the WTP for a delay results - they are counter-intuitive;
- the WTP results are not consistent with the other findings from the market research;
- the scale of the WTP for delay is too large to be plausible;
- the WTP results are inconsistent with the CC's own market analysis.

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<sup>3</sup> Accent, Consumer Attitudes to Payment Protection Insurance, April 2010, page 22.

<sup>4</sup> The median monthly payment is reported in the Accent Quantitative Findings, page 23. This figure relates to all survey respondents, rather than just those who prefer to buy after the credit POS. However, Table 12 of the Accent Quantitative Findings, page 44, suggests that PPI payments are similar for those who prefer to buy at the POS, after the POS, and those customers who are indifferent.

## 2.1 Loss of convenience is difficult to capture in WTP study

The fact that the results from the WTP are meaningless is only to be expected given the difficulties in applying a conjoint analysis to this issue. The review undertaken by Philip Graves identified two fundamental conceptual flaws with the stated preference experiment.

- **The variables include both product and process attributes.** The type and period of cover are product attributes, the timing of purchase is a process attribute. As Philip Graves explains:

*“These require different mental processing. Considering the type of cover and period of time they will be covered for requires a respondent to create a value calculation against his own needs in light of the price being charged. However, contemplating the implications of delaying purchase requires respondents to project how they would act in circumstances that are, for the vast majority of the sample, hypothetical. In one instance customers are considering what they want, in the other they are speculating how they will behave. Three attributes are tangible and one is abstract. In my view, mixing these types of attributes compromises the test.”*

- **The timing variable includes both time and direction of communication.** In consequence, the results of the WTP experiment could reflect customers' valuation of the time available or their view on which party is required to make contact or some combination of the two.

Furthermore, there are other weaknesses with the application of the WTP experiment to this case.

- **Consumers may not be willing to purchase “unbundled” PPI at all.** The CC's customer research does not directly address whether, after imposing a POSP and unbundling PPI from credit, some customers would no longer be willing to purchase PPI. The stated preference choice exercise implicitly assumes that the customer will buy PPI whether or not it is available at the point of sale but fails to address the additional effort required to purchase PPI on a standalone basis.
- **Absence of consideration of alternative remedies.** The CC's customer research does not ask respondents for their views on alternative remedies. Consequently, the CC is unable to say that the POSP is the most appropriate remedy for consumers who wish to delay their purchase, even if one accepts that it is appropriate at all.

Faced with these conceptual issues in using WTP evidence in this case, the independent review by Mr Graves has recommended that the best source of evidence would be to conduct live trials:

*“I remain unconvinced that a Stated Preference test, even where the variables of delaying purchase from the point of sale of the loan and the method of communication are separated, can provide reliable data in these circumstances. The requirement on respondents goes beyond what people are capable of reporting accurately in interrogative market research:*

1. *People are unlikely to hypothesise their reaction to an unconsciously experienced emotional driver of behaviour accurately (i.e. the risk felt in delaying purchase)*
2. *People have a tendency to idealise how they will act in the future and their projections of how they will use the time available from a compulsory delay are, in my view, unlikely to be borne out in practice (particularly given the complexity many attribute to the process and how unrewarding many find interactions with financial products that they only experience a few times in their lives).*

**I recommend constructing a live trial using a test and control approach.** Customers arranging a loan or mortgage in the test cell (or cells if 24 hour and seven day alternatives are to be evaluated) would be informed of the requirement for a delay between taking out the loan

*and arranging PPI, a control cell would offer PPI on the present basis. The take-up rate for PPI with the institution offering the loan could then be compared to provide real data for the proportion who take out a policy.” [emphasis added]*

This conclusion suggests that the CC should have attached attaching significant weight to the evidence from the pilot studies, including the  $\times$  pilot. It is also inconsistent with the current CC decision to ignore this evidence. The impact of including this evidence is shown in Section 4 below.

## 2.2 The WTP results are impossible to interpret and counter-intuitive

As explained above, the survey design is seriously flawed. The result of the flawed survey design is a meaningless valuation of the WTP for a delay in purchase. For example:

- The way in which the options are presented means that the insurance product with the delay is an inferior good, in that it comprises the same product at the same price but purchased seven days later (in other words, the consumer is left with seven days fewer days of cover). The survey results indicate that customers are willing to pay **more** for this inferior product - a result which is clearly counter-intuitive.

- This point was also picked-up by Philip Graves in his review:

*“It is also worth noting that the results of the Stated Preference test are not consistent with consumer behaviour in general. Consumers frequently pay more for convenience or to satisfy desires immediately. Whilst a lot of consumer behaviour is not rational it is hard to conceive of a comparable scenario where consumers choose to delay purchase so that they can pay more for the same product subsequently.”*

- The survey identifies two main reasons why respondents would prefer a delay (see Figure 18 of the report). These are “to make an informed decision” and to “shop around”. These factors indicate that these customers are concerned with:
  - first, whether they should buy the insurance (and the type of insurance they should purchase); and
  - secondly, a view that they could get a better deal.

These motivations affect the other attributes in the conjoint analysis (i.e. the product specification and the price) but, because of the flawed survey design, result in a positive WTP valuation for the delay itself. The research indicates that the customers who prefer a delay do so, in part at least, because they consider they may get a lower price for the product yet the stated preference result is that these customers are willing to pay a **higher** price. As a result, to the extent that there is a benefit to some customers from being able to take some additional time before completing the purchase it cannot be reliably captured with the WTP survey.

## 2.3 Results are not consistent with other findings in the survey

For the majority of customers that prefer to purchase at the point of sale the WTP results are at odds with the wider survey evidence. For this group, the WTP results are either small or insignificant. This appears counter-intuitive when compared to the other WTP results. The main reasons given by consumers for wanting to buy at the point of sale (Figure 17 of the Accent report) are:

- to get covered straight away;
- in case they forget; and
- for the convenience.

In general these factors are independent of the other attributes included in the stated preference question design. Therefore, to the extent that customers place a significant weight on these factors, a meaningful WTP figure might be expected to result. The evidence for this, and other surveys, is that for this group of customers these factors are important. Examples of this evidence include the following.

- The Accent research suggests that the most commonly cited advantage is the peace of mind offered by immediate cover. It offers customers “a ‘hassle free’ seamless offering”.<sup>5</sup> Customers “also mentioned the ease and convenience of buying the PPI at the credit point of sale”.<sup>6</sup> A further consideration is that “disclosing financial information is an uncomfortable experience” and customers were keen “to minimise such episodes”.<sup>7</sup>
- Figure 12 of the Accent research reports the spontaneous explanations for purchasing at the credit point of sale. Around 50% of respondents said “being covered straight away”, “for job security”, or “possible changes in personal circumstances”.<sup>8</sup> A further 10% (9% personal loan customers, 12% mortgage customers) suggested “convenience”. The Accent research noted that delaying the PPI sale “might mean that its purchase was overlooked”, exposing them to a financial risk because “something might happen in the meantime”.<sup>9</sup>

Given the potential weaknesses mentioned above that can arise in WTP estimation; it is best practice to cross-check the results against other questions in the survey and other evidence. These cross-checks have not been made in this case and this constitutes a serious omission in the analysis. With the correct checks, the correct conclusion must be that very little weight can be placed on the survey results.

The independent review by Mr Graves also identified that the WTP experiment did not adequately represent the importance of peace of mind to consumers.

*“However, no prompted question raises the consideration of consumer “peace of mind” as a driver of purchase timing, nor is it referenced in the description prior to the Stated Preference test. Conversely, the introduction to the SP test does mention the opportunity (or benefit) of additional time (i.e. after explaining the time of purchase delays of 24 hours or seven days: “If you want to take out Payment Protection Insurance from another provider you can do this at any time.”*

The review concludes that this omission in the design of the WTP experiment could have introduced a bias by “not drawing respondents’ attention to the potential risk associated with delaying purchase of PPI alongside the potential benefit.”

## 2.4 Magnitude of WTP results are not credible

Notwithstanding the points identified above, the order of magnitude of the WTP results does not make sense. The survey suggests that the group of customers that prefer the delay would be “willing to pay” over £25 per month to delay their PPI purchase by seven days compared with median monthly PPI payments of £20.

It is not plausible that customers would be willing to pay that much extra as a result of a 7-day delay. It is out of proportion with the potential benefits of such a delay. The CC makes a very limited reference to this order of magnitude,<sup>10</sup> but then uses the results at face value in its modelling exercise.

It is surprising that the Accent report itself does not comment on the scale of the WTP for a delay. The figures appear to confirm that the respondents were not able to interpret the questions in a meaningful way.

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<sup>5</sup> Accent Qualitative Findings, page 14.  
<sup>6</sup> Accent Qualitative Findings, page 14.  
<sup>7</sup> Accent Qualitative Findings, page 15.  
<sup>8</sup> Accent Quantitative Findings, page 31.  
<sup>9</sup> Accent Qualitative Findings, page 16.  
<sup>10</sup> Paragraph 7.100 of the Provisional Decision.

## 2.5 Results not consistent with CC market analysis

Finally, if the WTP for a delay analysis is correct, it suggests a serious error in the CC's market analysis, which identified a strong point-of-sale advantage. The WTP results suggest that the point-of-sale advantage is not that significant - indeed, consumers place a significant value on not purchasing PPI at the same time as the credit product. If this is the case, it is surprising that:

- More consumers do not exercise the existing option to buy protection away from the credit point of sale.
- More PPI providers have not offered standalone products to cater to this group of consumers (indeed, since the CC's investigation began, standalone providers have actually exited the market).

This inconsistency between the CC's interpretation of the market research and its own market analysis serves to underline the fact that the interpretation of the market research is flawed and invalid.

## 3 The CC's modelling of static consumer benefits from the remedies

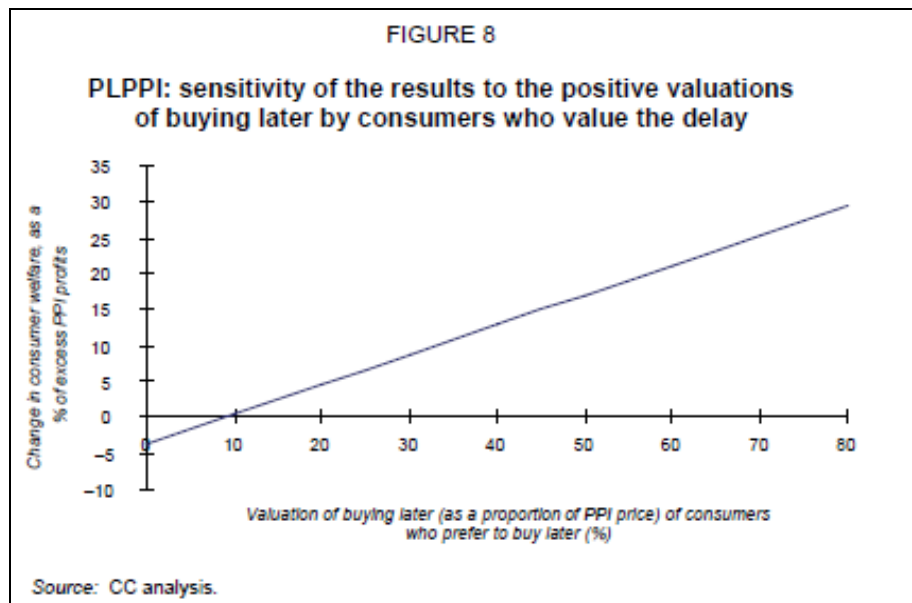
The CC's assessment of the proportionality of the remedies package is reliant on Excel-based economic models of the markets for credit and PPI. Reviewing these economic models, and the CC's description of its modelling in Appendices I and J to the Provisional Decision, reveals that the CC's approach is unsatisfactory in a number of respects. In particular, it is very sensitive to the inputs regarding the loss of convenience suffered by customers as a result of the POSP. The analysis in this Section (and in Section 4 below) focuses on in-depth analysis of the PLPPI modelling results (by necessity, given that the  $\times$  pilot results predominantly concerned PLPPI). For the sake of completeness, HSBC considers that the same criticisms apply to the CC's findings on the proportionality of MPPI (and CCPPI) and that the CC should take into account findings from natural experiments concerning these products. The CC's modelling of MPPI is briefly considered in Section 4 below.

### 3.1 Inappropriate use of Accent's "willingness to pay" results

The CC's modelling uses the Accent stated preference survey results as an input to its modelling. The CC assumes that 30% of customers prefer to delay the purchase of PLPPI. These are referred to in the model as "Group 2" customers. Applying the Accent "willingness to pay" results directly to their model, the CC assumes that the consumer surplus received by these customers, for each unit of PLPPI purchased, increases by 60%. However, the Accent WTP results are unreliable, for the reasons outlined in the previous section.

If instead the CC had assumed that there was no such quantifiable benefit, its modelling indicates that there would be no benefit from the package of remedies. Figure 8 from Appendix J of the CC's Provisional Decision illustrates the sensitivity of the CC's own modelling results to the assumption that Group 2 customers, who prefer to buy PLPPI after the credit point of sale, place a positive valuation on being required to purchase later. For valuations below around 10% of the PLPPI price (compared to the CC's central case of 60%, informed by the Accent research), the CC's modelling indicates a net loss in consumer welfare as a result of the remedies package. Given the inherent flaws in the WTP evidence, the CC's own sensitivity analysis indicates that the remedy results in a loss of consumer welfare and this is therefore not a proportionate remedy.

### CC's analysis of sensitivity to willingness to pay for delay



Source: Competition Commission, Provisional Decision, Appendix J

### 3.2 Including WTP benefits represents double counting of benefits

Even if the WTP results were considered to be robust it would be double counting to include them in the modelling in the way that the CC has.

The Accent survey asked the Group 2 customers why they prefer to take out PLPPI later. 40% of the personal loan sample indicated they preferred this because they “*would like time to consider alternative deals (shop around)*”. This was the second most important factor for the personal loan sample (and the most important factor for the mortgage sample). This indicates that a significant proportion of the perceived benefit from a delay is the expectation of lower prices.

The CC’s modelling already assumes that, post remedy, the price of PPI falls to what the CC considers a competitive level - i.e. by 59% in the case of PLPPI. This highlights the importance of lower PPI prices in the CC’s modelling. It appears therefore that even if the WTP results were considered to be a robust measure of the customer benefit for delay then this benefit is being double-counted within the CC’s modelling.

### 3.3 Sensitivity of results to assumption on waterbed effect

In its 2009 decision, the CC assumed a pass-through of PPI profits to credit of 80% or 100%. In the Provisional Decision the CC has used a base case assumption of 80%. The basis for this change in assumption has not been robustly set out. Para 55 of Appendix I states that the CC “*found some references to a reduction in cross-subsidization in internal documents*”. The context and wider validity of these internal documents is not explained. Furthermore, the reduction in cross-subsidization if it has occurred appears to be related to the current conditions in credit markets. The CC has not considered whether these conditions would persist in this context and, indeed, elsewhere has suggested that they will not.<sup>11</sup>

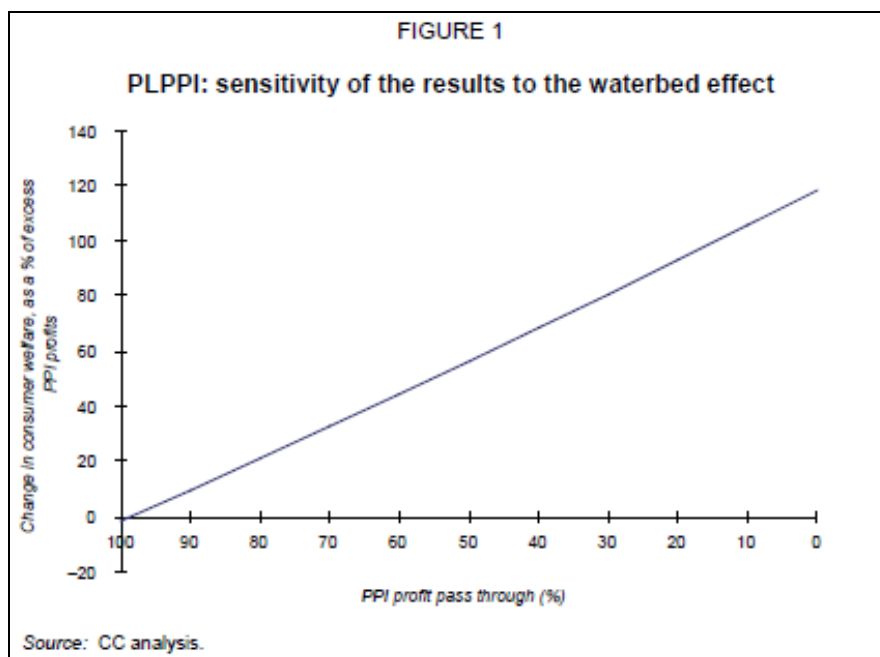
Figure 1 from Appendix J of the CC’s Provisional Decision (shown below) illustrates the sensitivity of the CC’s results to the assumption of the waterbed effect. For values of the

<sup>11</sup> See, for example, paragraph 9.8 of the Provisional Decision.

waterbed parameter close to 100% (compared to the CC's central case of 80%), for PLPPI, the CC's modelling indicates a small net loss in consumer welfare as a result of the remedies package. This highlights that the change in the CC's modelling assumption for the waterbed effect is material to the outcome of the modelling.

It also shows that combining these two factors (removing the flawed WTP results and assuming a 100% waterbed) will increase the net welfare loss of the proposed remedy package.

#### CC analysis of sensitivity of waterbed effect



Source: Competition Commission, Provisional Decision, Appendix J

## 4 Modelling results ignore evidence from the “real world” (✗)

HSBC has previously submitted that the ✗ pilot provides strong evidence that customers were much less likely to purchase PPI following the introduction of a POSP. Penetration rates declined by around one-quarter during the pilot (incremental to the decline observed in non-pilot branches over the same period). HSBC submits that this decline in penetration is due to the loss of convenience suffered by customers as a consequence of the POSP. The CC's modelling currently accounts for this loss of convenience using the “willingness to pay” inputs described above. These inputs are equivalent, in modelling terms, to a decline of around one-twentieth in the penetration rate post-remedy. If instead the CC had assumed that penetration rates would decline by ✗ [20 - 30%] (in line with the ✗ evidence), its model would have predicted a substantial net cost of implementing the package of remedies rather than a substantial net benefit.

### 4.1 Including the ✗ evidence in the CC's welfare modelling

We have used the CC's modelling approach to include the evidence from the natural experiments. The aim was to replace the unsound valuation based on market research evidence with the more legitimate data from the ✗ pilot. In order to do this a number of minor adjustments were made to the model. These are set out below.

- The first step was to remove the willingness-to-pay evidence from the CC's modelling. This was done in the spreadsheet model by assuming that all consumers belong to the

CC's "Group 3". This is the category of customer that the CC identified as being indifferent to the timing of PPI purchase.

- The CC's modelling exercise estimated that the remedies package would lead to a 21% increase in net consumer welfare relative to pre-remedy PLPPI profits. By assuming that all consumers belong to "Group 3" the CC's modelling gives a net consumer welfare gain of 31%. Clearly though this does not include any impact of the loss of convenience.
- The most straightforward way to incorporate the impact of loss of convenience is to assume that the post-remedy penetration rate of PLPPI falls. This is equivalent to a shift in the demand curve.
- The CC's model currently assumes that, for a given PLPPI price, the penetration rate of PLPPI remains unchanged post-remedy, at 30% (before the impact of a loss of convenience).
- For comparison with the analysis that follows, if one were to lower the post-remedy penetration rate to 28.3%, it would restore the CC's modelling result of a 21% net consumer welfare gain relative to pre-remedy PLPPI profits. This means that the CC's modelling result is equivalent to a decline in penetration as a result of loss of convenience of roughly one-twentieth.

Having simplified the CC modelling approach in terms of a single decline in penetration, the next stage was to include the results from the  $\times$  pilot.<sup>12</sup> The  $\times$  pilot evidence indicates that, as a result of implementing a POSP, protection penetration rates fell more sharply than the CC's result (a decline from 30% to 28.3%) would suggest.

The Table shows the impact of the pilot on the penetration rate for the LifeChoices product. It compares the LifeChoices penetration rates observed for pilot and non-pilot branches for the 3 months before the pilot with the 5 months during the pilot:

**Table: Impact on penetration of  $\times$**

LifeChoices penetration rate	Non-pilot branches	Pilot branches
3 months before pilot	$\times$ [5 - 10%]	$\times$ [10 - 15%]
5 months during pilot	$\times$ [5 - 10%]	$\times$ [5 - 10%]
Decline during pilot	$\times$ [-20 - 30%]	$\times$ [-40 - 50%]

Source: HSBC

The Table shows that the non-pilot branches exhibited a  $\times$  [20 - 30 %] decline in penetration rates from  $\times$  [5 - 10%] to  $\times$  [5 - 10%] between the pre-pilot and the pilot sample period. Over the same periods the pilot branches exhibited a  $\times$  [40 - 50%] decline in penetration rates from  $\times$  [10 - 15%] to  $\times$  [5 - 10%].

We assume that the  $\times$  [20 - 30%] decline observed in non-pilot branches represents changes to other market conditions (such as prices, marketing or consumer attitudes and incomes). As a result, we would have expected pilot branches to have experienced a similar decline, absent the  $\times$  pilot programme.

Applying the non-pilot decline to pilot branches indicates that penetration rates would have fallen from  $\times$  [10 - 15%] to  $\times$  [5 - 10%]. The fact that actual penetration rates at pilot branches declined to  $\times$  [5 - 10%] therefore indicates that the POSP led to a  $\times$  [25 - 35%] decline (from  $\times$  [5 - 10%] to  $\times$  [5 - 10%]).

<sup>12</sup> The precise model results calculated by HSBC are included as Annex 3 to this submission. Changes made to input cells or formulae are highlighted.

The final stage in the modelling exercise is to calculate the welfare impact of this change in penetration. We have used the CC's model to calculate this and we have not made any changes to the CC's assumptions in the model (other than those outlined above).

Applying the decline in sales observed in the  $\times$  pilot to the CC model implies a reduction in the post-remedy PLPPI penetration rate (before changes in prices) from 30% to  $\times$  [20-25%], compared to the 28.3% rate implicit in the CC's modelling.

This decline in penetration rate would significantly alter the results obtained using the CC's modelling approach. As outlined above, the CC estimates that the net consumer welfare gain relative to pre-remedy PLPPI profits achieved by the remedies package is 21%. Under our modelling, based on the actual results from the  $\times$  pilot, the net consumer gain becomes a net loss of  $\times$  [-15 - 20%].<sup>13</sup>

Figure 4.1.1 below indicates the sensitivity of the CC's model to alternative assumptions regarding the post-remedy PLPPI penetration rate (before price changes).

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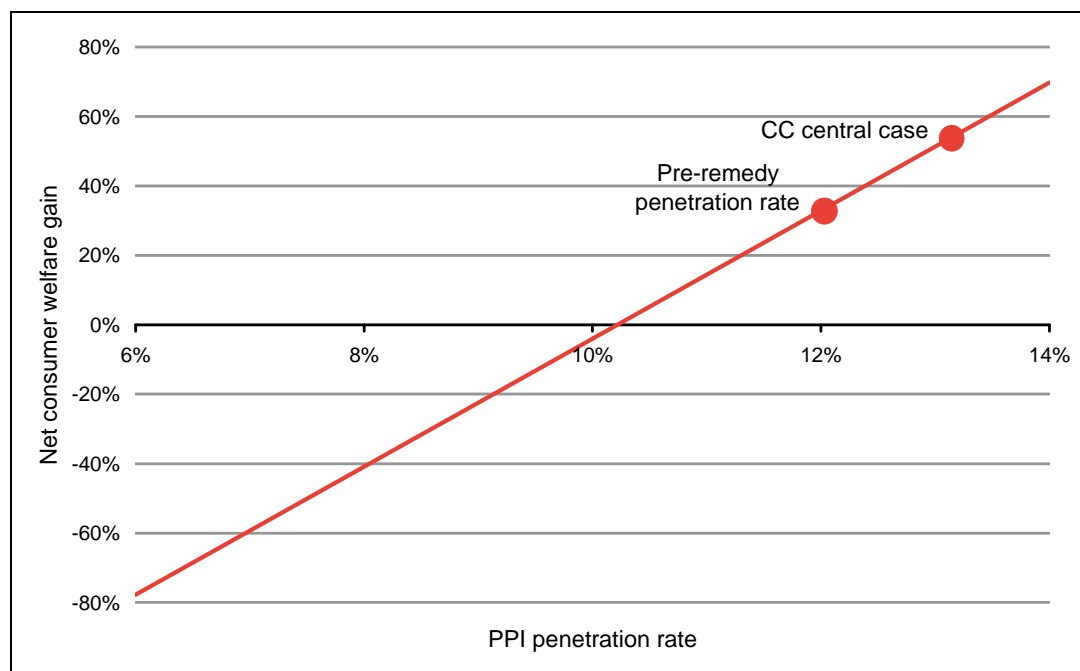
Source: HSBC

Figure 4.1.1 identifies that, using the CC's model, a decline in (post-remedy demand for PLPPI equivalent to a decline in) the PLPPI penetration rate to below  $\times$  [20 - 30%] (compared to the pre-remedy rate of  $\times$  [30 - 40%]) leads to a net harm to consumers from implementing the remedies package.

The results from the pilot cover PLPPI but not MPPI. We have also investigated the sensitivity of the CC's MPPI modelling to the assumption regarding the post-remedy penetration rate, using the same approach as above. This is shown in Figure 4.1.2 below.

#### Figure 4.1.2: Welfare impact of remedy package (MPPI)

<sup>13</sup> One of the CC's criticisms of HSBC's  $\times$  evidence was that the pilot branches appeared variable and there was limited evidence on pre-pilot penetration rates. HSBC conducted a further analysis on an additional 6 months' data from pilot and non-pilot branches to analyse pre-pilot penetration rates and the results are shown in Figure 4.2 below. On this analysis, non-pilot branches exhibited a  $\times$  [20 - 30%] decline in penetration rates during the pilot (from  $\times$  [5 - 10%] to  $\times$  [5 - 10%]), whilst pilot branches exhibited a  $\times$  [40 - 50%] decline (from  $\times$  [10 - 15%] to  $\times$  [5 - 10%]). Making the same assumption as above about the decline observed in non-pilot branches (that this represents changes in other market conditions) so that one would have assumed to have seen a similar decline in pilot branches, absent the  $\times$  pilot, one would have expected penetration rates in pilot branches to fall from  $\times$  [10 - 15%] to  $\times$  [5 - 10%]. In fact, they fell to  $\times$  [5 - 10%], indicating that the POSP led to a  $\times$  [20 - 30%] decline (from  $\times$  [5 - 10%] to  $\times$  [5 - 10%]). Applying this reduction to the post-remedy penetration rate within the CC's model would result in a net consumer loss of  $\times$  [10 - 15%] (see Figure 4.1.1 above).



Source: HSBC

Figure 4.1.2 shows that, using the CC's model, a decline in the MPPI penetration rate to below 10.2% (compared to the pre-remedy rate of 12%) leads to a net harm to consumers from implementing the remedies package. The CC's results are therefore very sensitive to the assumption that penetration rates do not fall as a result of the inconvenience flowing from the remedies package.

If the decline in penetration rates of around one-quarter experienced in the  $\Sigma$  pilot were repeated for MPPI customers, this would leave the MPPI penetration rate around  $\Sigma$  [5 - 10%] or lower. This would result in net harm to consumers. We also note that other parties<sup>14</sup> have estimated reductions in MPPI penetration rates of 40% or higher, significantly higher than the decline needed to generate net harm to consumers.

The PLPPI and MPPI modelling above is, in HSBC's view, a conservative outcome of the likely net harm to consumers. There are a number of factors that indicate that the likely harm to consumers will be even greater.

- Waterbed effect.** The modelling results shown in Figures 4.1.1 and 4.1.2 are based on a conservative view of the waterbed effect. They are based on the CC's revised assumption of 80%. The analysis in Section 3 highlighted that the modelling results are sensitive to alternative scenarios on the waterbed effect. Repeating the analysis above with waterbed effect values between 80% and 100% (which was the CC's range during the main inquiry) would increase the net harm to consumers.
- PPI margins.** The modelling results are sensitive to the assumed excess margins on PPI products. A lower level of margin results in higher net harm to consumers. The CC's assumptions for margins are likely to be too high. Generally the assumed margins were significantly higher than the observed margins for 2009. Although 2009 may not be a representative year the CC has not properly considered the likely trend in margins from 2009 onwards. In the case of PLPPI the CC has not made any adjustment for the switch from single to regular premium policies.

<sup>14</sup> Annex D, paragraph 10 of the Provisional Decision.

- **Timing of costs and benefits.** The CC's analysis does not take proper account of the fact that many of the implementation costs are incurred upfront while the benefits take a number of years to be achieved. The CC's model, which has been used to generate the results in Figures 4.1.1 and 4.1.2, measures the net impact to consumers after all the benefits have been achieved. As a result it will understate the net harm to consumers.
- **Timeframe for benefits is too optimistic.** Furthermore the CC's assumption that the benefits will be fully realised within three years is too optimistic. First it assumes that the remedies will be fully effective with respect to new sales with immediate effect from the introduction of the POSP. Secondly, it assumes that for existing customers the remedy will be effective within three years. This is despite evidence that churn rates are less than one-third, particularly for MPPI.

Furthermore, the modelling above is robust to changes in the assumptions regarding the proportion of customers who are myopic. The CC notes (in Appendix I) that its model predicts that consumer welfare may reduce after the remedies are in place, if the positive valuations associated with buying PLPPI after the credit point of sale are ignored. Yet the CC's modelling indicates that if just 10% of customers behave in a non-myopic manner (compared to the CC's central assumption that no customers do so), then the remedies package will result in a net consumer welfare gain.

In contrast, the modelling in this submission, which estimates a  $\approx$  [15 - 20%] reduction in net consumer welfare for PLPPI using the  $\approx$  evidence, would require over 50% of customers to act in a non-myopic manner for this to result in a positive net consumer welfare gain. This level of non-myopic behaviour is significantly above any plausible level. As a result, our results are not sensitive to assumptions regarding the proportion of non-myopic consumers.

#### 4.2 CC is wrong to dismiss $\approx$ evidence

HSBC recognises that there are limitations to the  $\approx$  evidence. It is impossible to recreate perfectly the world as it could exist following the implementation of a POSP. However, the pilot should not be dismissed for the reasons that the CC gives. In particular:

- The CC suggests<sup>15</sup> that the pilot does not take account of the dynamic benefits that *might* arise as a result of the POSP. However, the CC's own modelling does not take these benefits into account suggesting that it was unable to do so - this is therefore no reason not to use the  $\approx$  evidence on loss of convenience in the CC's modelling.
- The CC suggests<sup>16</sup> that the pilot does not inform them on the cause of the reduced PPI penetration. However, again, in the CC's modelling, the assumption is that "*there were not significant volumes of policies being sold which would not have been sold if consumers had had more time and space to consider their needs*"<sup>17</sup> - this is therefore no reason not to use the  $\approx$  evidence on loss of convenience - the CC admits that the pilot does suggest that a break in the sales process "*could*" lead to reduction in take-up rates of PPI.
- The CC notes that some current PPI purchasers might not purchase it with a split in the sales process between credit and PPI because they are difficult to contact by telephone but they are unable to quantify how many would purchase PPI if contacted.<sup>18</sup> It is not clear to HSBC that being able to quantify this is relevant. Of more relevance is the fact that the experiments show that some current PPI purchasers will not be contacted (and so will not be reminded about PPI) by the credit provider, reinforcing the fact that a POSP will lead to many existing PPI consumers not obtaining cover in future.

<sup>15</sup> Appendix C to the Provisional Decision, paragraph 2.

<sup>16</sup> Appendix C to the Provisional Decision, paragraph 3.

<sup>17</sup> Paragraph 7.109 of the Provisional Decision. The CC has suggested that evidence on alleged mis-selling may be useful in indicating the number of consumers who would not purchase PPI if they had time and space to think about it. HSBC disagrees strongly with this suggestion for all the reasons set out in Annex 2 to this submission.

<sup>18</sup> Paragraph 7.11 of the Provisional Decision.

- The CC points to “*performance of sales staff*”<sup>19</sup> as an issue with the  $\propto$  evidence and suggests that the pilot “*showed that the detail of how a distributor chooses to set up its sales processes - including the motivation of sales staff - can have a material impact on the penetration rates that can be achieved*”.<sup>20</sup> It is unclear to HSBC on what basis the CC reaches this conclusion or what this “material impact” might comprise. HSBC notes that the overall rate of quote execution, whilst lower than expected, can be explained by a whole range of factors, including customer preference and eligibility.

In addition, FSA rules require firms not to offer inducements to staff if these are likely to conflict to a material extent with the duty the firm owes its customers.<sup>21</sup> In relation to PPI, in its November 2005 thematic review, the FSA considered that “*the commission and incentive structures and targets for individual sales staff could encourage the mis-selling of PPI*.”<sup>22</sup> HSBC sees a clear disconnect between the CC’s suggestion and best practice in the industry. Put simply, it is unrealistic to expect staff to be heavily incentivised to sell an insurance product.<sup>23</sup>

$\propto$

- The CC argued<sup>24</sup> that the decline in penetration in the pilot branches was uncertain due to the limited evidence on the pre-pilot penetration rates. To address this, HSBC has analysed the sales data for the pilot and non-pilot branches for 9 months prior to the start of the  $\propto$  pilot.

This data is shown in Figure 4.2 below.<sup>25</sup>

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<sup>19</sup> Appendix C to the Provisional Decision, paragraph 68.

<sup>20</sup> Appendix C to the Provisional Decision, paragraph 70.

<sup>21</sup> FSA Handbook, Insurance Conduct of Business Rules, Rule 2.3 Inducements.

<sup>22</sup> Financial Services Authority, “The sale of payment protection insurance –results of thematic work”, published November 2005, at page 18.

<sup>23</sup> Even if it were appropriate to expect this, it would necessitate an additional implementation cost (the cost of incentivising staff) being added to the model.

<sup>24</sup> Paragraph 65 of Appendix C to the Provisional Decision.

<sup>25</sup> The precise data and workings are provided in Annex 4 to the submission.

✂

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Source: HSBC

The following points emerge from this extended analysis.

- First, there is a degree of variability in the month-by-month penetration rates. This variability is greater for the pilot sample than the non-pilot sample, due to its smaller size.
- Secondly, it is clear that there has been a decline in penetration in the pilot branches following the introduction of the pilot. Penetration fell from ✂ [10 - 15%] for the nine months before the pilot to ✂ [5 - 10%] during the pilot period. For the three months pre-pilot sample used in the original analysis the penetration rate was ✂ [10 - 15%].
- Thirdly, in the pre-pilot period the penetration rates in the pilot branches were above those of the non-pilot branches in every month. This confirms that there are underlying characteristics of the pilot sample that result in penetration above that of the non-pilot branches.

Although the ✂ (and other pilot) evidence has its limitations, it is submitted that, for all the reasons set out in Sections 2 and 3 above, it carries significantly more weight than the hypothetical, counter-intuitive and unreliable results produced by the Accent survey:

- The results from the experiments conducted by numerous parties are consistent in showing a significant reduction in PPI penetration rates when a POSP is implemented,<sup>26</sup> so removing the most obvious point in time at which to discuss protection.
- ✂
- Experts such as Philip Graves suggest that such live trials are the best source of evidence in this scenario.<sup>27</sup>

Yet, the CC ignores this evidence and chooses instead to use the Accent survey evidence in its modelling almost without question. This appears irrational.

## 5 The CC must consider a remedy package without the POSP

For all the reasons set out above, HSBC considers that the CC has incorrectly re-assessed the proportionality of imposing a POSP on the sale of MPPI, PLPPI and CCPPI. In particular:

- The Accent market research (and the CC's interpretation of it) is flawed. In particular, the finding that customers are willing-to-pay a significant amount in order to delay their purchase of PPI is a counter-intuitive and unreliable conclusion, which is inconsistent with other findings in the Accent survey and the CC's own market analysis.
- This finding plays a major role in the CC's modelling result that the benefits from the remedies package significantly exceed the costs. If the unjustifiable findings are removed from the model, the results are materially different.
- In relying on hypothetical, counter-intuitive and unreliable survey evidence, the CC is too quick to dismiss evidence from "real world" experiments conducted by a number of parties and, in particular, the ✂ pilot evidence, which suggest that the loss of

<sup>26</sup> These findings are also consistent with the majority of evidence received by the CC regarding internal estimates by parties of the likely impact on PPI penetration rates following a POSP (as set out in Appendix D of the Provisional Decision).

<sup>27</sup> At Annex 1 to this submission, page 11, Philip Graves concludes: "...a live trial...is the most reliable approach available to gauge how consumers will act in a new scenario."

convenience associated with a POSP will be significant. If this evidence is taken into account in the CC's modelling, the result is significantly different. The decision to rely on the Accent survey evidence at the expense of a considerable number of "real life" experiments which all suggest a significant reduction in PPI penetration rates when a POSP is implemented appears irrational.

HSBC submits that a proper application of the modelling exercise shows that the proposed POSP is disproportionate to the aims it seeks to achieve and consequently the proposed remedy package fails the proportionality test. HSBC has shown in Section 3 that the CC's own analysis is extremely sensitive to the unreliable and unrealistic assumptions made regarding the WTP for a delay results and the waterbed effects and that on a number of measures, the CC's own analysis suggests that the POSP is disproportionate. When one considers the loss of convenience demonstrated by "real world" experiments such as  $\times$ , the level of net consumer welfare loss arising from the POSP increases.

As a result, it is submitted that the CC must consider alternative remedy packages, including those that may not be fully effective to remedy the AEC. In HSBC's view, and as previously submitted, the AEC would be substantially mitigated in a proportionate manner by implementation of a package of information and transparency remedies coupled with a break in the sales process (albeit that a PPI sale could be made immediately after the conclusion of the credit sale, if the consumer so wished) and the provision of a guaranteed quote which could be taken away by the consumer and would remain valid for a fixed period.