

Response to the super-complaint on payment protection insurance
made by Citizens Advice

8 December 2005

OFT825

BACKGROUND

1 On 13 September 2005 Citizens Advice (CitA) submitted a super-complaint to the Office of Fair Trading (OFT) about payment protection insurance (PPI). The super-complaint was based on the CitA report 'Protection racket: CAB evidence on the cost and effectiveness of payment protection insurance'. In its super-complaint CitA stated that the evidence presented in its report suggests that features of the PPI market are seriously harming the interests of consumers. The issues and concerns raised by CitA are wide ranging. The super-complaint reveals four main areas of concern for the OFT to consider:

- consumers pay an excessively high price for PPI
- the protection consumers buy is partial, with many policies unreasonably excluding common causes of credit default
- consumers are frequently mis-sold PPI, with evidence of high pressure and unfair sales tactics
- the administration of PPI claims can be slow and unfair, and can leave consumers facing additional charges or serious debt enforcement action.

CitA's view is that these concerns arise because of a combination of market failure and regulatory gaps.

- 2 The super-complaint made the following specific recommendations to OFT:
 - that OFT undertakes a market investigation into PPI¹
 - that OFT produces guidance for consumer credit licence holders on standards for sales and content of PPI policies they offer that would be consistent with fitness to hold a consumer credit licence
 - that OFT takes regulatory action on PPI policies linked to hire purchase and conditional sale agreements, where borrowers exercising termination rights under sections 99 and 100 of the Consumer Credit Act are told that they cannot cancel the linked PPI or receive a refund of the premium or end any loan funding the premium early
 - that OFT works with the Financial Services Authority (FSA) to develop a joint strategy for regulating PPI.
- 3 The right to submit a super-complaint was created by section 11 of the Enterprise Act 2002 (the Act). A super-complaint is defined under section 11(1) of the Act as a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. CitA is a designated consumer body.²
- 4 Section 11(2) of the Act requires the OFT, within 90 days after the day on which it receives a super-complaint, to publish a response saying whether it has decided to take any action, or take no action, in respect of the complaint and what action, if any, it proposes to take. The response must

¹ Note: this is the wording used in the super-complaint. OFT can launch a market study under section 5 of the Enterprise Act 2002 or make a market investigation reference to the Competition Commission (CC) pursuant to section 131 of the Enterprise Act 2002 if it considers that the test for a market investigation reference is met. In respect of the latter the CC would carry out the market investigation.

² The National Association of Citizens Advice Bureaux is designated by the Enterprise Act 2002 (Bodies Designated to make Super-complaints) Order 2004 (as amended) SI 2004/1517. (Citizens Advice is the operating name of The National Association of Citizens Advice Bureaux – see www.adviceguide.org.uk)

state the OFT's reasons for its proposal (section 11(3)). This document represents the OFT's response to CitA's super-complaint on PPI.

- 5 In considering this super-complaint we have consulted interested parties, including lenders and insurers and their trade associations, by means of meetings and a questionnaire. We have also drawn on the knowledge of the PPI sector which the OFT has gained as a result of its work on store cards³ and through its regulatory role under the Consumer Credit Act 1974.

OVERVIEW OF THE SECTOR

- 6 PPI protects a borrower's ability to maintain repayments and should help them avoid getting into debt should they be unable to keep up their repayments due to accident, sickness or unemployment.
- 7 PPI can be applied to a number of credit products including mortgages, unsecured loans and credit and store cards. It is sold almost exclusively as a secondary product, typically introduced and sold to the consumer at the point of sale of the credit agreement. A recent FSA report,⁴ and the Competition Commission's provisional findings report in its store cards market inquiry,⁵ noted that consumers do not shop around for PPI and in general have little understanding of PPI pricing, alternatives or product attributes.
- 8 Datamonitor⁶ estimates that PPI generated £5.4 billion in premiums in 2003 of which 60 per cent of premium income was from the sale of unsecured loans PPI. This was followed by credit cards and mortgages which each accounted for 15 per cent of premium income.⁷ Around 6.5 to 7.5 million

³ Leading up to the market investigation reference to the CC on 18 March 2004

⁴ FSA *The sale of payment protection insurance – results of thematic work* (www.fsa.gov.uk/pubs/other/ppi_thematic_report.pdf) and *The sale of payment protection insurance – mystery shopping results* (www.fsa.gov.uk/pubs/consumer-research/crpr45.pdf) 4 November 2005

⁵ CC *Store cards Market Inquiry- Provisional findings report* www.competition-commission.org.uk/inquiries/current/storecard/provisional_findings.htm September 2005

⁶ Datamonitor UK Creditor Insurance 2004 *A comprehensive analysis of the PPI market in the UK*.

⁷ Figures for 2003 are the most recent figures available to the OFT.

policies are taken out annually with approximately 450,000 claims made each year (around one claim for every 15 policies taken out).⁸

- 9 The claims information that has been shared with us in the course of our consultation with the industry suggests that claims ratios⁹ in the PPI sector are estimated to be between 15 and 20 per cent. This figure is supported by work carried out by Credit Suisse First Boston¹⁰ and is markedly lower than for other types of general insurance.¹¹
- 10 The nature of the way the product is sold, at point of sale with the consumer focusing on the primary credit product rather than the secondary PPI product, limits (thus far) the potential for stand-alone providers to attract customers. During the course of our research we came across few suppliers of stand-alone products. Where they do exist they tend to focus on mortgage PPI (MPPI). Discussion with industry stakeholders indicated that a number of insurers have tried to enter the stand-alone market in the past but found the product was not financially viable.
- 11 The question of whether it is appropriate to divide the PPI sector into various categories according to the associated loan and/or the distribution chain has been discussed with interested parties as part of OFT's consultation. While no conclusion has been reached on what those categories might be, early observations suggest that MPPI, for example, differs from the rest of PPI, with a distribution chain more likely to include brokers and stand-alone providers and monthly premiums rather than upfront single premiums. MPPI also faces competition from alternative protection products such as critical illness insurance, income protection insurance and permanent health insurance.

⁸ CitA report *Protection racket: CAB evidence on the cost and effectiveness of payment protection insurance*.

⁹ Claims as a percentage of premium income.

¹⁰ Credit Suisse First Boston's report *UK banks: PPI – Time for change* estimated claims ratio to be around 20 per cent.

¹¹ For example, ABI data indicate that the loss ratio for motor insurance for 2003 was 74 per cent and Datamonitor indicate that the loss ratio for household insurance in 2004-5 was 55.2 per cent.

OFT'S APPROACH ON THIS SUPER-COMPLAINT

- 12 The PPI sector is complex and the CitA concerns wide ranging. While discussion of the issues with industry bodies and their individual members has helped us to start to gain an initial understanding of the sector, the 90 day timetable has not allowed us the opportunity to explore all of the issues or concerns in detail or reach substantive conclusions on how well the PPI sector is working for consumers.
- 13 Furthermore, the timing of the super-complaint prevents us from fully taking into account the findings of the FSA work, which was published some way through the 90 day period or the CC inquiry on store cards, the report on which is not expected until January 2006. A natural consequence of this is that OFT will wish to undertake work on the PPI sector beyond the date of this response.

WORK CURRENTLY BEING UNDERTAKEN IN THIS SECTOR

- 14 In considering OFT's response to the super-complaint it was essential that we took account of the two pieces of work which were underway at the time the super-complaint was submitted. These are the FSA's thematic work on PPI, published on 4 November 2005, and the CC's report on its market inquiry into store cards, including PPI, which, according to the CC's administrative timetable,¹² is scheduled to be published in January 2006. The findings and outcomes from both pieces of work play a key role in influencing the direction of OFT's work.

FSA - The sale of PPI: results of thematic work

- 15 The FSA announced the findings of its thematic work on PPI on 4 November. The focus of this work was to assess whether firms were complying with FSA rules, particularly Conduct of Business and training and competence rules, and whether firms were treating their customers fairly. The findings from this work are variable, with some firms, particularly those selling prime mortgages, demonstrating good compliance with FSA rules. However, in other sectors selling practices were poor and

¹² See www.competition-commission.org.uk/inquiries/current/storecard/core_timetable.htm

some firms lacked proper compliance controls. The FSA found that, while most firms were unlikely to pressurise customers into buying PPI:

- there was a risk of inappropriate sales – some firms failing to take reasonable steps to ensure customers did not buy policies on which they could not claim or which provide only limited cover
- there were inadequate controls in place for non-advised sales: some firms selling on a non-advised basis did not have adequate systems to stop their staff giving advice
- advice on PPI was likely to be of poor quality – there was a failure to assess suitability adequately. Documentation setting out reasons for a recommendation was too generalised and did not take into account a customer's specific requirements or circumstances
- the quality and timeliness of product and price disclosure by some firms selling single premium policies was poor
- the level and structure of inducements and targets for sales staff could encourage mis-selling in some firms.¹³

16 FSA was particularly concerned about single premium policies.¹⁴ Information on interest was not disclosed, insufficient information was given on the lack of refunds, and in some cases misleading comparisons were made between single and regular premiums in favour of single premiums.

17 These findings are generally consistent with a number of the concerns raised by CitA. For example, CitA expressed concern that many borrowers are sold policies that they will never be able to benefit from as their circumstances immediately exclude them from cover.¹⁵ CitA also expressed concern about the lack of transparency of PPI products and the

¹³ See *The sale of payment protection insurance – results of thematic work* 4 November 2005 paragraph 6.

¹⁴ See 5.6 to 5.13 of the FSA Thematic Work.

¹⁵ See chapter 3 of the CitA report *Protection racket*.

difficulty for consumers in making a judgement on the comparative worth of their purchase.¹⁶

CC store cards market inquiry provisional findings report

- 18 The CC market inquiry on store cards includes consideration of insurance purchased in association with the provision and use of those store cards (including PPI). The CC report is not expected to be published until January 2006. However, the CC's provisional findings, published in September 2005, indicate,¹⁷ among other things, that there is little or no competitive pressure on the pricing of insurance premiums to cardholders; that third party providers cannot readily compete to offer more competitive terms to store card providers because premiums are charged as a fixed percentage of the outstanding balance on the card account and neither retailers nor a third party insurer would have access to these balances; that, to the extent that payment, purchase and price insurance are packaged together and are not individually available, consumers often have little choice in the products available to them; and that consumers have a weak understanding of why they buy insurance and the nature and extent of cover it provides.¹⁸
- 19 Should its provisional findings be confirmed in its final report, the CC has put forward a number of possible remedies,¹⁹ primarily focused on improving post-sale information to consumers so that they are well informed about their ongoing costs. One specific remedy related to insurance is the requirement that 'bundled' insurance packages²⁰ be offered separately.

REGULATION AND CONSUMER PROTECTION

- 20 CitA's report acknowledges that OFT does not regulate the sale of PPI: it is the responsibility of the FSA.²¹ The OFT does, under the Consumer Credit

¹⁶ See paragraph 2.6 of the CitA report *Protection racket*.

¹⁷ www.competition-commission.org.uk/inquiries/current/storecard/provisional_findings.htm

¹⁸ See paragraph 8.157 of the Competition Commission's provisional findings.

¹⁹ www.competition-commission.org.uk/inquiries/current/storecard/index.htm

²⁰ Where two or more elements of payment, purchase and price protection are packaged together.

²¹ The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No 2) Order 2003, SI 2003/1476.

Act 1974, license those involved in the sale and broking of credit and can refuse or revoke a credit licence if the applicant or holder is unfit. FSA evidence of, for example, mis-selling of PPI might amount to conduct inconsistent with fitness. OFT and FSA are aware of the need for joined up strategies, particularly in areas that straddle both regimes such as PPI. However, any strategy will need to operate within the statutory constraints on the information that can be exchanged on particular cases.

- 21 A decision to develop OFT guidance to licence holders on the promotion and sale of PPI will in part be informed by the impact of FSA's findings of its thematic work on PPI. FSA have put the PPI sector on notice regarding non-compliance with FSA rules, and next financial year will undertake another round of thematic work to determine if compliance has improved. If significant improvement is evidenced, then the need for OFT guidance may be reduced.

- 22 During OFT's consultation on this super-complaint, a common theme put to us by the industry was that the introduction of insurance conduct of business (ICOB) regulations in January 2005²² had led to significant changes in the sale of PPI, which should have reduced the likelihood of complaints such as those set out in CitA's report. The CC reported in its provisional findings on store cards that the ICOB regulations may well offer consumers greater protection in purchasing store card insurance and increase transparency. However, the CC was clear that the new regulations would not address three concerns, namely: the bundling of store card insurance and hence the lack of choice for consumers; the possibility that consumers might be paying for insurance cover they no longer needed (for example, price protection) or were entitled to receive; and the lack of competitive pressure on this aspect of the store card offer. The FSA's findings, (which are based on thematic visits to firms and mystery shopping) carried out after the introduction of the ICOB regulations, show that problems still exist and there are issues of non-compliance. In any event it appears unlikely that compliance with the ICOB regulations would alone be enough to conclude that this market is working well.

²² The above Regulations govern the sale of non-investment insurance contracts to consumers and require insurance intermediaries to be authorised by the FSA from 14 January 2005.

PROPOSED ACTION

23 OFT intends to carry out a market study into PPI, the precise scope of which will be announced in early 2006. As set out in paragraph 3.18 of the OFT's Guidance,²³ the principal outcomes of a market study are:

- giving the market a clean bill of health
- publishing information to help consumers
- encouraging firms to take voluntary action
- encouraging a consumer code of practice
- making recommendations to the Government or sector regulators
- investigation and enforcement action against companies suspected of breaching consumer law or competition law, and
- a market investigation reference to the Competition Commission.

The case for a market study

24 A market study may be launched in response to a super-complaint if, on consideration of the complaint, it is felt to meet the criteria for a study.²⁴

*Scale and significance of the possible problems*²⁵

25 PPI generated £5.4 billion in premiums in 2003 with, in some cases, penetration rates²⁶ of 70 per cent.²⁷ PPI is a relatively complex insurance product sold as a secondary purchase in conjunction with a credit

²³ *Market Studies: Guidance on the OFT approach* November 2004 ('the Guidance')

²⁴ See paragraph 2.2 of the Guidance.

²⁵ Paragraphs 2.5 – 2.13 of the Guidance set out factors which will be relevant to the OFT's consideration of whether to conduct a market study. The initial selection takes into account a number of factors including the scale and significance of the possible problems or consumer detriment in the market.

²⁶ In percentage terms the number of loans which are sold with PPI.

²⁷ See paragraph 4.9 of the FSA Thematic Work.

arrangement (the credit arrangement being the primary product), rather than as a stand-alone product.

- 26 The combination of the sheer scale of the sector, the complexity of the product coupled with the limited understanding on the part of the customer, as well as the way in which the product is sold (secondary purchase), point to a potentially high risk of consumer detriment in this sector.
- 27 In accordance with our Guidance, we have sought to identify whether there are any issues within the PPI sector which give us grounds to suspect that the PPI sector may not be working well for consumers and, therefore, warrants further work, in this case in the form of a market study. The following issues point to the need for a more detailed examination of the sector.

High costs or other barriers to entry

- 28 The nature of the way the product is sold, at point of sale with the consumer focusing on the primary credit product rather than the secondary PPI product, limits (thus far) the potential for stand-alone providers to attract customers. The CC in its provisional findings on store cards PPI has expressed concern that third party insurance providers cannot readily compete to offer more competitive terms to store card credit providers because of the way premiums are charged. During the course of our research we came across few suppliers of stand-alone products. Where they do exist they tend to focus on MPPI. As set out in paragraph 10 above, discussion with industry stakeholders indicated that a number of insurers have tried to enter the market with stand-alone products in the past but found the product was not financially viable.

The difficulties faced by consumers in respect of (a) gaining information they need about alternative suppliers and (b) the technical nature and/or lack of transparency of the information available to them

- 29 The evidence we have seen from the CC and CitA points towards consumers having little general awareness or understanding of PPI pricing, alternatives or product attributes. Customers tend to focus on arranging

the credit agreement and often do not consider the associated risk or the value of insurance in laying off that risk.²⁸ Consumers seem to be less likely to shop around for PPI than they might do for the primary credit product. CitA has indicated that people who are primarily shopping for credit or goods purchased with a linked credit facility are likely to take the product offered by the lender or retailer if they are going to obtain PPI cover at all. The FSA's evidence of high penetration rates suggests that some people may be being sold products which are not suitable for them. The super-complaint highlights the difficulties consumers have in working out either the total cost of PPI or the effect buying PPI has on the total cost of borrowing on revolving credit agreements.

- 30 In addition, the information which is available to consumers is unduly technical or lacks transparency. The FSA found that disclosure documentation on PPI was often of poor quality and unhelpful. Information relating to single premium policies raised particular concerns – information on interest not disclosed as is required under FSA rules, insufficient information on the lack of refunds, and in some cases misleading comparisons between single and regular premiums in favour of single premiums. The evidence from CitA and the CC found that consumers are not sufficiently aware of exclusions and cancellation rights.

Degree of variation in pricing in the market

- 31 A 2004 survey by Datamonitor of some 50 providers of PPI for unsecured personal loans found a three-fold difference between the cost of the most expensive to the cheapest policy, not accounted for by differences in cover. A similar price variation has been found by Credit Suisse First Boston.²⁹

Gross profit margins appear high

- 32 While there is a lack of market-wide profitability data, claims ratio figures can be used as a useful proxy for profitability. Claims ratios for PPI are estimated to be between 15 and 20 per cent,³⁰ markedly lower than for

²⁸ ABI submission to OFT 18/11/2005.

²⁹ Credit Suisse First Boston 13/09/05 *UK Banks PPI-time for change*.

³⁰ Credit Suisse First Boston 13/09/05 *UK Banks PPI-time for change*.

other types of general insurance. The claims ratio of motor insurance for 2003, for example, was 74 per cent and for household insurance, 55.2 per cent.³¹

Taking forward the market study

- 33 A market study will allow us to look in more depth at the issues CitA has raised and particularly at the issues set out above in order to assess how well this market is working. A market study will enable further consideration of the recommendations directed specifically at the OFT, including the scope for a more joined-up strategy for regulating PPI between OFT and FSA, considering the degree to which guidance can raise standards in this market and how the guidance can be targeted, as well as assessing whether more far-reaching reform is required.
- 34 The market study will also give us the opportunity to look more carefully at the outcomes of the FSA and CC work and assess the impact they might have on the sector, including the extent to which there is effective competition in the market.
- 35 During the course of our work on the super-complaint we spoke to several organisations about the concerns which the super-complaint raised and found that there is recognition within the industry that there are issues which need to be tackled. This encourages us to think that they will co-operate with our study and help us to acquire the evidence we need in order to assess whether or not the market is working well for consumers.

³¹ Datamonitor UK Household Insurance 2004-2005