

PPI and regulation

1. This appendix outlines the regulatory framework and rules that affect the provision of Payment Protection Insurance (PPI) to consumers.¹ Parts 1 and 2 of this appendix 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. The key points to note in this appendix 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 authorizes PPI providers and intermediaries. It also regulates PPI product disclosure and sales processes, under the Financial Services and Markets Act 2000 (FSMA). The FSA has the lead role in ensuring consumer protection in relation to PPI. The FSA also has regulatory responsibility for first-charge mortgages.
 - The OFT licenses credit providers and intermediaries, including those involved in second-charge mortgages, under the Consumer Credit Act 1974 (CCA) as amended. It also enforces the CCA regulations including those regarding credit agreements and advertising. In addition, the OFT has a wider role in ensuring that markets work well for consumers.
 - There is a degree of overlap between the functions of the FSA and the OFT, and a firm may be regulated by both when conducting certain business activities — including when promoting PPI ancillary to a credit agreement.

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

- The regulatory regimes specify that the annual percentage rate (APR) should be the prime cost to the customer comparator used by credit providers when supplying information to consumers.
- The cost of PPI only has to be included in the APR calculation if the taking out of PPI is a compulsory condition of the credit, or of taking out credit on the terms advertised.
- Benefits received following a claim on a PPI policy do 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 the credit provider.

Part 1—Background

Regulatory responsibilities

3. The FSA and the OFT are the lead regulators for both PPI and the related credit products. According to the Report on PPI by the OFT,² they have complementary regulatory roles in relation to 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 for PPI and other insurance products. The OFT also regulates consumer credit providers and intermediaries, and the FSA regulates first-charge mortgage firms. There are additional government departments and independent bodies that have an interest in the regulation of PPI and related credit products (the regulatory stakeholders).
4. In summary the regulatory stakeholders are:

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

Her Majesty's Treasury

- (a) One stated aim of Her Majesty's Treasury (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'. HMT is also responsible for the UK's financial stability and as such has close links with the FSA and Bank of England.
- (b) It was a consultation conducted by HMT which 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).³

Department for Business, Enterprise and Regulatory Reform

- (c) As part of its remit to protect the rights of customers, the Department for Business, Enterprise and Regulatory Reform (BERR) (formerly the Department of Trade and Industry) is responsible for policy and legislation on consumer credit.
- (d) BERR was responsible for the Consumer Credit Act 2006, and changes to consumer credit regulations, for increasing the availability of debt advice to customers and for working with the European Commission on the proposed new EU consumer credit directive. It also has an interest in reducing over-indebtedness.

FSA

- (e) The FSA was given statutory powers by the FSMA. HMT appoints the FSA Board, which then sets the FSA's overall policy.
- (f) The FSA regulates the financial services industry and has four statutory objectives:
- (i) maintaining confidence in the financial system;
 - (ii) promoting public understanding of the financial system;
 - (iii) securing the appropriate degree of protection for consumers; and

³www.hm-treasury.gov.uk/newsroom_and_speeches/press/2003/press_66_03.cfm.

- (iv) reducing financial crime.
- (g) The FSA authorizes firms to engage in regulated activity (including PPI) and supervises their operations and compliance with relevant rules.
- (h) Following the Government's decision in 2001 to widen the scope of the FSMA, the FSA now regulates over 28,000 firms (including 15,984 general insurance brokers as of December 2007⁴).

Financial Ombudsman Service

- (i) The Financial Ombudsman Service (FOS) is the statutory dispute-resolution scheme set up under the FSMA. The FOS is intended to provide consumers with a free, independent service to help settle disputes with financial firms. Its remit was extended to consumer credit licensees in April 2007, by virtue of the Consumer Credit Act 2006. It deals with issues of redress to customer complaints, and generally aims to put people in the position they would have been in if things had not gone wrong. This can include instructing the financial firm to make good the consumer's losses.
- (j) On 28 May 2008 the FOS published its annual review for the 2007/08 financial year.⁵ The Annual Review reported a sixfold increase in complaints about PPI to 10,652 complaints in that period. Most complaints to FOS now relate to how the policies were sold (rather than complaints about rejected claims). The review noted that FOS had seen a significant number of complaints from consumers who said they did not ask for PPI, did not know they had PPI or were told they had to take out PPI, even though they did not want it. Separately, FOS identified that it had seen many cases where consumers complained that when they took out PPI, they were not aware of relevant important features—such as exclusions which would have made them ineligible for cover. FOS also noted that 'single-

⁴www.fsa.gov.uk/pages/About/Teams/Retail/statistics/insurance/index.shtml.

⁵Annual Review, Financial year 2007/08, Financial Ombudsman Service Limited, May 2008.

premium policies sold by a lender at the same time as the loan appear to present considerably more problems than monthly mortgage protection policies’.

OFT

- (k) The OFT is the licensing authority for consumer credit licensees, including lenders, brokers and debt collectors. It has a duty, along with Trading Standards Officers (TSOs), to enforce the CCA, including through enforcement action under Part 8.⁶
- (l) In addition, under the CCA, 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 and 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.
- (m) The OFT also has a wider role in relation to competition and consumer protection, with the aim of making markets work well for consumers.

TSOs

- (n) TSOs are part of the Local Authority Regulatory Services and are funded by local authorities. TSOs advise businesses and customers on consumer protection.
- (o) 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 OFT, they have power to seek enforcement orders under Part 8 of the Enterprise Act where the legislation is infringed.

Ministry of Justice

- (p) The Ministry of Justice (MoJ—formerly the Department for Constitutional Affairs, Justice, Rights & Democracy) is responsible for debt collection legislation, data protection legislation and court proceedings. The MoJ aims to ensure that where possible, debt problems and disputes are resolved without court proceedings. It

⁶The OFT, the TSOs and the Department of Enterprise, Trade and Investment in Northern Ireland can apply to the court for an enforcement order under Part 8 of the CCA where a person has infringed specified legislation (including the CCA and regulations) and this harms the collective interests of consumers. They can also accept an undertaking in lieu of an application to the court.

envisages the courts being used as the last resort to resolve genuine legal disputes and enforce judgments against those who will not pay. The MoJ has responsibility for data protection legislation as well as being the Government's lead organization for information and advice with regard to debt.

- (q) The Ministry of Justice has recently consulted⁷ on changes to Administration Orders (AO) and the introduction of a new Enforcement Restriction Order (ERO). As Her Majesty's Courts Service notes in the consultation, under current arrangements an AO is currently available to County Courts as a debt management scheme. It is currently restricted to those persons with maximum debts of £5,000, one of which must be a judgment debt. The proposed changes include the raising of the maximum debt to £15,000 and the introduction of an Enforcement Restriction Order (ERO)—to provide short-term assistance (via enforcement relief) to those who encounter a sudden and unforeseen change to their financial circumstances from which they are likely to recover within a relatively short period. The proposed maximum period for an ERO is 12 months. The proposals do not apply to credit which is secured against property.

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

- (r) The Home Ownership Task Force was established by the Office of 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 (ISMI).

Department for Work and Pensions

- (s) The Department for Work and Pensions is primarily responsible for pensions and benefits rules. It is also involved in the Home Ownership Task Force.

⁷Administration and Enforcement Restriction Orders: setting the parameters, Consultation Paper CP01/08, 16 January 2008 by Her Majesty's Courts Service, part of the Ministry of Justice.

Part 2—The regulatory framework

5. There is a historical split between deposit-taking investment and insurance organizations (for example, banks and pension providers), which are regulated by the FSA and for which HMT leads on high-level policy and primary and secondary legislation⁸, and consumer credit (for example, personal loans and 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). This means, for example, that although the OFT is responsible for licensing credit card issuers and supervising their compliance with the CCA, most credit card firms are also authorized by the FSA as a credit card firm 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 regulation.⁹

6. PPI product promotion is one example of an activity which will require firms to deal with different sets of regulations which are overseen by different regulators. The FSA authorizes PPI providers and intermediaries and regulates PPI product disclosure and the sales processes (see the Insurance Conduct of Business Sourcebook (ICOB) rules). The FSA's Treating Customers Fairly (TCF) initiative also covers PPI promotions. The CCA regulates, through the OFT, the form 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, a separate signature box for PPI is required in the main credit agreement.¹⁰ Further, a number of general consumer protection rules are relevant to PPI sales practices and contracts. As a

⁸Secondary legislation is added by the Treasury as areas are added or removed from the remit of the FSA.

⁹By way of example, as at end June 2007, around 21,000 firms are 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.

¹⁰Consumer Credit (Agreements) Regulations 1983 as amended by the Consumer Credit (Advertisements) Regulations 2004 (the 2004 Amendment Regulations).

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>
<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 (products under the Insurance Mediation Directive).</p>	<p>Credit—consumer credit, including credit cards, store cards and unsecured personal loans.</p> <p>Mortgages—second-charge mortgages from firms which are not authorized by the FSA to sell first-charge mortgages.</p> <p>Insurance mediation—advising on or dealing with investments as an agent in relation to an insurance policy.</p>
<p>Source: FSA—www.fsa.gov.uk/Pages/Doing/Regulated/Promo/Role/index.shtml.</p>	

7. The FSA also regulates the advice that can be given to consumers regarding PPI. Sales of financial products can either be made on a non-advised or an advised basis. An advised sale occurs when the customer receives a recommendation¹¹ from a sales person after an exchange of information has taken place about the requirements and ability to pay of the customer. This compares with an unadvised sale where the product is made available to a customer, without any recommendation as to its suitability to their personal circumstances. If sales are made on an advised basis, then there are a number of procedures that must 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 are required have adequate systems in place to prevent staff giving advice or providing information that amounts to giving advice.¹²

¹¹The FSA definition provides that a recommendation can be provided in many ways including: (a) face to face; (b) orally to a group; (c) by telephone; (d) by correspondence (including email); (e) in a publication, broadcast or website; and (f) through the provision of an interactive software system.

¹²See paragraphs 25 to 27 for a more detailed explanation.

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

	<i>Primary policy maker</i>	<i>Primary regulator</i>
Insurance products* (including PPI)	HMT	FSA
First-charge mortgages	HMT	FSA† (since 31 October 2004)
Second-charge mortgages‡	BERR	OFT/TSOs (other than in respect of advertising of second-charge mortgages from FSA-authorized lenders)
Personal loans	BERR	OFT/TSOs
Credit cards	BERR	OFT/TSOs

Source: CC.

*Only includes those products regulated under the Insurance Mediation Directive. This does not include policies in areas such as event arrangement or car hire.

†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 (such loans are also generally exempt from the CCA).

‡If the mortgage is a second (or subsequent) charge on a home it is a 'second-charge mortgage', ie the customer already has another loan secured against the home.

The Financial Services Authority and its powers

8. 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 provides the FSA with its powers and established the overall regulatory framework for the financial services sector in the UK. 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 such as being an Appointed Representative of an authorized firm.

9. All financial firms authorized by the FSA must meet the 'threshold conditions' set out in Schedule 6 to the FSMA, and include adequate financial resources, management and systems and controls.

10. Since 14 January 2005, insurance intermediaries have been subject to the Insurance Mediation Directive (the Directive). As it is implemented in the UK, the Directive provides for the FSA to have responsibility for the regulation of insurance intermediaries in the UK. Some of the relevant provisions of the Directive have been

implemented by the FSA in its Handbook of rules and guidance such as the Conduct of Business rules and the FSA's Principles for Business. The FSA Handbook provides detailed rules for the sale and administration of general insurance, including rules on product disclosure, claims handling, complaints procedures and holding client money.

11. Under the 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 discipline firms and individuals, including the ability to levy unlimited fines or to bring criminal proceedings. For example, if a firm carries on activities regulated under FSMA without being authorized or exempt, it can be prosecuted by the FSA.

12. The FSA has been given a wide range of rule-making, investigatory and enforcement powers to discharge its functions.¹³ 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 its 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, the Principles recognize the international character of markets and the UK's competitive position in those markets. Although the principles of good regulation are not absolute requirements, they guide the FSA's actions and encourage it to consider the wider impact of its rules, eg on competition. The FSMA does not, however, give the FSA any specific powers concerning competition issues or any responsibilities regarding the fees and prices charged by regulated firms.

¹³For example, sections 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).

13. The FSA Handbook sets out the rules made by it under the FSMA with which regulated firms are required to comply. The Principles for Businesses (the Principles) set out the fundamental obligations of regulated businesses, provide a basic yardstick by which firms can order their behaviour and provide a basis for supervisory and enforcement activity by the FSA itself. The breach of any of the Principles 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;

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; and

Principle 11. deal with its regulators in an open and cooperative way, and disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

TCF and thematic work

14. The FSA's TCF initiative began in July 2004 and 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 FSA's expectations of firms and to establishing what fair treatment might mean.¹⁴

15. The FSA has defined six consumer outcomes which explain what they want TCF to achieve:
 - (a) Consumers can be confident that they are dealing with firms in which their fair treatment 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.
 - (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.
 - (f) Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

16. The FSA required all firms to provide an implementation plan for their TCF programmes by March 2007. As at the end of March 2008 firms are expected to have appropriate management information or other measures in place to test whether they are treating their customers fairly. The TCF initiative applies to firms regulated by the FSA dealing with consumers but not in relation to their wholesale arrangements.

¹⁴Principles 1, 2, 3, 7, 8 and 9 are all relevant to the TCF initiative.

17. In addition to the TCF initiative, the FSA is carrying out a specific thematic programme on PPI.¹⁵ 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.¹⁶ Where necessary, the FSA will take enforcement action against firms using its powers under the FSMA and the FSA Handbook, including the Principles, ICOB or the Unfair Terms in Consumer Contracts Regulations (UTCCRs—see paragraph 47).

18. Areas relating to PPI which the FSA is currently addressing include disclosure of information, eligibility and suitability of customers and issues around the product design. The FSA has stated that it will consider higher fines for breaches of the Principles or ICOB and will be further assessing compliance by firms.

ICOB rules

19. ICOB is an extensive set of rules that govern the relationship between insurers (acting as product providers), insurance intermediaries who arrange insurance for retail customers and how they conduct their business with their customers. ICOB contains general rules¹⁷ which reflect the Principles 1 and 6, which 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 also contains specific rules in relation to financial promotions, advising and selling standards, product disclosure and cancellation.¹⁸ The issue of redress to customer complaints in these areas is handled via the FOS.¹⁹ Generally, the FOS aims to put

¹⁵The FSA has a policy of reviewing major regulatory interventions to ensure that they are effective and addressing the issues intended. The ICOB review is one such stand-alone post-implementation effectiveness review.

¹⁶For further information, see www.fsa.gov.uk/pages/Library/Communication/PR/2007/102.shtml.

¹⁷Chapter 2.

¹⁸The rules that govern the holding of client money are set out in the Client Assets Sourcebook (CASS); specifically CASS 5 Client money: Insurance mediation activity.

¹⁹The FOS is the statutory dispute-resolution scheme set up under the provisions of Part XVI and Schedule 17 of the FSMA and section 59 of the CCA. The FSA handbook section REDRESS has the detailed requirements for handling complaints and

people in the position they would have been in if things had not gone wrong. This can include instructing the firm to make good the consumer's losses.

Product disclosure, cancellation and claims

20. The ICOB rules relating to product disclosure elaborate on Principle 7 in relation to consumer insurance products. Principle 7 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. ICOB requires that an FSA authorized firm has to approve the content and production of information for the consumer and make intermediaries responsible for provision of that information to the consumer.

21. ICOB requires the provision of certain information to consumers, 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 consumer's attention must be drawn to the importance of reading the contract documentation before the end of any cancellation period to check that the policy is suitable for their needs.

22. Where a contract is concluded by telephone, a retail customer may give explicit consent to receiving only limited information; and the contract is subject to regulation under the Directive. In that situation, the salesperson 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 limitations, the total price (or the basis of the calculation), notice of other possible costs, cancellation rights,

the Financial Ombudsman Service arrangements which are set out in DISP (Dispute Resolution: Complaints). The rules governing eligibility under, and levies for, the Financial Services Compensation Scheme are set out in COMP (Compensation).

contact details for any claim and the nature of other information available on request.²⁰

23. Retail customers who have entered into a non-investment insurance contract are entitled to a period of reflection during which they can decide whether to proceed with their purchase. Cancellation periods for 'protection products' (life insurance) and PPI are now 30 days and are 14 days for general insurance contracts. The cancellation period begins on the day the customer is informed that the contract has been settled or the day on which they receive the terms and conditions and information (whichever is the later).²¹

24. ICOB's claims handling requirements 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 them 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).²²

ICOB Chapter 4 and advised sales

25. There is no requirement that firms advise their customers in regard to the purchase of PPI; firms have a choice about whether to sell PPI on an advised or a non-advised basis. The general distinction lies in the making of a personal recommendation; a non-advised sale will be based on the provision of facts and figures about the product, whereas an advised sales process results in the making of a personal recommendation in some form by a representative of the firm to the customer that

²⁰Chapter 53.

²¹Chapter 67.

²²Chapter 8.

the product being sold to them is suitable for their needs. Where a firm chooses to provide advice in relation to its sales of insurance, it must comply with the requirements of Chapter 5 of ICOB which governs advised sales, specifically matters such as assessment of customer needs. Chapter 6 of ICOB sets out the requirements regarding product disclosure.

26. ICOB has a high-level rule which requires that a firm must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgement. In taking reasonable care to ensure the suitability of advice on a PPI policy (or a pure protection contract) a firm should:
- (a) establish the customer's demands and needs. It should do this using information readily available and accessible to the firm and by obtaining further relevant information from the customer, including details of any existing insurance cover; it need not consider alternatives to policies nor customer needs that are not relevant to the type of policy in which the customer is interested;
 - (b) take reasonable care to ensure that a policy is suitable for the customer's demands and needs, taking into account its level of cover and cost, and relevant exclusions excesses, limitations and conditions; and
 - (c) inform the customer of any demands and needs that the policy does not meet.
27. It should be noted that even where a firm has chosen not to conduct advised sales, it is still required to ensure that its sales are compliant with other FSA Principles and other ICOB rules and guidance including eligibility checking which requires firms to take reasonable steps to ensure that customers only buy policies under which they are eligible to claim benefits, and if at any time while arranging the policy the firm finds that parts of the cover do not apply, inform the customers so they can take an informed decision on whether to buy the policy. There are also ICOB rules which require firms to disclose orally all the main characteristics of a policy in a sales

dialogue where it provides information on a main characteristic of a policy. This means that the firm must ensure that customers receive sufficient information on the product to enable them to make an informed decision as to whether it meets their demands and needs.

New ICOB rules

28. In December 2007 the FSA published a feedback statement in response to a consultation paper²³ and the new insurance selling and administration rules, a successor to ICOB (new ICOB). The new ICOB rules came into effect on 6 January 2008 and firms were given a six-month transitional period to comply with the bulk of the requirements. The main deadlines for firms to complete the transition of their documentation and processes relating to PPI are 5 July 2008 and updating initial disclosure documentation by 6 January 2009. For general insurance business, such as household, motor or pet policies, new ICOB 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.
29. The FSA has published additional rules for protection products (PPI, critical illness, income protection and term assurance), which are designed to improve selling practices. Some of the new rules apply to all protection products from June 2008, such as the new standard to ensure balanced oral disclosure to help consumers make informed purchasing decisions. Others will have particular impact on PPI markets, including the requirement for firms to provide information orally on price to the consumer where a discussion takes place. There are also some new rules which

²³ 07/11

will apply to PPI alone, such as extending the cancellation period from 14 days to 30 days.²⁴

30. The new ICOB rules will retain the requirement to establish customer demands and needs for advised sales of protection products. In addition, during non-advised sales consumers must be informed that they are responsible for ensuring the suitability of the product offered.
31. Under the FSA's additional rules, 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 enable 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.²⁵ 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 he is eligible to claim benefits. If certain parts of the cover do not apply, the customer must be informed of this so that he can take an informed decision on whether or not to buy the policy. Firms will also be required to draw customers' attention (orally in sales with an oral element) to the importance of reading documentation before the end of the cancellation period to check the policy is suitable for them.²⁶

The OFT and its powers

The Consumer Credit Regime

32. The OFT is responsible for the credit licensing regime and the general supervision of the consumer credit market. The CCA (as amended by the Consumer Credit Act 2006 (the 2006 Act)) requires most businesses that lend money or offer goods or

²⁴FSA/PN/077/2007.

²⁵FSA Consultation *Proposed amendments to the Insurance: Conduct of Business sourcebook*, June 2007, FSA/07/11, paragraph 5.13.

²⁶Paragraph 5.7.

services on credit to hold a credit licence issued by the OFT. The licensee must satisfy the OFT that it is fit to carry out the type of business in question. The CCA applies to personal loans, credit cards and second charge mortgages. It does not apply to most first charge mortgages.²⁷ Most consumer credit products are therefore regulated in some form by the OFT in conjunction with TSOs.²⁸ Along with TSOs, the OFT monitors and enforces compliance with the CCA and the licensing regime. The OFT also produces advice for consumers and guidance for businesses.

33. The CCA is augmented by a number of regulations and orders. The CCA regime sets out detailed rules covering (among other things): the form and content of credit agreements; the advertising of credit; post-contract transparency; and procedures on default or termination of a credit agreement. In particular, the regulations:
- (a) govern the calculation of credit charges and APR;²⁹
 - (b) make the APR the prime comparator in advertising consumer credit;³⁰ and
 - (c) require lenders to provide clear information about costs and key terms of loans in credit agreements³¹ and pre-contract.³²

The Regulations also govern the early settlement of credit agreements, based on an actuarial formula for calculation of a rebate to the customer.³³

34. The regulations on credit advertising require certain information (including the 'typical APR')³⁴ to be shown where triggered by other information in the advertisement.

²⁷There is an overlap between the OFT and the FSA in relation to advertising. 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 (unless falling within a specific exemption). If an advertisement covers both mortgages and unsecured credit, it may be subject to both regulatory regimes.

²⁸Since April 2008 the CCA has applied to loans of any amount, the previous financial limit of £25,000 having been removed by the 2006 Act.

²⁹The Consumer Credit (Total Charge for Credit) Regulations 1980.

³⁰The Consumer Credit (Advertisements) Regulations 2004/1989 (as amended in 2007/1989 (repealed)).

³¹The Consumer Credit (Agreements) Regulations 1983 (as amended in 2004).

³²The 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.

³³The Consumer Credit (Early Settlement) Regulations 2004.

³⁴The typical APR is an APR at or below which the advertiser expects 66 per cent or more of business resulting from the advertisement to be written.

There are also rules on how the information is presented, including its relative prominence. The aim is to ensure that consumers are given sufficient, balanced information about the nature and cost of credit to enable them to compare different products and choose the ones that are best for them.

35. The regulations on pre-contract disclosure specify the information that must be provided to consumers before they enter into a credit agreement. The information must be:
 - (a) easily legible;
 - (b) not interspersed with other information;
 - (c) presented with equal prominence;
 - (d) contained in a separate document from the contract concerned, headed 'pre-contract information'; and
 - (e) capable of being taken away by the consumer to read.

36. The regulations on credit agreements specify the information that must be included in contracts and the way that the information must be ordered. Information must be shown in three main sections: key financial information (including the APR); other financial information; and key information (including prescribed 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 a cross-reference to the relevant terms and conditions.

37. The 2006 Act amended and updated the CCA to enhance the existing consumer protections. In particular, it strengthened the credit licensing regime and the powers of investigation and enforcement available to the OFT. It broadened the test of fitness to hold a consumer credit licence to incorporate evidence of competence in the

relevant credit activities, and to specify irresponsible lending as an example of an unfair business practice. The OFT can impose requirements on licensees where dissatisfied with any aspect of their licensable activities, and financial penalties if these are breached. The relevant provisions came into force in April 2008.

38. The 2006 Act also enabled consumers to challenge unfair credit agreements in court where the credit relationship as a whole is unfair to the borrower. This may arise not only as a result of the cost of credit but also by virtue of the terms of the agreement or the way in which the lender operated or enforced it or anything done (or not done) by or on behalf of the lender either before or after the making of the agreement or a related agreement. Most PPI contracts will be 'related agreements' for these purposes. These provisions came into force for new agreements in April 2007, and for pre-existing agreements in April 2008.
39. In addition, the 2006 Act entitled consumers to take complaints about lenders and other credit businesses to a dispute resolution scheme run by the FOS (from April 2007). The 2006 Act also introduced new requirements relating to post-contract transparency, to ensure that consumers receive adequate information about the state of their accounts to help them identify problems earlier. Lenders will be required (from October 2008) to provide consumers with regular statements and notices, including notices of sums in arrears or default sums.

PPI and the calculation of APRs

40. The Consumer Credit (Total Charge for Credit) Regulations 1980 (as amended) provide the basis for calculating APRs in credit agreements.³⁵ Regulation 4(c) provides that the total charge for credit includes:

³⁵There are also special rules for APR calculation for credit cards and other running-account credit in the 2004 regulations on credit advertisements and agreements.

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

- (i) **as a condition** of making the agreement **and**
- (ii) 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]

41. As can be seen from the above, the question of whether a PPI premium forms part of the total charge for credit, and hence the APR, for the purpose of the current regulation 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.
42. Where PPI is financed by credit, the OFT takes the view that there will generally 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, but the cost of the PPI will be factored into the APR for the separate agreement. There will be no composite APR in such cases. However, if PPI is mandatory, the cost of the PPI must also be reflected in the APR for the principal agreement, and hence in the typical APR in relevant credit advertisements.³⁶

³⁶The 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.

43. 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. In the OFT's view, therefore, there are two different credit agreements on offer. Under the agreement with the lower rate of interest, the PPI is in effect mandatory—because it is a condition of getting the credit on those terms—and as such its cost falls to be included in the APR for that agreement.³⁷

General consumer protection regime

Background—Part 8

44. Part 8 of the Enterprise Act 2002 came into force in June 2003 with the aim of improving consumer protection by strengthening the powers of enforcers (TSOs and the OFT) 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 did not remove the enforcement provisions in the various pieces of consumer protection legislation. Rather, it added a coordination mechanism between enforcers and enables a single Part 8 Enforcement Order to be sought for activities which 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.

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

³⁷*Discounted APRs and PPI*, OFT299, and *Credit Charges and APR*, OFT144.

- general enforcers, namely the OFT, TSOs and the Department of Enterprise, Trade and Investment in Northern Ireland (DETI);
- designated enforcers, which are those designated by the Secretary of State. This list currently includes the FSA,³⁸ Which?,³⁹ the Information Commissioner and the sectoral regulators;⁴⁰
- community enforcers;⁴¹ and
- CPC enforcers.⁴²

46. Part 8 gives the OFT a central coordination role to ensure that action is taken by the most appropriate body and is not duplicated.⁴³ Enforcers who wish to apply for an enforcement order must first consult with the OFT as well as with the business against which they wish to proceed.⁴⁴ 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.⁴⁵ 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

47. The UTCCRs⁴⁶ apply a principle of fairness to terms in standard-form consumer contracts. 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

³⁸See The Enterprise Act 2002 (Part 8) (Designation of the Financial Services Authority as a Designated Enforcer) Order 2004.

³⁹See The Enterprise Act 2002 (Part 8) (Designation of the Consumers' Association) Order 2005.

⁴⁰See The Enterprise Act 2002 (Part 8 Designated Enforcers: Criteria for Designation, Designation of Public Bodies as Designated Enforcers and Transitional Provisions) Order 2003.

⁴¹'Qualified public entities' listed in the *Official Journal* in accordance with the Injunctions Directive 1998/27, who can enforce the legislation which implements certain consumer directives.

⁴²Enforcers authorized under the Consumer Protection Cooperation Regulation EC No 2006/2004 (the CPC).

⁴³Section 216 of the Enterprise Act.

⁴⁴See section 214 of the Enterprise Act and the CPC.

⁴⁵Section 216 of the Enterprise Act.

⁴⁶The UTCCRs implement the Unfair Terms in Consumer Contracts Directive 93/13/EEC.

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'.⁴⁷ Core terms (concerning price or main subject matter) are exempt from the UTCCRs, provided that they are in plain and intelligible language.

48. 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.⁴⁸ 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'.⁴⁹ Transparency is also fundamental to fairness. Regulation 7 of the UTCCRs says that any written term of a contract must be in plain and intelligible language. The UTCCRs 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 consumer⁵⁰ and the FSA or the OFT may seek an injunction to prevent the continued use of such terms.⁵¹
49. 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, contrary to the requirement of good faith, could cause a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer.

⁴⁷Regulation 6.

⁴⁸Regulation 5.

⁴⁹*Director-General of Fair Trading v First National Bank [2002] 1 All ER 97.*

⁵⁰Regulation 8.

⁵¹Action 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).

Schedule 2 to the UTCCRs 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;⁵²
- permit the supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract;⁵³
- 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.⁵⁴

50. In addition to the OFT's Part 8 coordination responsibilities, the OFT and FSA, which along with Which? may enforce the UTCCRs directly,⁵⁵ 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.⁵⁶

Consumer Protection from Unfair Trading Regulations 2007

51. The Consumer Protection from Unfair Trading Regulations (CPRs)⁵⁷ came into force on 26 May 2008 and introduced a general duty not to trade unfairly in relation to 'business to consumer' (b2c) transactions. The CPRs implement the European Unfair Commercial Practices Directive 2005⁵⁸ (UCPD), the objectives of which are to harmonize⁵⁹ the consumer protection framework across the EU, and to provide a uniform and robust system of law relating to business to consumer commercial

⁵²For example, 'Notice of cancellation must be sent by recorded delivery.' See *Unfair Standard Terms*, OFT143.

⁵³For example, 'In the event of an order being cancelled no refunds can be given', OFT143.

⁵⁴For example, 'No employee has authority to make statements inconsistent with these terms', OFT143.

⁵⁵See Schedule 1 of the UTCCRs.

⁵⁶July 2006 http://www.fsa.gov.uk/Pages/Library/Publications_by_date/2006/index.shtml

⁵⁷Consumer Protection from Unfair Trading Regulations 2008.

⁵⁸Directive 2005/29/EC.

⁵⁹With 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 can not retain or introduce laws pertaining to b2c commercial practices that fall below or go beyond the standards in the UCPD.

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.⁶⁰

52. 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 might influence a consumer's decision to exercise a contractual right (for example, to switch or claim on a policy).
53. The CPRs contain a general prohibition⁶¹ 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);
 - 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.
54. The CPRs also specifically prohibit practices automatically considered contrary to the requirements of Professional Diligence: misleading actions, misleading omissions and aggressive practices:⁶² 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

⁶⁰Recital 8.

⁶¹Regulation 3.

⁶²These practices are defined in Regulations 5 to 7.

- claim was valid, or failing systematically to respond to pertinent correspondence, in order to dissuade a consumer from exercising his contractual rights; and
- falsely stating that a product will be available only 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.

55. Subject to a couple of small exceptions, the CPRs 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 be able to seek a Part 8 Enforcement Order in relation to the CPRs. The FSA and the OFT plan to enter into a concordat similar to that used for the UTCCRs, to ensure that the division of responsibility for enforcing the CPRs is clear.⁶³

⁶³See *Delivering better regulatory outcomes*, OFT940.