COMPETITION COMMISSION

MARKET INVESTIGATION INTO PAYMENT PROTECTION INSURANCE

RETAIL FINANCE PPI

Provisional findings report

Published: 10 October 2008

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive alternative wording is also indicated in square brackets.

Contents

Page

Summary

1. The PPI market investigation provisional findings report published on 5 June 2008 (the provisional findings report) did not reach a provisional finding on the state of competition in the supply of retail finance PPI (retail PPI). In this supplementary provisional findings report we consider retail PPI, which is PPI sold to cover payments on a customer's retail finance credit account. A retail finance credit account is a credit facility provided by a retailer which allows customers the option of spreading payments over time when purchasing that retailer's goods. Although retail PPI may be offered by any retailer, our investigation shows it to be characteristic of home-shopping retailers.[1] Home-shopping retailers usually do not have a high-street presence and sell mainly clothing, gifts, furniture and electrical goods through bi-annual catalogues.

2. We found that PPI sold alongside 'personal loan' retail finance (typically used to finance one-off purchases, such as large items of furniture) is a form of personal loan PLPPI, and therefore our conclusions on PLPPI in our June provisional findings apply to PPI sold alongside this form of credit.

3. We considered evidence provided by the four retail PPI distributors with retail PPI GWP in excess of £1 million in 2007. These four distributors received £73 million of retail PPI GWP from their customers in 2007, following declines of 12 and [10–20] per cent in the previous two years. The largest distributor, Shop Direct Group Financial Services (SDGFS), whose main brand is Littlewoods, received over half of this in 2007.

[1]See paragraphs 17 to 19 for further explanation of how we have defined retail PPI. Retail credit accounts may be offered by any retailer, but we found only home shopping retailers providing retail PPI on such accounts. Other retailers may offer different types of finance, either store card credit accounts or personal loans. Store card PPI for store card credit accounts offered by retailers is outside the scope of this investigation. See paragraph 2 for personal loans.

Market definition

4. We identified three ways in which retail PPI customers could potentially react to a small but significant non-transitory increase in price (SSNIP) in retail PPI and which could result in that SSNIP being unprofitable. These were that customers could substitute to other insurance policies, customers could substitute to other forms of insured credit and customers could substitute to other retailers that offered a credit account and retail PPI.

5. We found that a lack of suitable alternatives to retail PPI, the limited sales of possible alternatives, their limited effectiveness as substitutes and the limited impact that they appeared to have on retail PPI sales following a price rise indicated that the prospect of customer substitution to alternative types of credit insurance was a weak constraint on retail PPI suppliers.

6. With regard to substitution between bundles of credit and PPI, we found that it was more difficult (and certainly no easier) for retail PPI consumers to consider the whole cost of a bundle including retail PPI when compared with other types of PPI. We saw no clear evidence to suggest that retail PPI customers were intrinsically more likely to substitute between bundles of credit and PPI than customers of other types of PPI. We also received conflicting views from the retailers regarding the extent to which their customers substitute between bundles in response to changes in retail PPI prices and terms. We concluded that the possibility that retail PPI customers may substitute to alternate bundles of credit and PPI, in response to an increase in retail PPI prices, was a weak constraint on retail PPI suppliers.

7. We also found that it was likely to be difficult for retail PPI customers to substitute between retailers offering retail credit accounts and retail PPI. We received conflicting views from the retailers regarding the extent to which their customers

would substitute in this way in practice and none of the parties was able to provide primary evidence that customers substitute between retailers in response to changes in retail PPI prices. We concluded that the possibility that retail PPI customers may substitute to other retailers offering home shopping, retail credit accounts and retail PPI, in response to an increase in retail PPI prices, was a weak constraint on retail PPI suppliers.

8. Because the constraint on retail PPI suppliers from each of the three potential sources of substitution was weak, we concluded that a narrow market definition was appropriate, and that it would be inappropriate to include other types of credit insurance, or other bundles of credit and PPI, or other bundles of merchandise, credit and PPI within the relevant market. We therefore defined the relevant product market as the supply of retail PPI by a distributor to its own retail customers.

Indicators of the extent of competition between retail PPI providers

9. We assessed a series of indicators of the level of competition between PPI distributors:

   (a) The level of price variation over time that we saw was consistent with there being few significant competitive pressures on retail PPI providers. In particular, retail PPI prices have only been changed three times in six years by the four distributors. Two distributors did not change their prices at all.

   (b) We found that distributors do not compete to any significant degree on the non-price aspects of retail PPI. We found that many of the changes to non-price factors that we identified were due to regulatory or compliance issues and that there was little evidence that changes in non-price factors were driven by, or reactions to, competitors' retail PPI offerings.

(c) We found that retail PPI distribution is highly profitable. Commission levels are high in relation to the costs incurred in selling PPI and the capital requirements are low, reflecting the low-risk nature of the activity.

10. These indicators suggested that there was a lack of competition in retail PPI distribution.

11. In terms of competition between retail PPI providers, these findings indicated that prices, and other competitive variables, are less favourable than would be the case in a well-functioning market with vigorous and effective rivalry between market players. We considered that these findings were consistent with our finding that there is limited substitutability between retail PPI policies provided by different providers and that retail PPI providers are not competitively constrained by the potential for customers to substitute between their PPI policies. The evidence on the extent of competition between retail PPI providers therefore supported our market definitions.

Factors affecting the nature and extent of competition among distributors

12. Having concluded that there is little competition among distributors of retail PPI policies, we looked at why this is the case, and what factors are involved. The purpose of this was to see if there are any features or combination of features of relevant markets which are preventing, restricting or distorting competition in the supply of retail PPI to consumers.

13. We provisionally concluded that there were features of relevant markets which, alone or in combination, prevent, restrict or distort competition in the supply of retail PPI to non-business customers in the UK:

    (a) Distributors fail actively to seek to win customers by using the price or quality of their retail PPI policies as a competitive variable.

(b) Consumers who want to compare retail PPI policies, stand-alone PPI or short-term income protection (short-term IP) insurance policies are hindered in doing so. Product complexity (the variations in terms and conditions, the way information on PPI is presented to customers); the bundling of retail PPI with credit accounts and with merchandise cover (also known as purchase protection insurance), and the limited scale of stand-alone provision act as barriers to search retail PPI policies. In addition, the time taken to obtain accurate information on benefits is a barrier in relation to the provision of retail PPI. These barriers to search impede the ability of consumers to make comparisons, and therefore effective choices, between retail PPI policies. They also, therefore, act as barriers to expansion for other retail PPI providers, in particular providers of stand-alone PPI.

(c) Consumers who want to switch retail PPI policies to alternative providers or to alternative types of insurance policies are hindered in doing so. Terms which risk leaving consumers uninsured (for a short period of time or in case they suffer a recurrence of a problem) and the bundling of retail PPI with merchandise cover act as barriers to switching. In addition, the lack of access to consumers' balance information acts as a barrier for switching for retail PPI as it renders stand-alone providers unable to offer equivalent retail PPI policies. These barriers to switching limit consumer choice. They also therefore act as barriers to expansion for other retail PPI providers, in particular providers of stand-alone PPI.

(d) The sale of retail PPI at the initial point of sale, subsequent points of sale and the continued access to credit accounts by distributors further restricts the extent to which other providers can compete effectively.

14. We have provisionally found, pursuant to section 134(1) of the Act, that there are features of relevant markets, which alone or in combination prevent, restrict or distort competition in the supply of retail PPI, and accordingly there is an adverse effect on

competition within the meaning of section 134(2) of the Act. The features are those that we have identified in paragraphs 143 to 181 and which are summarized in paragraph 182.

15. We provisionally concluded that the detrimental effects on consumers of these features were higher prices for, and less choice in, retail PPI policies than would be expected in well-functioning market.

Introduction

16. The PPI market investigation provisional findings report, published on 5 June 2008, did not reach a provisional finding on the state of competition in the supply of retail finance PPI (retail PPI). This supplementary provisional findings report should be considered alongside the main provisional findings report which explains the background to the inquiry and many general features about PPI products.

17. We concluded that the type of retail finance sold in conjunction with the PPI defines the type of PPI policy. We found two types of retail finance:[2]

(a) 'Personal loan' retail finance, which is a personal loan provided by or on behalf of the retailer granting credit to the consumer to purchase a specific good (or goods, usually of high value) sold by the retailer of that good.

(b) 'Credit account' retail finance, which is a running account credit facility provided by the retailer to the consumer to purchase goods from the retailer. The consumer typically buys goods at different times, such that his credit balance rises and falls over time.

[2]A third type of retail finance may be provided by store cards, but these and store card PPI are outside the scope of this investigation.

18. We concluded that PPI sold alongside 'personal loan' retail finance was a form of personal loan PPI (PLPPI), in that the PPI is typically sold to insure one-off purchases (similar to motor retail finance PPI—see paragraph 2.10 of the provisional findings report), and the PPI is not bundled with a product such as merchandise cover. Therefore our conclusions on PLPPI in the provisional findings report apply to 'personal loan' retail PPI and we do not consider 'personal loan' retail PPI any further in this report.

19. We concluded that PPI sold alongside 'credit account' retail finance, although sharing some of the characteristics of credit card PPI (CCPPI), required separate investigation into the state of competition for 'credit account' retail PPI.

Retail PPI

What is retail PPI

20. Although credit account retail finance may be offered by any type of retailer, our investigation found that retail PPI was only offered by home-shopping retailers. We found that the underwriters we consulted provided PPI for retailers who offered personal loan retail finance and to home-shopping firms that distributed retail PPI for credit account retail finance, but not to any other type of retailer. Many retailers may distribute PPI for store card retail finance, but this is outside the scope of our investigation. Therefore, only home-shopping retailers distributed retail PPI for credit account retail finance which is the subject of this supplementary provisional findings report. In the remainder of this report we use 'retail PPI' to refer to retail PPI for credit account retail finance.

21. Home-shopping retailers generally do not have a high-street presence and sell mainly clothing, gifts, furniture and electrical goods through biannual catalogues. Orders are placed by telephone, post or, increasingly, over the Internet. Goods can

be paid for by cash, credit card, or by using a credit account facility offered by the retailer. The credit account may be opened at the point of purchase of the goods and offers a variety of methods to pay: either spreading payments over a fixed period, for example 20 weeks, or making minimum payments on the account, which may be interest-free or may involve some interest or pay the entire balance. Table 1 shows the proportion of home-shopping sales by method of payment for three of the largest retail PPI providers. It shows that the clear majority of home-shopping purchases are made using a retail credit account.

TABLE 1 **Home shopping sales in 2007 by method of payment**

per cent

	Cash/	*Retail credit*	
Retailer	*credit card*	*Uninsured*	*Insured*
SDGFS	[✂]	[✂]	[✂]
J D Williams	[✂]	[✂]	[✂]
Express Gifts	[✂]	[✂]	[✂]

Source: Information provided by retail PPI distributors.

22. Retail PPI insures a percentage of the outstanding balance on a credit account with a retailer. The policy pays a benefit which is typically the minimum monthly payment due each month on the credit account, which may vary from 5 per cent up to 33 per cent of the outstanding balance.[3] These policies insure against some or all of accident (A), sickness (S), unemployment (U), incapacity (I), death (life insurance—L), hospitalization (H) and critical illness (CI). The premium is paid monthly (either on a calendar or four-weekly basis) and is calculated as a percentage of the monthly outstanding balance.

23. Average retail credit account balances for customers with retail PPI are typically between close to £100 and £400 per month. SDGFS told us that average monthly premiums were between £[✂] and £[✂] per month. This is consistent with average

[3]The outstanding balance may be that on the day of the claim, or the balance as it declines throughout the claim.

balances of £[✂] to £[✂] per month. Other distributors told us that their average premium income was lower and consequently their average balances were lower. JD Williams Limited (JD Williams) receives on average £[✂] per year in premium income per customer—consistent with average balances of around £[✂]. Otto UK (Otto) receives on average £[✂] to £[✂] per year—consistent with average balances of between £[✂] and £[✂]. Finally, Express Gifts Limited (Express Gifts) receives on average £[✂] per year—consistent with average balances of around £[✂].

24. All the distributors we received evidence from sold retail PPI bundled with merchandise cover. This is insurance that covers the merchandise purchased for accidental damage and theft. It is bundled with the retail PPI so that the retail PPI is not available without the merchandise cover.[4] We did not consider merchandise cover, except where it affected the extent of competition for retail PPI.

Who sells retail PPI?

25. We identified four home-shopping retailers that achieved a GWP for retail PPI in excess of £1 million in 2007. These were SDGFS,[5] JD Williams, Otto and Express Gifts, whose main retail brands are shown in Table 2.[6] Retail PPI is a small part of these retailers' overall business, contributing between 1 and 5 per cent of total turnover.[7]

[4] One distributor, Otto, sold a retail PPI policy for which the merchandise cover was optional for a short period in 2007. It subsequently exited the supply of retail PPI.
[5] Formerly Everyday Financial Services.
[6] In November 2007, Express Gifts suspended sales of retail PPI, except to online customers, and Otto ceased selling retail PPI entirely.
[7] We consider profitability of retail PPI from paragraph 106.

TABLE 2 **Selection of main retail brands selling retail PPI**

Distributor	
SDGFS	Littlewoods, Littlewoods Direct, Great Universal, Kays, Abound, Additions, Marshall Ward
JD Williams	J D Williams, Ambrose Wilson, Simply Be, Premier Man, Fashion World, Fifty Plus
Otto	Grattan, Freemans, Kaleidoscope, Look Again, Montage
Express Gifts	Studio, Ace

Source: Information provided by retail PPI distributors.

Possible alternative policies

26. In the provisional findings report, we considered possible alternative products to PPI.[8] For retail PPI, there were particular potential alternatives for customers and retailers that were linked to alternative types of credit available and which shared similar characteristics to a credit account and retail PPI. First, customers could purchase goods from the retailer using a credit card with the associated CCPPI product. CCPPI was considered in the provisional findings report. Second, retailers could offer a store card credit facility with an associated store card PPI policy. Store card PPI is outside the scope of this investigation.

Sales of retail PPI

27. Table 3 sets out the total GWP[9] and number of customers for retail PPI distributed by the four distributors for the six-year period 2002 to 2007. These distributors sold very small volumes of retail PPI compared with the distributors of other forms of PPI. One distributor, SDGFS, sold over half of all retail PPI by GWP over most of this period. GWP has been declining—falling by 12 per cent in 2006 and by a further [0–10] per cent in 2007. This mirrors the trend in other forms of PPI.[10] There were around 2 million retail PPI customers for most of this period, although numbers declined to around 1.4 million by 2007. In November 2007, Express Gifts stopped selling retail

[8]See paragraphs 2.15 to 2.22 in the provisional findings report.
[9]GWP is for retail PPI only, although the distributors reported GWP to us for retail PPI and merchandise cover combined (with the exception of Express Gifts), and all sold combined policies. We calculated GWP for retail PPI, excluding merchandise cover, based on the price per £100 outstanding balance which related to retail PPI only as reported to us by each party.
[10]See paragraph 2.24 of the provisional findings report.

PPI, except to online customers, and Otto stopped selling retail PPI entirely (see paragraphs 134 and 135).

TABLE 3 **Retail PPI GWP and number of customers split between distributors**

GWP						*£ million*	*Share of supply (%)*
Distributor	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2007*
Total	73	72	71	69	61	73	100%
Total (excluding SDGFS other brands)	73	72	71	69	61	[✂]	
Growth (%)		0	–3	–3	–12	[0–10]*	
SDGFS: Littlewoods	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	>50
SDGFS: other brands†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	
JD Williams	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	20 - 50
Otto	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	<10
Express Gifts	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	<10
Customers‡						*'000*	
Total	1,857	2,016	2,121	2,064	1,687	1,441	
Growth (%)		9	5	–11§	–18	–15	
SDGFS	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	
JD Williams	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	
Otto	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	
Express Gifts	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	

Source: CC calculations based on information provided by retail PPI distributors.

*Growth rate excludes SDGFS: other brands.
†SDGFS does not hold data on other brands prior to 2007/08.
‡This is the number of accounts at the end of each year. Retailers differ in how they manage accounts that hold nil balances and are therefore not contributing retail PPI premiums. This excludes SDGFS: other brands.
§Growth rate figure excludes sales of Otto.
[✂] does not hold this data prior to 2005.

28. Table 4 shows the penetration rates of retail PPI for each of the distributors. The penetration rate for [✂] and [✂] is much higher at over 25 per cent, and up to 50 per cent respectively, than for [✂] and [✂] at below 16 per cent. However, penetration rates fell by over a quarter for both [✂] and [✂] between 2005 and 2007.

TABLE 4 **Penetration rates for retail PPI**

						% of credit
Distributor	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
[✂]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]
[✂]	[40–50]	[40–50]	[40–50]	[30–40]	[30–40]	[20–30]
[✂]				[40–50]	[40–50]	[30–40]
[✂]	[0–10]	[0–10]	[0–10]	[10–20]	[0–10]	[0–10]

Source: CC calculations based on information provided by retail PPI distributors.

Note: The penetration rate used here, for all except [✂], is the value of purchases made using a credit account with retail PPI as a proportion of the value of all purchases made using a credit account. [✂] provided the proportion of insured balances with retail PPI. Other measures could also have been used such as the proportion of customers with retail PPI.

Organization of the retail PPI value chain

Underwriters

29. All distributors of retail PPI are vertically separated from the underwriter of the insurance. We found no evidence of a lack of competition in underwriting for other forms of PPI,[11] and, as underwriting for retail PPI follows the same principles as for other forms of PPI, we had no reason to believe that this did not apply to retail PPI. Therefore, we provisionally found that there is a significant level of competition between underwriters of retail PPI.

How retail PPI is sold

Sales process for retail PPI

30. Retail PPI is offered by distributors to new and existing customers with a credit account. Unlike the other types of PPI that we considered in the provisional findings report, retail PPI is not necessarily sold at the point of sale of the credit account. Customers of Otto were, and customers of JD Williams are, called some weeks after opening an account and holding a balance. Sales are usually initiated by the distributor, either during the sales process for merchandise and a credit account, from a telemarketing call or by providing a tick-box for online customers. The payment method for retail PPI policies is always 'regular premium'.[12] The method of sale differs for each of the retail PPI distributors and is shown in Table 5.

---

[11]See section 6 of the provisional findings report.
[12] That is a monthly premium is paid to maintain the policy, which may vary from month to month depending upon the balance of the account. See paragraphs 2.74 and 2.75 in the provisional findings report.

TABLE 5 **Sales processes for retail PPI**

Distributor	
SDGFS	Retail PPI is offered at the point of sale of the retail good and credit account when a customer first telephones to place an order. It is offered at [✂] intervals to existing customers without retail PPI, and is available at any time for Internet orders. Sales have been on a non-advised basis since June 2007.
JD Williams	After their third statement, customers are sent information about retail PPI and are telephoned by an out-sourced telemarketing bureau. Sales are non-advised.
Otto	Sales were suspended in 2007. Prior to this, customers were telephoned once they had opened an account and held a balance. This was some weeks after opening the account. Sales were on an advised basis.
Express Gifts	Retail PPI is available only to customers who open or use a credit account online. A tick-box is provided for customers to accept retail PPI. Direct telephone marketing was suspended in 2007. Sales are non-advised.

Source: Information provided by retail PPI distributors.

The price of retail PPI

31. The price of retail PPI is quoted as pounds per £100 of outstanding balance, similar to CCPPI. We found that prices were in the range £1.95 to £1.99. The cost of merchandise cover is included in this price; SDGFS told us that retail PPI made up £[✂] of the total premium, Otto briefly sold a retail PPI policy without merchandise cover for £[✂], JD Williams told us that retail PPI made up £[✂] of the total premium, and Express Gifts told us that the retail PPI element was £[✂]. In all cases the amount of the premium which related to retail PPI was more than £1, significantly so in some cases. In comparison, we found that the price for CCPPI was around £0.79.

Market definition

32. In this section, we define the relevant market for the distribution of retail PPI. As noted in our guidance, and in the provisional findings report, the key to market definition is substitutability—the extent to which customers can readily switch between products, or suppliers can readily switch their facilities between the supply of alternative products.[13] In assessing the likelihood of substitutability, as in the

[13] *Market Investigation References: Competition Commission Guidelines, CC3*, and paragraph 3.10 of the provisional findings report.

provisional findings report, we apply the SSNIP framework in our analysis regarding the relevant market.

33. We identified the following substitution possibilities that could, potentially, render unprofitable a SSNIP (above competitive levels) by a hypothetical monopolist of sales of retail PPI to customers of a particular retailer:

(a) customers could substitute to another method of insuring their retail credit balances (for example, by taking out stand-alone PPI or a short-term IP policy);

(b) customers could substitute to an alternative method of financing and insuring their purchases (for example, by substituting to a credit card with CCPPI); or

(c) customers could substitute to another retailer that offers a retail credit account and retail PPI.

34. As in the provisional findings report, we started with the narrowest conceivable market—that of the sale of retail PPI by a distributor to its own retail customers. We then considered whether the substitutability of retail PPI with any of the alternatives listed in paragraph 33 was sufficient to justify a wider market definition, including one or more of the alternatives outlined in paragraph 33. We assess the constraint on retail PPI suppliers from *(a)* the possibility of consumers substituting to alternative types of credit insurance in paragraphs 35 to 44. We consider the constraint on retail PPI suppliers from *(b)* the possibility that customers may substitute to alternative bundles of credit and PPI in paragraphs 45 to 66. Finally, we consider the constraint on retail PPI suppliers from *(c)* the possibility that customers may substitute to alternative bundles of merchandise, credit and PPI in paragraphs 67 to 80.

Substitutability of retail PPI with short-term IP and stand-alone CCPPI

35. In order to assess the extent to which retail PPI suppliers are constrained by the potential for their customers to substitute to other types of credit insurance, we looked at the following:

    (a) the availability and suitability of alternatives to retail PPI; and

    (b) the responsiveness of retail PPI demand (in terms of the penetration rate) to past increases in retail PPI prices.

36. In a wider market, where customers can substitute easily between retail PPI and alternative types of credit insurance, we would expect to see a range of alternative policies which are close substitutes for retail PPI. We would also expect to see the result of customer substitution to these alternatives, namely significant sales of these alternative products.

37. In addition, in a wider market we would expect to see that increases in retail PPI prices cause customers to substitute away from retail PPI to these alternative products. Changes in retail PPI prices should therefore result in a reduction in the proportion of retail credit balances that are insured using retail PPI.

The availability and suitability of alternatives to retail PPI

38. We found that it was not possible to buy retail PPI from one distributor to cover a credit account with another retailer. However, a customer could use stand-alone PPI or short-term IP, which was an alternative to all forms of PPI including CCPPI.

39. In the provisional findings report we found only two providers offering stand-alone substitutes for CCPPI sold at the point of sale: Paymentcare and, as of 2007, Barclays (which is available to customers who hold a Barclaycard and want to insure

other credit cards as well).[14] We similarly concluded that these were the only stand-alone products available as possible substitutes to retail PPI. However, only [0–2,500] of these products were sold in a year[15] which represents a very small proportion of the 1.4 million retail PPI customers in 2007. Similarly, in the provisional findings report, we found that sales of short-term IP were very low, with sales of 25,000 to 30,000 sold in a year.[16]

40. We noted that these policies are poor substitutes for retail PPI which will limit the extent to which retail PPI customers can substitute away from retail PPI in response to a price rise. First of all, short-term IP and stand-alone CCPPI policies do not track the balance of the credit account. Therefore a customer will be over- or under-insured for their balance at any time. In addition, no alternative short-term IP or stand-alone CCPPI policy that we are aware of includes merchandise cover, so consumers cannot switch to an alternative policy offering comparable cover. We therefore concluded that substitution to stand-alone CCPPI and/or short-term IP in response to a retail PPI price rise would be unlikely.

The responsiveness of retail PPI demand to past increases in retail PPI prices

41. In addition to assessing the availability and suitability of alternatives to retail PPI, we also looked at the retailers' experiences following increases in retail PPI prices in the past. If retailers are constrained by the potential for customers to substitute to alternatives, then we would expect an increase in the price of retail PPI to result in a reduction in the penetration rate, as customers substitute away from retail PPI to these alternatives.

---

[14]See paragraph 3.38 of the provisional findings report.
[15]See paragraph 3.39 and Table 3.3 of the provisional findings report.
[16]See paragraph 3.39 of the provisional findings report.

42. We asked the distributors for evidence on the responsiveness of retail PPI demand to price changes. There have been only three price changes for retail PPI in the period 2002 to 2007 by Otto and JD Williams; SDGFS and Express Gifts did not change their price at all over the period. In each case, the price of the combined retail PPI and merchandise cover policy was increased:

- Otto increased prices by 22 per cent in late 2002, at the same time as increasing merchandise cover from 12 months to 24 months, and by 9 per cent in summer 2004, whilst increasing merchandise cover to 30 months. Otto told us that whilst limited relevant historical data was available in relation to these improved levels of cover and the product's consequent marketability, 'it is not apparent that the price increases significantly impacted the marketability of the retail PPI product'. We considered that the impact on sales may have been offset by the increase in merchandise insurance, but it was not possible to separate these two factors. We can therefore infer very little from the Otto price rises.
- JD Williams increased prices by 14 per cent in June 2003. JD Williams told us that:

  > Initially there was no material impact on sales after the retail PPI premium increase, but sales penetration did begin to fall towards the end of that year (penetration was unchanged until October before falling). At around the time of the decline in penetration rates a new telemarketing script in line with GISC[17] standards was introduced. Given the timings of the price rise and the script change, we thought the decline in penetration rates was more likely to be related to the new script than the price rise four months previously.

  The lack of impact on sales in the four months following the price rise implied to us that the fall in sales from October onwards was not related to the price change.

[17]General Insurance Standards Council.

43. We considered the experience of JD Williams in June 2003 to be evidence that customers did not react to a retail PPI price change by substituting to alternative types of credit insurance. This evidence was therefore consistent with a narrow market which does not include alternative types of credit insurance.

Conclusion on the substitutability of retail PPI with other types of credit insurance

44. We found that the lack of suitable alternatives to retail PPI, the limited sales of those alternatives, their limited effectiveness as substitutes and the limited impact that they appeared to have on retail PPI sales following a price rise indicated that the prospect of customer substitution to alternative types of credit insurance was a relatively weak constraint on retail PPI suppliers.

The substitutability of the retail credit and retail PPI bundle with alternative bundles of credit and PPI

45. As outlined in paragraph 33, in addition to other means of insuring their retail credit balances directly, it is also possible for consumers to react to retail PPI prices by substituting to alternative methods of financing their merchandise purchases, on which PPI is available.

46. It is not possible to take out a retail credit account with one retailer to pay for purchases of merchandise at another retailer. We therefore concluded that the main potential source of substitution of this type, in response to a rise in retail PPI prices, would be for retail PPI customers to substitute to a credit card with CCPPI to pay for their purchases of merchandise instead of using a retail credit account and retail PPI.

47. An important factor in the assessment of the constraint imposed on retail PPI suppliers from substitution to alternative bundles of credit and PPI is the extent to which customers consider retail PPI when deciding on their choice of credit supplier.

48. A change in the price of retail PPI will affect the price of a combination of retail credit and retail PPI from that retailer too. This in turn may induce some customers to respond to changes in the price of retail PPI, in the same way that they would respond to an equivalent change in the price of retail credit by substituting to alternative insured credit products. In other words, customers may base their decisions on the whole cost of credit and PPI, rather than just on the cost of PPI alone and as a result they may substitute between bundles of credit and PPI. Those customers that do not consider the whole cost in this way will not substitute between bundles of credit and PPI.

49. Where such substitution in response to a change in retail PPI price is sufficient, it may warrant a wider market definition to include alternative bundles of credit and PPI. However, if few customers respond in this way to changes in retail PPI prices, then this constraint will be weak and a narrow market definition would be appropriate.

50. In order to assess the constraint on retail PPI suppliers from this potential source of substitution, we assess the available evidence on the propensity of retail PPI consumers to consider retail PPI prices when making their choice of the method of financing their home-shopping purchases. In other words, we assess the propensity of retail PPI consumers to consider the whole cost of the bundle of credit and PPI.

The extent to which retail PPI customers consider the whole cost of the bundle of credit and PPI

51. In order to consider the extent to which retail PPI customers consider the whole cost of the bundle of credit and PPI, we looked at the following:

    (a) whether retail PPI exhibited any differences, when compared with other types of PPI (and in particular CCPPI), that would make it more likely that retail PPI customers would consider the whole cost of the bundle; and

(b) the evidence supplied by the parties regarding the extent to which their customers consider and react to the whole cost of the bundle.

Evidence from other forms of PPI

52. In the provisional findings report we concluded that for personal loan PPI, mortgage PPI and CCPPI the relevant product market was no wider than the sale of PPI by a distributor to its own credit customers, and in particular that customers in these markets did not consider the whole cost of the bundle to a sufficient degree to warrant a wider market definition.[18] In this section, we consider whether retail PPI customers are more likely to consider the whole cost of the bundle than customers of these other forms of PPI and therefore whether a wider market definition is appropriate.

53. If retail PPI customers do consider the whole cost of the bundle, then there must be some differences between how customers shop for retail PPI compared with other forms of PPI, where we have already found that few customers consider the whole cost. These differences may be because *(a)* customers are more likely to consider the whole cost of the bundle when shopping for retail PPI than for other forms of PPI or *(b)* different customers or types of customers are involved and that these types of customer are more likely to consider the whole cost of the bundle. We considered each of these two possibilities.

54. First, we looked at the similarities and differences between retail PPI and other types of PPI to assess whether customers would be more likely to consider the whole cost of a bundle for retail PPI than is the case for other types of PPI. We identified the following similarities and differences:

---

[18]See Section 3 in the provisional findings report.

(a) CCPPI and retail PPI polices have similar characteristics. They both insure a variable balance; premiums are calculated as a percentage of the monthly balance and are zero when a nil balance is held; they provide cover for similar types of risk; prices, terms, conditions and benefits are expressed in the same way.

(b) Unlike personal loans and credit cards and their associated PPI policies, retail PPI and retail credit is available only on the purchases made with a particular retailer.

(c) Unlike other forms of PPI, merchandise protection is included with retail PPI policies.

(d) The level of balances insured by retail PPI is generally much smaller than average credit card balances, personal loans or mortgages.[19]

55. We considered that many of the key differences would appear to make it more difficult for customers to consider the whole cost of a bundle of PPI and credit for retail PPI when compared with other forms of PPI. For example, although retail PPI and CCPPI are similar, the bundling of retail PPI with merchandise cover, and the differences in terms of the credit between retail credit accounts and credit cards, would seem to make comparing a bundle including retail PPI, with an alternative bundle of credit and PPI, more difficult. In addition, because the characteristics of a retail PPI and retail credit bundle are markedly different from the characteristics of a credit card with CCPPI, customers will be less likely to react to changes in retail PPI prices by substituting to credit cards with CCPPI from retail PPI than they would be to substitute between insured credit cards.

---

[19]See paragraph 23. In 2006, the average balance across all credit cards, calculated using data from Datamonitor, was £940.

56. We also found that as the average balance on a retail credit account is small, the benefits to search for retail PPI would appear to customers to be smaller than for other types of PPI. We did not think that the fact that retail credit and retail PPI was available only on purchases from one retailer would affect substitution between retail PPI and insured credit cards. However, this factor does prevent substitution between bundles of retail credit and retail PPI offered by different distributors. We therefore formed the view that it is unlikely that customers would have a higher propensity to consider the whole cost of a bundle of credit and PPI in retail PPI than in other forms of PPI.

57. Second, we considered whether the customers of retail PPI are a separate group from customers of other types of PPI. SDGFS conducted a survey of its customers in 2007 which reported that only [<25] per cent of its retail PPI customers had CCPPI. This suggests that there may be only a limited overlap between CCPPI customers and retail PPI customers.

58. We also looked at the demographic profiles of retail PPI customers compared with the profiles of customers for other forms of PPI. Systematic information on the demographics of retail PPI customers was not available. However, all four of the largest distributors of retail PPI told us that the majority of their customers were female. For example, [✂] told us that 82 per cent of its home shopping customers were female in [✂] (though PPI penetration rates were about the same for its male and female customers). [✂] told us that 91 per cent of its retail PPI customers were female in [✂]. This contrasts with other forms of PPI where the gender mix of customers is more even.[20]

---

[20] See the provisional findings report, Appendix 2.6, Tables 1 and 2.

59. However, it is not clear that any differences in the demographics of retail PPI customers, when compared with customers of other types of PPI, mean that it is more or less likely that retail PPI customers will consider the whole cost of the bundle of credit and PPI. Retail PPI customers may have lower average incomes than customers of other types of PPI, which may mean that they are more price sensitive than customers of other types of PPI. However, we have no evidence that this is the case. Furthermore, even if this were the case, we concluded that this would not out-weigh the additional difficulties in considering the whole cost of a bundle including retail PPI outlined in paragraph 55.

60. In the provisional findings report we found a consistent pattern across other types of PPI that we studied, that PPI customers do not consider the whole cost of the bundle of credit and PPI when making their choice of supplier in the markets for credit. We considered whether there are material differences in the characteristics or behaviour of retail PPI customers that would make them significantly more likely to consider the whole cost of the bundle than customers of other forms of PPI. We concluded that it is more difficult for retail PPI customers to substitute a bundle including retail PPI for an alternative bundle of credit and PPI than is the case for CCPPI customers substituting between different insured credit cards.

Evidence from the parties

61. We asked the providers for evidence relating to whether retail PPI customers consider the whole cost of the bundle of credit and PPI. In particular, we asked for any available primary evidence on this point. We asked:

(a) whether customers take retail PPI prices into account when choosing a credit supplier; and

(b) for any evidence or analysis of the impact that an increase in retail PPI prices would have on sales of credit.

62. [✂] told us that it had no evidence to suggest that customers took retail PPI prices or other terms and conditions into account when making their choice of retailer or credit. It said that customers were attracted to the product offering rather than the credit account or PPI product that may subsequently be offered to them. It also said that, as far as it was aware, changes in prices of their retail PPI have no impact on its sales of credit or its merchandise.[21]

63. [✂] told us that although it had no specific evidence with which to answer this question, given that the sale of PPI was not directly linked to a retail purchase or the opening of a credit account, the impact was likely to be minimal.

Conclusion on the substitutability of the retail credit and retail PPI bundle with alternative bundles of credit and PPI

64. We found that it is more difficult for retail PPI customers to substitute a bundle including retail PPI for an alternative bundle of credit and PPI than is the case for CCPPI customers substituting between different insured credit cards. Given that we found, in the provisional findings report, that substitution between insured credit cards, in response to a change in CCPPI prices, was low, we concluded that it was unlikely that substitution to alternative bundles of credit and PPI would be sufficient to constrain retail PPI suppliers.

65. We sought evidence from the parties regarding the extent to which retail PPI customers would or do substitute to alternative bundles of retail PPI in practice. Two of the distributors considered that this was unlikely and none of the parties was able to provide documentary, survey or any other primary evidence that this was the case.

---

[21]However, these changes in price have, in the past, been concurrent with a change in terms and conditions. See paragraph 42.

66. We therefore concluded that the possibility of customer substitution to alternative bundles of credit and PPI, in response to an increase in the price of retail PPI, would be a relatively weak constraint on retail PPI suppliers.

The substitutability of the merchandise, retail credit and retail PPI bundle with alternative bundles of merchandise, credit and PPI

67. As outlined in paragraph 33, in addition to substitution to alternative types of insurance, and substitution to alternative bundles of PPI and credit, it is also possible that retail PPI consumers could respond to an increase in retail PPI prices by substituting to another retailer and purchasing a bundle of merchandise, retail credit and retail PPI from that retailer instead.

68. As discussed in relation to substitution between bundles of credit and PPI above, a key question in this regard is the extent to which retail PPI customers consider retail PPI when making their choice of retailer.

69. We note that there are a number of practical reasons why substitution between retailers in response to a change in retail PPI prices may be expected to be limited. First, home-shopping catalogues are differentiated products. They have different ranges of products, they may focus on different segments of customers, and they operate under different brands. Customers may therefore be deterred from substituting between retailers because the specific product they are interested in is not available or because of a preference for one retailer over another.

70. In addition, in order to compare the bundles on offer from competing retailers, retail PPI customers must compare not only the differences in retail PPI offer, but also the differences in retail credit account terms and the differences in the home-shopping offer itself. This makes the task of comparison more difficult.

71. The difficulty of this task is further compounded by the difficulty customers face in assessing and comparing the whole cost of the bundle of merchandise, retail credit and retail PPI. The price of merchandise is readily available within the home-shopping catalogues produced by retailers. However, there is no easy way for customers to compare the whole cost of a bundle and no readily available measure of the combined price. Similarly, we are not aware of any comparison tools, such as comparison websites, that cover retail PPI.

72. Finally, we note that, with the exit of Otto and Express Gifts from the supply of retail PPI in 2007, there are only two large retailers for customers to choose from in order to purchase a bundle of merchandise, retail credit and retail PPI.

The extent to which retail PPI customers consider the whole cost of the bundle of merchandise, credit and PPI

73. Notwithstanding the difficulties outlined in paragraphs 69 and 72, we asked distributors of retail PPI directly for evidence on whether retail PPI customers consider the whole cost of the bundle of merchandise, credit and PPI. In particular, we asked for any available primary evidence on this issue.

74. First, we asked distributors to provide evidence that their customers take retail PPI prices or other terms and conditions into account when making their choice of retailer. Otto and Express Gifts told us that they had no such evidence. SDGFS and JD Williams gave contradictory evidence in response to this question (although neither was able to provide us with primary evidence):

- SDGFS told us that 'any increase in the price of its shopping insurance would have a material impact on Littlewoods sales of goods. Littlewoods home shopping customers will have the catalogues for the other home shopping providers and will actively compare prices for the total package offered by each provider'. It did not provide any internal documents, or other primary evidence, to support this evidence.

- JD Williams told us that:

> We have no evidence to suggest that customers take retail PPI prices or other terms and conditions into account when making their choice of retailer or credit. With regard to our particular mail order catalogue experience, the customers are attracted by the product offering rather than the credit account or PPI product we may subsequently offer them.

75. Second, we asked for any evidence and analysis of the extent to which their customers would or do switch to any alternative products in response to a small but significant change in the price of retail PPI. We also asked whether they had any evidence of the actual or likely impact of changes to retail PPI prices on sales of retail PPI, retail credit or sales of merchandise. Such evidence would directly inform us about the level of competition for retail PPI and, if merchandise or credit sales were affected, whether customers were considering the whole cost of the merchandise, credit and retail PPI bundle. None of the distributors was able to provide analysis of the likely impact of a change in prices of retail PPI. SDGFS, JD Williams and Otto gave contradictory evidence in response to this question:

- SDGFS told us:

> Although there is no specific evidence or analysis in relation to Home Shopping Retail PPI, it is well known that home shopping customers do compare total retail prices (including PPI) across different retailers. The increased participation of the internet also means it is becoming even easier for customers to compare home shopping against other providers. Customers will switch their primary retail purchasing

> decisions between different home shopping providers if the total cost of the goods plus any required PPI is too high.

- JD Williams told us:

> We have no evidence to suggest that a change in retail PPI price has any impact on sales of retail PPI. We recently made an increase in premium charge from £1.98 per £100 of outstanding balance to £1.99. This had no impact, however it was accompanied by improvements to the PPI product overall. As far as we are aware changes of this type also have no impact on sales of retail credit, or product.

- Otto told us 'we have no evidence or analysis with which to answer this question. However, given that the sale of PPI is not directly linked to a retail purchase or the opening of a retail credit account the impact is likely to be minimal'.

76. Finally, we asked for examples of any reports, analyses, comparisons or other documents for the purpose of monitoring competitors in the provision of retail PPI and retail credit. If customers are considering the whole cost of the bundle, then providers will need to ensure that their whole offer, including the prices of merchandise, credit and retail PPI, is competitive. All the providers told us that they monitored competitors' catalogues and other retail promotions. However, we received no documentary evidence of such analysis and comparisons from SDGFS or Express Gifts.

77. JD Williams produced analyses of competitors' retail PPI offerings, including prices and benefits. These analyses were conducted in March and June 2003 and in April 2005.

78. Otto provided an analysis of its typical retail customer and their shopping behaviour, and an analysis of customers' retail credit offers. Neither analysis looked at retail PPI.

Conclusion on the substitutability of the merchandise, retail credit and retail PPI bundle with alternative bundles of products

79. We identified a number of practical reasons why, in the absence of other evidence, we would consider it unlikely that retail PPI customers would respond to an increase in retail PPI prices by substituting to other retailers offering retail credit accounts and retail PPI. These reasons include the differentiation between home-shopping providers' retail offers, the complexity of the task of comparing bundles of merchandise, retail credit and retail PPI and the limited number of retailers to choose from.

80. We received conflicting evidence from the retailers regarding whether, in practice, these obstacles were overcome by consumers and that substitution between retailers, in response to changes in retail PPI prices, did in fact occur. We actively sought, and were unable to find, primary evidence to support the view that substitution between retailers, in response to retail PPI prices, did occur. We therefore concluded that, given the practical reasons why substitution may be expected to be limited (see paragraphs 69 to 72), the constraint on retail PPI distributors from the possibility that their retail PPI customers might substitute to other retailers in response to an increase in retail PPI prices was weak.

Conclusion on market definition

81. We identified three ways in which retail PPI customers could potentially react to a SSNIP in retail PPI and which could result in that SSNIP being unprofitable. These were that customers could substitute to other insurance policies, customers could substitute to other forms of insured credit and customers could substitute to other retailers that offered a credit account and retail PPI.

82. We found that a lack of suitable alternatives to retail PPI, the limited sales of possible alternatives, their limited effectiveness as substitutes and the limited impact that they appeared to have on retail PPI sales following a price rise indicated that the prospect

of customer substitution to alternative types of credit insurance was a weak constraint on retail PPI suppliers.

83. With regard to substitution between bundles of credit and PPI we found that it was more difficult (and certainly no easier) for retail PPI consumers to consider the whole cost of a bundle including retail PPI when compared with other types of PPI. We saw no clear evidence to suggest that retail PPI customers were intrinsically more likely to substitute between bundles of credit and PPI than customers of other types of PPI. We also received conflicting views from the retailers regarding the extent to which their customers substitute between bundles in response to changes in retail PPI prices and terms. We concluded that the possibility that retail PPI customers may substitute to alternative bundles of credit and PPI, in response to an increase in retail PPI prices, was a weak constraint on retail PPI suppliers.

84. We also found that it was likely to be difficult for retail PPI customers to substitute between retailers offering retail credit accounts and retail PPI. We received conflicting views from the retailers regarding the extent to which their customers would substitute in this way in practice and none of the parties was able to provide primary evidence that customers substitute between retailers in response to changes in retail PPI prices. We therefore concluded that, given the practical reasons why substitution may be expected to be limited, the constraint on retail PPI distributors from the possibility that their retail PPI customers might substitute to other retailers in response to an increase in retail PPI prices was weak.

85. Because the constraint on retail PPI suppliers from each of the three potential sources of substitution was weak, we concluded that a narrow market definition was appropriate, and that it would be inappropriate to include other types of credit insurance, or other bundles of credit and PPI, or other bundles of merchandise, credit

and PPI within the relevant market. We therefore defined the relevant product market as the supply of retail PPI by a distributor to its own retail customers.

Indicators of the extent of competition between retail PPI providers in the supply of retail PPI

86. In this section, we assess a series of indicators of the level of competition between retail PPI distributors.

Variation of retail PPI prices over time

87. We looked for price changes of retail PPI by the four distributors, to see if this showed evidence of competition between providers. Table 6 shows the price changes during the period 2002 to 2007. There were only three significant price changes over a period of six years. These were all increases; two of them were accompanied by a major change to merchandise cover, although not the retail PPI offering. There were some price-led promotions, for instance one month of free cover.[22]

TABLE 6 **Price changes between 2002 and 2007**

Distributor	
SDGFS	PPI prices have remained constant
JD Williams	2003: Increased from 1.73% to 1.98%.
	2002: Increase from 1.50% to 1.83% (accompanied by increase to merchandise cover)
Otto	2004: Further increase to 1.99% (accompanied by increase to merchandise cover)
Express Gifts	No changes made.

Source: Information provided by retail PPI distributors.

88. In a competitive market we would normally expect to see price variations over time as firms seek to win business from each other. The level of price variation over time that we saw was consistent with there being few significant competitive pressures on retail PPI providers.

[22]Otto gave the first month free between 2006 and 2007. JD Williams was running a similar offering on its website on 11 August 2008.

Indicators of non-price competition

89. In order to make an assessment of the extent to which retail PPI distributors engaged in non-price competition, we considered evidence supplied to us to identify any new retail PPI policies which had been introduced and whether there had been any innovations within existing policies. Individual providers will sometimes find product changes profitable absent any competition and so we also considered evidence that the rationale for product change or innovation was to win customers from competitors.

90. We were provided with evidence of one new product being introduced by Otto[23] between 2002 and 2007. This product was more flexible and could be tailored to suit different customers, for instance with different policies and prices available to over 65s or unemployed customers, as well as an increase in the monthly benefit. It was launched in November 2007; however, sales were halted after the first week and Otto no longer offers retail PPI. We look at Otto's decision to stop selling retail PPI in paragraph 135.

91. Table 7 shows the innovations in cover offered by the four distributors. There were many changes to terms and conditions of policies which increased the number of customers that were eligible for retail PPI, such as increasing unemployment cover to 75 or removing pre-existing exclusions. There were also increases in the range of circumstances for which a claim could be made, such as having to leave employment to care for a relative, and the introduction of merchandise insurance. One distributor, Express Gifts, made no changes to its policies.

[23]Otto introduced 'Complete Cover' to replace 'Product and Payment Protection'.

92. Given the lack of changes to the price of products, in a competitive market we would expect to see changes in the monthly benefits of policies as firms seek to win customers from each other. However, for customers who were always eligible under these policies, the actual benefits received in the event of a claim were not changed within the period 2002 to 2007.[24]

TABLE 7 **Changes to policies between 2002 and 2007**

Distributor	
SDGFS	• Standardization of terms and conditions to ABI creditor claims levels. • Introduction of Carer cover (if you have to leave work to become a carer). • Increased unemployment cover to age 75. • Removal of pre-existing exclusions and other conditions. • Reduced waiting period before claims can be made. • Extension of merchandise cover (from 2 years to 3 years after purchase).
JD Williams	• Mar 2003: Personal accident cover, hospitalization qualifying period and death age limit all increased. CI cover introduced. • Jan 2005: Death age limit reduced. Hospitalization benefit increased. • May 2008: L, CI. Accidental cover age limit increased. Exclusions to CI, L, S & U extended, now easier to claim. Pet care included with hospitalization claims. • No changes to monthly benefit.
Otto	• Increases in merchandise cover from 12 months to 24 months in 2002, and later to 30 months in 2004. • Other changes to waiting times and enhanced benefits for hospitalization cover. • Removal of claims cap for merchandise cover. • Permit claims for mental illness. • No changes to monthly benefit (except with introduction of Complete Cover product).
Express Gifts	No significant changes.

Source: Information provided by retail PPI distributors.

93. We considered the reasons for introducing new products and amended retail PPI policies. First, we looked at internal documents provided by the distributors for evidence that they were monitoring, and reacting to changes to, their competitors' retail PPI policies. Second, we considered the explanations and internal documents provided by the distributors outlining the reasons for the changes in Table 7.

94. Only one distributor provided examples of monitoring competitors' retail PPI policies. JD Williams compiled a comparison of retail PPI policies in spring 2003 and 2005,

[24] SDGFS increased monthly benefits in 2000 and Otto increased the benefits with its new policy, but withdrew the product a week later.

including prices and benefits. Other distributors told us that they monitored competitors' catalogues and retailer promotions on an ongoing or ad-hoc basis, but not specifically in relation to retail PPI. Otto told us that it would 'be aware of any price changes, but not necessarily changes to Terms and Conditions'.

95. The distributors provided us with explanations of the motivation behind changes to their retail PPI policies:

- Otto extensively developed a new product that was launched in November 2007 (see paragraph 90). It told us that the motivation for this new product was to ensure that it was offering and selling a product in line with all current and future regulatory requirements.
- JD Williams explained that its policy changes in 2003 were to 'improve the scope of the product offering to our customers'. In 2005, policy changes were made due to a change of underwriters. Finally, changes in 2008 were made when regulatory changes to life cover took place and following the FSA Treating Customer Fairly Initiative. Changes were also made to 'make it easier for customers to claim'.
- SDGFS told us that many of its changes to terms and conditions were due to competition with other home-shopping brands in an attempt to differentiate the product offering. Furthermore, it had an objective to achieve a Defacto 5* product rating. However, SDGFS was unable to provide documentary evidence of the motivation for these changes. In addition, we were told that the monthly benefit received in the event of a claim was significantly higher than that described in policy documents available to consumers. This would appear to be inconsistent with competition on non-price elements of the product, since if this were the case we would expect SDGFS to publicize these higher benefits in order to win or retain customers.

96. We did not find evidence that there were significant changes to non-price factors in response to competition. We found that many changes to non-price factors were due to regulatory or compliance issues. Further, there were no material changes to the actual monthly benefit paid to claimants in the period 2002 to 2007,[25] and we found no evidence that retailers attempted to win customers by promoting these changes. We therefore formed the view that distributors do not compete to any significant degree on the non-price aspects of retail PPI.

Advertising

97. We looked at evidence of how retail PPI distributors advertised and marketed their policies. We found that there were three main channels used to promote retail PPI:

(a) Retail PPI distributors have regular contact with their customers through catalogues and continued purchasing of the retail goods and these points of contact can be used to advertise their retail PPI policies. SDGFS advertises, and Otto advertised, retail PPI products in their catalogues. Express Gifts advertised twice in its catalogues between 2002 and 2007. For SDGFS and Otto, these advertisements are, or were, full-page advertisements, equivalent to advertisements for other insurance products.

(b) Distributors can also market their products alongside the monthly statements they send out for their credit account customers. JD Williams sends all of its credit account customers information about retail PPI and the opportunity to purchase it as part of their third credit account statement.

(c) All the retail PPI distributors, except Otto, use their websites to advertise retail PPI. This is usually found in the financial services part of the website, alongside advertisements for other financial products such as general insurance and loans.

---

[25]SDGFS changed monthly benefits in 2000 and Otto changed benefits in 2007, but withdrew retail PPI a week later.

Links to retail PPI information are also provided for customers shopping online during the payment process.

98. We found that the degree and nature of advertising of retail PPI was different from other forms of PPI. First, the distributors do not rely on advertising of credit, and credit prices in particular, to sell both credit and retail PPI and subsequently market retail PPI at the credit point of sale. Instead, they must attract customers to their retail offering more generally and not by any single price. Second, they generally give an equivalent amount of advertising space to their retail PPI products as to other financial products, for example alongside other insurance products in the back of catalogues.

99. The cost of retail PPI in the advertisements is usually stated in a comparable format as a price per £100 balance, although it is sometimes stated as a price per £1 balance or accompanied by price related offers, such as one month of free cover.

100. We did not find any comparative advertising for retail PPI or advertising of the changes made to the scope of policies. Given that all retail PPI policies (bundled with merchandise cover) are sold at around the same price (see paragraph 103), advertisements are only useful for customers to compare retail PPI policies if they give information about the different benefits, such as the level of monthly payments or life payment.

101. We found some variation between different distributors in the accessibility of advertising and information about prices. For instance, JD Williams provides information about retail PPI in the 'Terms and Conditions' part of its website, rather than

with other financial services.[26] In contrast, SDGFS provides information about retail PPI, including pricing information, as part of its 'Your money' section of the Littlewoods website. We also found that sometimes the merchandise cover part of the product was given greater emphasis within advertisements than the retail PPI element.

102. We found that the level of advertising of retail PPI policies was comparable to other financial services and to the credit offering from the retailers. We also found that relevant price information was included with these advertisements. We therefore found that the degree and nature of advertising of retail PPI did not indicate a lack of competition.

Price dispersion

103. We found (see paragraph 87) that prices of individual retail PPI policies did not vary much over time and that they all had about the same price. In a competitive market where consumers search effectively, it might be expected that such similarities in price of differentiated products could be explained by similarities in non-price features of the products, but in this case the evidence showed material variations in the non-price features. Table 8 shows the variation in benefit that is received for each of the policies for four different claim events as given in the policy summary documents. The higher-than-advertised level of monthly benefit for unemployment or sickness under the SDGFS policy is not given in the policy documents, but we have been told that this is the current level of monthly benefit.

[26] Using the website: www.jdwilliams.co.uk/policies?decoration=true&finalTarget=policies_pomp on 11 August 08.

TABLE 8 **Benefits for claim events where a £500 balance is held at the time of event**

Distributor	*Price per £100 of outstanding balance* £	*Monthly benefit for unemployment or sickness* £	*Not working and hospitalized for 3 weeks* £	*Life* £	*Merchandise cover (years)*
SDGFS	1.98	100–£167*	167	500	3
JD Williams	1.99	30	1,000	500	5
Otto	1.99†	42	500	500	3
Express Gifts	1.95	52	52	500	2

Source: CC calculations, based on information provided by retail PPI distributors.

*This range depends upon whether an item was bought from Littlewoods or Littlewoods Direct.
†The Complete Cover product had different prices for customers who are over 65 and/or unemployed.

104. There were trade-offs between some events and policies. For instance, the Otto policy had a higher monthly benefit but lower hospitalization benefit compared with the JD Williams policy. In other cases, there were policies that were clearly of a higher quality, for instance the SDGFS policy has higher benefits than the Express Gifts policy. Whilst we are only able to compare for four products, there did appear to be a lack of correlation between price and quality between policies.

105. This is reflected in the relatively large differentials in claims ratios among retail PPI underwriters. We found that the claims ratios for two of the three largest underwriters of retail PPI in 2006 were 9 per cent for [✂] which underwrites [✂], and 30.6 per cent for [✂] which underwrites [✂].

Profitability

106. The CC guidelines[27] state that it is normally helpful to consider the effectiveness of competition by examining the outcome of the competitive processes in the particular market. One of these outcomes is profitability. The section in the CC guidelines on profitability states that a situation where, persistently, profits are substantially in excess of the cost of capital for firms that represent a substantial part of the market

[27]CC3, paragraph 3.78.

could be an indication of limitations in the competitive process.[28] We were interested in the profitability of retail PPI distribution only.

How we examined profitability of retail PPI distribution

107. We examined the profitability of retail PPI in the same way as we did for other types of PPI in the provisional findings report, by identifying the revenues and costs incurred in the sale of retail PPI, as distinct from those incurred in the sale of the goods or the retail credit. As described in paragraph 30, we noted that retail PPI was sold separately from the sale of the goods and the retail credit. Retail PPI distributors were generally able to separate out revenues and costs relating to retail PPI distribution, although in some cases revenues of retail PPI were combined with merchandise cover, and costs were shared with other activities of the distributor.

108. We focused on the economic profitability of retail PPI (the post-tax profits less a charge to reflect the cost of capital required to support this business line), as well as calculating return on equity capital, being post-tax profits divided by equity capital. These were the two measures of profitability which we examined in the provisional findings report. We thought that the use of a combination of economic profits and return on equity capital afforded an economically meaningful picture of both the absolute and relative (in relation to the cost of capital) level of profits earned from retail PPI distribution.

109. We used the revised Market Economics Model as in the provisional findings report, collecting data from the four largest distributors of retail PPI. We considered the model suitable for our analysis of the profitability of retail PPI. We considered the following inputs for the revised model:

---

[28] Ibid, paragraph 3.82.

(a) the share of income earned by distributors;

(b) the operating costs associated with the distribution of retail PPI; and

(c) the appropriate capital base and cost of capital for the distribution of retail PPI.

110. As retail PPI is all regular premium, there is no interest income earned on retail PPI premiums.

Share of premium income earned by distributors

111. As explained in more detail in the provisional findings report, the distributor retains commission, expressed as a percentage of GWP, on each policy sold. The distributor may also be entitled to a profit share payment in the event that the amount paid out in claims is less than expected.

112. We examined data on the GWP each distributor collected from the sale of retail PPI policies between 2002 and 2007. We found that retail PPI is always sold with merchandise cover by all the distributors we looked at (see paragraph 24),[29] and that the figures the distributors had provided, with the exception of [✄], included merchandise cover. In order to examine the profitability of retail PPI, we needed to isolate the GWP received from retail PPI only. Distributors told us how much GWP per £100 outstanding balance per month related to retail PPI and how much to merchandise cover (see paragraph 31). Using this information we estimated, on a distributor-specific basis, that in 2007 total GWP relating to retail PPI was approximately £73 million, as shown in Table 3.[30]

113. We collected data on the income (in the form of commission and profit share) that the distributors received from the sale of retail PPI between 2002 and 2007. This is

[29]With the exception of Otto which briefly sold retail PPI policies without merchandise cover.
[30]This is [60–80] per cent of the GWP originally reported to us.

shown in Table 9. We used the data to calculate the percentage of GWP that the distributors received as income. We found that distributors received income of between 52 and 96 per cent of retail PPI GWP,[31] and received income on an aggregate basis of approximately 70 per cent of retail PPI GWP.

TABLE 9 **Income from PPI as percentage of GWP for each distributor, 2002 to 2007**

	2002	*2003*	*2004*	*2005*	*2006*	*2007*
SDGFS	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
JD Williams	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Otto	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Express Gifts	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aggregate	68	67	68	68	70	70

Source: CC based on information provided by the parties.

114. We looked at the contracts between retail PPI distributors and their underwriters in order to collect data on commission rates and the share of profit. We found that commission rates ranged between [50–60] and [70–80] per cent and that profit share ranged between [60–70] and [90–100] per cent. Details of each contract that we looked at are set out in Table 10. This data is useful as it corroborates the data on typical distributor income levels shown above.

TABLE 10 **Summary of financial arrangements**

Underwriter	*Distributor*	*Date of contract*	*2007 GWP £m*	*Commission %*	*Profit share %*
[✂]	[✂]	[✂]	[✂]	[65–75]	No profit share*
[✂]	[✂]	[✂]	[✂]	[50–60]	[60–70]
[✂]	[✂]	[✂]	[✂]	[70–80]	[90–100]
[✂]	[✂]	[✂]	[✂]	[65–75]	[85–95]

Source: CC based on contracts provided by the parties.

*[✂]

115. For the purposes of the revised model of retail PPI profitability, we used the aggregate figures as shown in Table 9 for the share of income estimate. We noted

[31][✂] told us that owing to timing considerations, any profit share element was not necessarily booked in the same year as the premium was written, and that a coincidence of circumstances could give rise to an apparently high income figure.

that the agreements between distributor and underwriter were structured differently for each contract, and often had complicated arrangements with regard to profit share payments. We based the model on actual income levels reported to us by distributors rather than contractual rates to ensure that we used actual income figures received by each distributor regardless of how the contractual agreements were arranged.

The operating costs associated with the distribution of retail PPI

116. We asked each distributor for information on costs associated with the distribution of retail PPI. Even though some costs of supplying retail PPI were shared with the cost of supplying the goods or retail credit, distributors were generally able to provide us with their estimates on the costs of supplying retail PPI.

- *Evidence from each of the parties*

117. Otto stopped selling PPI in November 2007, but before that date it sold PPI in-house, through telephone channels only (both inbound and outbound). Otto told us that the direct costs of selling PPI were £[✂] per new sale, and that ongoing compliance and servicing costs totalled £[✂] in 2007/08. Based on sales of [✂] new policies in 2007, this equated to an approximate total cost of [£40–£60] per sale.

118. As with other parties to the investigation, JD Williams told us that it did not have data solely concerning the profitability of retail PPI, as it was such an integral part of its customer accounting process and service, but was able to provide us with a detailed costs schedule showing costs of sales, regulation, servicing and claims for the retail PPI business. JD Williams used an external telemarketing company to make the outbound sales calls so these costs were easy to identify: based on [✂] policies sold in 2007 and £[✂] costs of external telemarketing, the direct cost per policy sold was £[✂]. JD Williams then allocated payroll, marketing, professional and overhead costs

to each of the cost lines of sales, regulation, servicing and claims. JD Williams also included customer recruitment costs, on the grounds that without new customers JD Williams would not have any customers to sell retail PPI to. We thought that the costs of selling retail PPI should rightly include some measure of relevant joint and common costs incurred by the business, but we thought that customer acquisition costs were attributable wholly to the sale of goods and credit. We did not consider these costs to be related to retail PPI and there was no conceptual reason for allocating a proportion of these to retail PPI. Deducting these costs from the schedule JD Williams provided, we calculated the total cost of supplying each new retail PPI policy sold in 2007 as [£100–£150].

119. Express Gifts told us that it sold retail PPI via the telephone, as well as via postal and Internet orders, at the same time that the customer placed the order for merchandise and retail credit, but that it suspended telephone retail PPI in November 2007. It provided cost data, which showed the cost of selling, compliance and handling enquiries and claims, as approximately £[✂] per new policy sold. Express Gifts told us that the cost data provided only included direct costs, with no overhead allocation.

120. SDGFS provided a schedule containing the costs it estimated of selling, compliance and servicing of retail PPI policies, showing a cost of [£250–£300] per sale. We disagreed with its approach for two reasons. First, it allocated categories of cost which were unrelated to the distribution of retail PPI such as warehousing costs on the basis that, if the company did not incur costs for distribution, warehousing, and customer support, it would not be able to sell any of the goods and services shown in its catalogues and on its website, and without these sales then there would not be any customer balances on which to offer a retail PPI product. We disagreed with this view. We thought that the costs of selling retail PPI should rightly include some measure of relevant joint and common costs incurred by the business. However, we

thought that costs such as warehousing and distribution were attributable wholly to the sale of goods and that there was no conceptual reason for allocating a proportion of these costs to retail PPI.

121. Secondly, we disagreed with SDGFS's method of apportioning costs to retail PPI. The large majority of costs were apportioned on the basis of GWP received on retail PPI as a proportion of total turnover of the business.[32] We did not believe that an apportionment based on turnover was appropriate when the price of retail PPI itself is under examination. This is because, if retail PPI prices were to be excessive, and hence sales figures inflated, then apportioning costs pro rata to sales could lead to an excessive proportion of costs being allocated to retail PPI, thus understating retail PPI profitability. We considered that a more appropriate method would have been to apportion costs on the basis of activity, ie activity-based costing. An activity-based costing system seeks to identify cause and effect, in order to assign costs to products objectively; these causes are called cost drivers. Once costs of the activity have been identified, the cost of each activity is attributed to each product to the extent that the product uses the activity. Thus, for example, a product which is not marketed would not have any marketing costs attributed to it.

122. Based on this methodology, we attempted to estimate a reasonable fully allocated cost of distributing retail PPI for SDGFS. We did not include the costs of warehousing, distributing the merchandise, or support services on the basis that they were not attributable to the distribution of retail PPI. We also included only a small proportion (10 per cent) of the £[✂] million annual costs of marketing which SDGFS

[32]The exception to this basis of apportionment were the costs of the SDGFS call centre (for existing customers), based on the estimated actual time spent making the PPI offer, although SDGFS did not show us the underlying calculations. The costs of the second contact centre (for customers making their first purchase) were allocated on the basis of turnover, however.

had allocated to retail PPI on the basis that the marketing of retail PPI was limited to a one-page advertisement in the catalogue and a page on the website.[33]

123. On this methodology, we calculated the cost per new policy sold as [£100–£150]. We regarded this as an upper estimate as it apportions all costs (other than the costs adjusted for above) on the basis of turnover; whereas we consider that many of the costs incurred in the sale of retail PPI are minimal compared with the sale of the retail goods or credit.

- *Figure to include in the revised Market Economics Model*

124. The range of fully allocated costs of distributing retail PPI was between [£100–£150] and [£100–£150] for JD Williams and SDGFS (with [£40–£60] for Otto). We took the upper end of the range to be generous, at [£100–£150].

125. We were aware that the estimates we noted above included the cost of selling merchandise cover. However, since retail PPI and merchandise cover are sold as one product, there is no obvious way to split the costs between them. In the absence of any other methodology, we decided that a reasonable split would be in proportion to GWP received by the distributor for retail PPI and merchandise cover, that is, [60–80] per cent[34] to retail PPI and the remainder to merchandise cover. We recognize that this method is arbitrary and a preferred method would be based on split of direct costs, but we have no information on this. Thus, we assume a cost of £96 ([60–80] per cent of [£100–£150]) in the revised Market Economics Model, which we consider to be a generous figure for the reasons set out above. We carry out sensitivity analysis on this figure below.

---

[33]We included the same proportion of costs relating to a subsidiary which undertook all the printing operations, mailing and fulfilment of customer orders (customer statements etc) for the same reasons.
[34]See paragraph 112.

The appropriate capital base and cost of capital for the distribution of retail PPI

126. We needed to estimate an appropriate capital base and cost of capital in order to estimate a capital charge for the purposes of assessing economic profit. An appropriate cost of capital was also needed to compare against the return on equity (RoE) in the revised Market Economics Model.

127. We considered that some capital should be allocated to the activity of retail PPI distribution. We noted that conceptually the capital requirement of a business should be irrespective of ownership and that we were attempting to assess the profitability of the retail PPI offering as a stand-alone product, separate from the retail offering. We therefore decided to use an estimate of 12 per cent of retail PPI income to reflect total economic capital in respect of the retail PPI distribution activity, the same figure as in the provisional findings report.

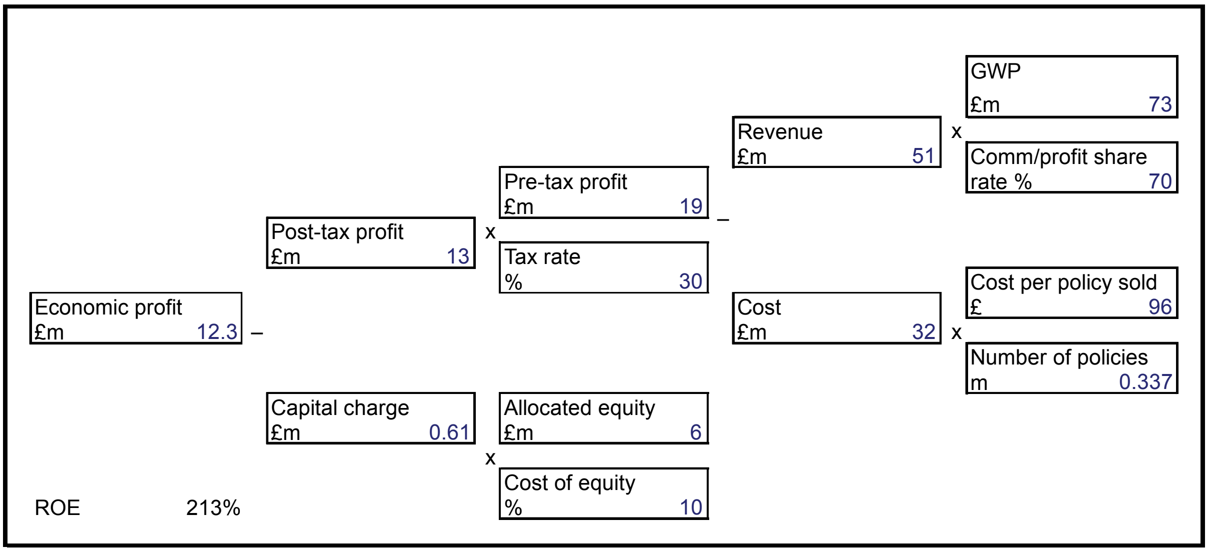
128. Similarly, we wanted to estimate a retail PPI-specific cost of capital. We noted that the cost of capital attached to the nature of the activity, rather than the ownership. In estimating the cost of capital, we decided to use a figure of 10 per cent, which was the same figure as in the provisional findings report.

Results of profitability analysis

129. Figure 1 is a schematic representation of the revised model of economic profitability for retail PPI distribution, using the assumptions discussed in further detail above. The model calculates that the four retail PPI distributors made economic profits of over £12 million in 2007, representing an RoE of 213 per cent. This is greatly in excess of any reasonable estimate of the cost of equity.

FIGURE 1

Profitability of PPI distribution



Source: CC analysis based on the [✂] Market Economics Model.

130. We carried out sensitivity analysis to examine the effect of changes to the cost per policy. If we allocated the combined cost of selling retail PPI and merchandise cover [£100–£150] the RoE would still be very high, at [45–50] per cent, with economic profits of over £2 million. For economic profit to be zero, costs per policy sold would need to increase to £148.

Conclusions on profitability

131. On the basis of the above model, including the assumptions discussed in paragraphs 113 to 129, we concluded that retail PPI distribution is highly profitable. Commission levels are high in relation to the costs incurred in selling retail PPI and the capital requirements are low, reflecting the low-risk nature of the activity.

132. Although the RoE we found was extremely high compared with the cost of capital, it was lower than in the provisional findings report where we found RoE of almost

500 per cent.[35] We considered this to be because distributors' revenues are directly linked to the level of GWP per policy (through the fixed percentage commission rate) which are lower than for other types of PPI. We found that the average income per customer per year was less than £41[36] for all retail PPI distributors, compared with £160 for a PLPPI policy;[37] however, the costs per policy are not materially different.

133. We looked at commission rates over the last six years and found that there had been no material change. We had no evidence to suggest that costs had been materially higher in previous years, and we therefore provisionally concluded that these levels of profitability had persisted over at least the last five years.

Recent developments in the supply of retail PPI

134. The indicators on price competition, non-price competition and profitability led us to conclude that there was a lack of competition. However, we also noted that two firms stopped selling retail PPI since we started our investigation. In November 2007, Otto stopped selling retail PPI completely and Express Gifts stopped selling retail PPI by telephone, although it continues to offer retail PPI for online customers. We wanted to understand why some distributors had stopped selling retail PPI despite the evidence we had seen that there is a lack of competition and it was highly profitable.

135. We asked Express Gifts and Otto for an explanation of why they had stopped selling retail PPI:

- Express Gifts raised the issue of opportunity costs, telling us that it had to balance the time it took to sell a retail PPI policy with the time taken in offering alternative products to its customers, as it only had a limited amount of time when speaking

---

[35] For 2006.
[36] Source: based on £[✄] average GWP per year for [✄] of which [60–80] per cent is retail PPI, multiplied by [✄] per cent (commission and profit share as a percentage of GWP).
[37] For a £2,000 personal loan repaid over 12 months. See Table 1 in Appendix 5.1 of the provisional findings report.

to them on the telephone. It explained that its decision to stop selling retail PPI was to shorten telephone call lengths to handle more effectively an increased volume of calls in the run-up to Christmas 2007. [✄] and retail PPI was replaced by a non-insurance product. It is currently reviewing its arrangements for retail PPI. Express Gifts continues to offer retail PPI for Internet customers.

- Otto told us that [✄]. The company decided to focus on Call Centre sales activity on products that had an immediate and profitable income stream—[✄]. Retail PPI sales were not profitable in the short term because of the costs associated with the selling process. Otto's conclusion was that it had not found a way of selling retail PPI which was both cost-effective in the shorter term, and compliant.

136. We also took the view that firms were concerned about increasing regulation and the risks of mis-selling and that this also had a bearing on their decision to stop selling retail PPI. Retail PPI is not the home-shopping retailers' core business and is a minor part of their business, despite potentially high profit margins. We took the view that the high-street banks and other suppliers of PPI which we examined in the provisional findings report dealt with, and were familiar with, compliance and regulation as part of their core business, whereas the home-shopping retailers would regard it as an additional business risk.

137. We concluded that there may be differences in the levels of income each firm could expect from selling retail PPI and that this may have some bearing on whether a firm would decide to sell retail PPI. Table 11 shows the average income earned per customer in commission from premiums. There is a wide range in income received from retail PPI, with SDGFS receiving [✄] times more income per customer than Express Gifts.

TABLE 11 **Average income per customer per year**

Distributor	*Average income per recruited customer* £
SDGFS	[30–40]
JD Williams	[30–40]
Otto	[10–20]
Express Gifts	[10–20]

Source: CC calculations based on data provided by retail PPI distributors.

Note: This is the average income paid per retail PPI customer over the year. This does not reflect the pattern of premiums paid over the year, for instance some may pay all in one month, and other spread premiums over the year.

138. We looked at how long it would take each distributor to recoup the costs of selling the retail PPI policy, given the differences in the levels of income each firm could expect from selling retail PPI. The costs of retail PPI to the distributor occur through selling the product, whilst income and profit accrues over several months and years as customers pay their premiums. Firms may require profits to be earned more quickly than this, even if they are at a lower level overall, and may prefer to sell alternative goods and services that deliver more immediate profits.

139. We calculated that, given a combined average cancellation and termination rate of 19 per cent for all the parties, the average life of a policy was just over five years.[38] Based on the selling cost of £96 we estimated (see paragraph 125), we calculated that it would take the lengths of time shown in Table 12 for each distributor to recoup the costs of selling the PPI policy.[39] If it took more time to recoup the costs of selling the policy than the average life of the policy, it would not be worthwhile for the distributor to sell a policy. Table 12 shows that it is only worthwhile for SDGFS and JD Williams to sell a policy, with a marginal result for Otto. It would not be worthwhile for Express Gifts to sell a policy.

[38]This assumes that the number of policies stays constant.
[39]We noted that Otto's estimate of the cost of selling a policy was significantly lower ([£40–£60]). However, we used £96 as this estimate was based on data provided by the largest providers of retail PPI, and was broadly in line with the cost we estimated of selling a policy which we found for other types of PPI policy in the June provisional findings report (see Appendix 4.4, paragraph 54).

TABLE 12 **Payback periods**

Distributor	*Length of time*
SDGFS	[<3 years]
JD Williams	[<3 years]
Otto	[>4 years]
Express Gifts	[>4 years]

Source: CC based on data provided by retail PPI distributors.

140. We also looked at the average retail PPI customer for each of the four distributors and by using simple cash-flow assumptions, calculated the internal rate of return (IRR)[40] for a single retail PPI policy given the same assumptions and figures as we used above. Table 13 shows that, given an assumed cost of capital of 10 per cent, it would not be a good investment decision for Otto and Express Gifts to sell a policy.

TABLE 13 **Internal rate of return**

Distributor	*IRR* *%*
SDGFS	[40–50]
JD Williams	[20–30]
Otto	[0–10]
Express Gifts	[negative]

Source: CC based on data provided by retail PPI distributors.

141. We found that this evidence was consistent with Otto and Express Gifts choosing to cease sales of retail PPI, and did not alter our finding of high average profitability across the firms which supplied retail PPI.

Conclusions on the extent of competition between distributors

142. The retail PPI evidence suggested that there was little competition between distributors of retail PPI. We saw minimal price variation over time (paragraph 87) and we found that product innovation was not motivated by competition with rivals

[40]An IRR is an indicator of the quality of an investment, being the annualized effective compounded return rate which can be earned on the invested capital, ie the yield on the investment. A project is a good investment proposition if its IRR is greater than the rate of return that could be earned by alternate investments. Thus the IRR should primarily be compared with the appropriate cost of capital (including an appropriate risk premium) and then to alternative projects.

(paragraph 96). We found that the sale of retail PPI is highly profitable relative to the cost of capital (paragraph 131). We balanced this evidence against the withdrawal of two distributors from selling retail PPI. We thought that this behaviour could be explained by the low absolute level of profit from selling retail PPI, and the need to earn a more immediate return. The evidence led us to conclude that there is not effective competition in the supply of retail PPI, and that prices for retail PPI are higher than they would be in a well-functioning market.

Factors affecting the nature and extent of competition in the supply of retail PPI

143. Having concluded that there is little competition between distributors of retail PPI policies, we looked at why this is the case, and what factors are involved. The purpose of this was to see if there were any features which are preventing, restricting or distorting competition in the supply of retail PPI.

144. In the provisional findings report, we focused on five factors which might contribute to the lack of competition.[41] We considered each of these factors with respect to retail PPI:

- the extent to which distributors actively seek to compete with each other;
- whether comparing retail PPI products is beneficial and whether there are barriers to such searching;
- having taken out retail PPI, whether consumers switch between retail PPI products, and whether there are barriers to switching;
- whether there are barriers to entry into the supply of retail PPI by new providers, or barriers to expansion by suppliers already in the market; and

[41] See paragraph 5.2 of the provisional findings report.

- whether there is an advantage for distributors to selling retail PPI and the credit point of sale (the point-of-sale advantage) and whether this contributes to the lack of competition we found.

Competition between retail PPI providers

145. In competitive markets we would expect firms to seek to win business by offering desirable products (based on a combination of price and quality) and proactively to advertise their products to customers. In a well-functioning market we would expect to see a range of activities associated with active price and non-price competition between suppliers. These could include: offering price reductions, discounts and other sales promotions; advertising based on price; and comparative advertising, along with other efforts, to simplify customers' choices.

146. However, we have not observed these activities in relation to retail PPI. In particular:

- We saw little in the way of price competition. We saw no evidence of price reductions in the period 2002 to 2007, and little evidence of price changes, discounts or sales promotions to seek to win customers (see paragraph 87).
- We also saw little in the way of competition in relation to quality (see paragraph 96).

147. We provisionally conclude that, as with other forms of PPI,[42] most distributors fail actively to seek to win retail PPI customers by using the price or quality of their retail PPI product as a competitive variable. We conclude that this is a feature of the relevant markets which prevents, restricts or distorts competition in the supply of PPI.

[42]See the provisional findings report, paragraph 5.8.

Search

148. We looked at whether customers benefit from searching for the best retail PPI product, and whether there are barriers to effective searching.

Benefits to search

149. We observed minimal price variation between retail PPI policies, but we observed significant variation in benefit calculations between policies suggesting that consumers would still benefit from search (see paragraph 104). This was similar to the conclusions reached for CCPPI[43] in the provisional findings report.

Barriers to search

150. Whilst we found that there are benefits to search, we thought that there could be significant barriers to search. We considered what these might be.

151. We focused on two possible barriers to search:

- the availability of, and ease of access to, information; and
- the ease of using information to compare products.

The availability of, and ease of access to, information

152. We found that although retail PPI distributors advertised their products and included price information, there are no benefits to search with respect to the price of retail PPI as all retail PPI policies were priced at around the same level. Instead, the benefits to search will come from comparing the benefits of policies. Therefore, we considered the availability of information about the benefits of policies.

---

[43] Ibid, paragraph 5.14.

153. We found that information on benefits, and therefore the differences between policies, were not explained in advertisements and introductory pages of websites. The detailed information on benefits, for instance the value of hospitalization cover or monthly benefits for unemployment, could only be found by reading policy summaries. To calculate monthly benefits may also require customers to read terms and conditions for credit accounts to calculate the minimum payment due each month, and therefore the benefit that would be received. For one distributor, SDGFS, the monthly benefit was up to five times greater than that given in the policy summary documents such that customers would not be aware of it even if they had searched.[44]

154. The practice of bundling merchandise cover and retail PPI into one combined policy also makes it difficult for customers to evaluate value-for-money of retail PPI policies, and contributes to a lack of transparency.

155. Finally, we note that Internet-based comparison tools, which are available for other types of PPI, do not cover retail PPI.

156. We therefore believe that consumers face significant difficulties when trying to obtain systematized information on retail PPI that hinders their ability to compare retail PPI products.

The ease of using information to compare products

157. We found that retail PPI policies were not easier to understand than other regular premium PPI policies, and that retail PPI customers would not have a higher level of understanding or financial skill than customers of other types of PPI. Therefore, our

---

[44] The monthly benefit for accident, sickness and unemployment is given in the policy summary as 'the scheduled payment' due on the credit account, which is 5 per cent of the balance for Littlewoods Direct customers. However, SDGFS told us that the actual benefit was 33 per cent of the balance.

conclusions for other forms of PPI regarding ease of using information to compare products also apply in relation to retail PPI. We found that the variation in terms and conditions and the way information is provided by firms mean that information is not available in a sufficiently usable format that enough consumers successfully compare products to drive competition between providers. This may restrict the ability of consumers to search effectively and to make an informed choice, and we concluded that this is a significant barrier to effective search for retail PPI, as for other forms of PPI.

Conclusions on search

158. We found that there are benefits for consumers in searching, but that customers face significant barriers in comparing products. These barriers to effective search are features of relevant markets which prevent, restrict or distort competition in the supply of retail PPI. If the benefits of policies were clearer to consumers, and if retail PPI were available separately from merchandise cover, distributors would have a stronger incentive to compete with each other to show consumers that their retail PPI product offer was the best value. This was similar to the conclusions reached for other forms of PPI in the provisional findings report.[45]

Switching

Barriers to switching

159. We considered whether there were any barriers to consumers switching, in addition to the search barriers we have previously identified. We looked at: providers' access to relevant information; and exclusions.

[45]See paragraph 5.57 of the provisional findings report.

Providers' access to relevant information

160. For retail PPI, we thought that access to consumers' credit account information restricted the extent to which customers switch retail PPI on a stand-alone basis. Although stand-alone PPI policies exist which could be used to cover outstanding balances, these products are not linked to credit account balances. Customers choose a level of insurance, which means that the level of insurance is not tied to the actual amount owing on a credit account, and hence the customer is more likely to be over- or under-insured in any given month than insured for the exact amount owing (and hence the coverage is of lower quality than one which tracks the balance exactly).

161. In addition to this, stand-alone providers do not have access to information on the merchandise items purchased by retail PPI customers. This makes it more difficult for them to offer merchandise cover and consequently makes it more difficult for consumers to substitute to stand-alone, as they have to substitute to a product without merchandise cover.

162. We considered this to be a barrier to switching to stand-alone retail PPI policies.

Initial exclusion periods

163. We noted that, for retail PPI as for all types of PPI, the initial exclusion period at the start of a policy before a consumer can claim limited switching. The evidence for other types of PPI,[46] which also applied to retail PPI, led us to the view that for all types of PPI the initial exclusion period can act as a deterrent to switching, as customers are not fully covered during the initial period of a new policy.

---

[46]See paragraph 5.61 of the provisional findings report.

Exclusions for pre-existing conditions

164. Similarly, we concluded that the exclusions in policies for pre-existing conditions acted as a barrier to switching.[47] We agreed that for all types of PPI, including retail PPI, for someone who has developed a condition which would be excluded from coverage as a pre-existing condition under a new policy, the existence of exclusions for pre-existing conditions constitutes a barrier to switching PPI policies.

Conclusions on switching

165. In addition to the costs of search already found (paragraph 158), we conclude that there are three barriers to switching:

(a) the inability of stand-alone providers to offer insurance which tracks the outstanding balance on a credit account, or to offer merchandise cover, means that retail PPI policy-holders cannot find a perfect substitute for their policy; instead they can only find a policy which insures a set amount, leading them to be over- or under-insured in any given month and which does not include merchandise cover;

(b) initial exclusion periods on retail PPI policies, which mean that someone switching is not insured against certain eventualities at the start of the new policy; and

(c) exclusions for pre-existing conditions, though only for those customers who have developed conditions which are exempt from cover after they took out their original retail PPI policy but before switching.

Barriers to entry and expansion

166. We considered whether there are additional barriers to entry or expansion for suppliers selling stand-alone retail PPI. We received evidence on the barriers facing

[47]See paragraph 5.62 of the provisional findings report.

stand-alone PPI suppliers in the provisional findings report, which we concluded also applied to stand-alone retail PPI suppliers.[48]

167. First, we received evidence from four large underwriters that there are problems with adverse selection in distributing stand-alone PPI.[49] The evidence provided suggested that stand-alone PPI providers suffered from an increased risk of adverse selection, because consumers who search for this type of insurance are more likely to make a claim than customers who purchase PPI when applying for credit. This was exacerbated by retail PPI being sold alongside credit accounts. When retail PPI is sold to existing credit account holders, distributors may experience some reduced risk of adverse selection as they have access to all credit purchasers to whom they can try to sell retail PPI, rather than just those who approach them for retail PPI. In addition, a consumer who is facing a potential loss of income may be less likely to take on more credit. We concluded that adverse selection was a barrier to entry and expansion faced by stand-alone PPI providers compared with distributors selling retail PPI alongside credit accounts.

168. Second, we considered whether customer awareness of retail PPI and the options available constituted a barrier to entry and expansion. For other forms of PPI we were told that 'customers generally had a low awareness of the offers of different credit providers'.[50] The evidence suggested to us that low customer awareness of PPI, and poor understanding of the options available, restrict the ability of stand-alone providers successfully to enter and expand into PPI markets. We concluded

[48]See paragraphs 5.79 to 5.87 of the provisional findings report.
[49]See paragraphs 20 to 24 of Appendix 5.3 in the provisional findings report. Adverse selection, sometimes referred to as anti-selection, occurs as a result of information asymmetries between the insurer and the customer. Customers who know they face a large risk of needing to make a claim on an insurance policy are more likely to take out insurance than those who face small risks; however, the insurer does not know which customers fall into which category and so cannot price its insurance premium accordingly.
[50]See paragraph 5.83 of the provisional findings report.

that CCPPI and retail PPI customers would be similar in their awareness of PPI and the options available such that this would also apply to customers of retail PPI.

169. In order to overcome the poor awareness of the availability of stand-alone options, providers must market their products. The evidence we received on marketing costs to attract customers for a stand-alone policy was that they were significant. We concluded that, with the current market structure and at current prices, the cost of marketing stand-alone PPI to consumers is large if PPI products are not sold in combination with a credit product, and we concluded that this also applied to retail PPI.

170. We noted that providers of stand-alone PPI and short-term IP have not achieved significant sales, and that some large underwriters (Axa, Aviva) have exited the stand-alone market as a result of their experience. We found that only [✄] policies for potential stand-alone retail PPI had been sold in a year (see paragraph 39), that sales of short-term IP were under 30,000 per year (see paragraph 3.39 of the provisional findings report) and that the four largest distributors of retail PPI did not sell retail PPI to customers of other retailers.

171. We concluded that there are significant barriers to entry for stand-alone PPI providers seeking to sell retail PPI products without access to customers at the credit point of sale and to customer account information.

The point-of-sale advantage

172. We found that other forms of PPI were sold at the point of sale of the credit product which they protected.[51] For retail PPI, there is an equivalent initial point of sale when

[51]See paragraphs 5.88 to 5.119 of the provisional findings report.

the credit account is opened with a retailer and, similar to CCPPI, regular billing when the distributor will contact the customer.

173. However, there are also additional points of sale when the customer purchases other goods from the retailer, either with or without using their credit account. Different distributors sell retail PPI at different points in their relationship with the customer. We considered whether the following different types of selling process restricted competition:

- selling retail PPI at the initial point of sale of a credit account;
- selling retail PPI at subsequent points of sale, either with or without using a credit account; and
- selling retail PPI by directly contacting customers outside the point of sale.

174. SDGFS sells around half of its retail PPI policies to telephone customers at the initial point of sale[52] when customers first contact the retailer to order goods and open a credit account. Table 5 sets out the sales process for each retail PPI distributor. We found that the penetration rates for [✄] were between two and three times greater than for the other distributors (see Table 4).

175. Sales could be made when customers make a subsequent purchase of merchandise. In these cases, customers have already used their credit account to pay for purchases and so have had the opportunity to consider their protection needs and would not believe that their credit application would be affected.

176. Distributors contact customers directly to sell retail PPI after the point of sale. For instance, JD Williams contacts customers by telephone after they have received

[52]Express Gifts sold 86 per cent of its retail PPI policies at the initial point of sale, until it stopped using this approach in 2007.

three monthly statements and have an outstanding balance. These contacts are not a point of sale as such, but we discuss them in this section.

177. For each of these three selling points for retail PPI, the point-of-sale advantage is weaker than for other forms of PPI. First, customers are primarily purchasing goods with a view to spreading the cost of purchase over time, rather than applying for credit, and therefore are less likely to believe that their ability to purchase goods on this basis was dependent on taking out retail PPI.[53] This is particularly the case for sales not at the initial point of sale. We have no reason to think that customers believed their application for a credit account was enhanced by taking out retail PPI. Second, retail PPI is advertised in the same catalogues as the goods being purchased and sold alongside other insurance products.

178. Despite these differences, there remain substantial advantages from selling retail PPI at the initial point of sale, and at subsequent points of sale, by virtue of supplying the credit to which the retail PPI relates. These are similar to the point-of-sale advantages identified in the provisional findings report for other forms of PPI. First, the distributor may more easily offer retail PPI that is tailored to the credit product, in particular the ability to tailor premiums to the changing balance, as we found was particularly useful for CCPPI.[54] Second, as with other forms of PPI, stand-alone providers, even if they were able to identify holders of credit products, are likely to be offering retail PPI to a customer who already has PPI or has been offered retail PPI and declined to take it out.[55] Third, once the retailer has established its relationship

[53] See paragraph 5.94 of the provisional findings report.
[54] See paragraph 5.107 of the provisional findings report.
[55] See paragraph 5.110 of the provisional findings report.

with the customers to whom it has provided credit, it has continued access to the customer to communicate the availability of retail PPI.[56]

179. We found that the sale of retail PPI at the initial and subsequent points of sale and continued exclusive access to customer accounts restricts the extent to which other PPI providers can compete effectively, and is therefore a feature of relevant markets which prevents, restricts and distorts competition in the supply of retail PPI.

The effects on consumers of the level of competition in the market

180. Having found features that prevent, restrict or distort competition in the sale of retail PPI products, we considered what the effects on consumers would be. First, as we found that distributors have high margins, and enjoy high profitability, when selling retail PPI, we concluded that consumers were paying prices higher than they would in a well-functioning market, in line with the provisional findings for other forms of PPI.[57]

181. However, unlike our provisional findings in relation to other types of PPI,[58] we did not find that high prices for retail PPI were significantly distorting prices for credit or retail goods—all parties we asked told us that the income earned on retail PPI did not affect the prices set for retail credit or the underlying goods.

Conclusions on factors affecting the nature and extent of competition

182. We provisionally conclude that there are features of relevant markets which, alone or in combination, prevent, restrict or distort competition in the supply of retail PPI to non-business customers in the UK:

---

[56]See paragraph 5.111 of the provisional findings report.
[57]See paragraph 5.135 of the provisional findings report.
[58]See paragraph 5.139 to 5.142 of the provisional findings report.

(a) Distributors fail actively to seek to win customers by using the price or quality of their retail PPI policies as a competitive variable.

(b) Consumers who want to compare retail PPI policies, stand-alone PPI or short-term IP insurance policies are hindered in doing so. Product complexity (the variations in terms and conditions, the way information on retail PPI is presented to customers); the bundling of retail PPI with credit accounts and with merchandise cover, and the limited scale of stand-alone provision act as barriers to search retail PPI policies. In addition, the time taken to obtain accurate information on benefits is a barrier in relation to the provision of retail PPI. These barriers to search impede the ability of consumers to make comparisons, and therefore effective choices, between retail PPI policies. They also, therefore, act as barriers to expansion for other retail PPI providers, in particular providers of stand-alone PPI.

(c) Consumers who want to switch retail PPI policies to alternative providers or to alternative types of insurance policies are hindered in doing so. Terms which risk leaving consumers uninsured (for a short period of time or in case they suffer a recurrence of a problem) and the bundling of retail PPI with merchandise cover act as barriers to switching. In addition, the lack of access to consumers' balance information acts as a barrier for switching for retail PPI as it renders stand-alone providers unable to offer equivalent retail PPI policies. These barriers to switching limit consumer choice. They also therefore act as barriers to expansion for other retail PPI providers, in particular providers of stand-alone PPI.

(d) The sale of retail PPI at the initial point of sale, subsequent points of sale and the continued access to credit accounts by distributors further restricts the extent to which other providers can compete effectively.

183. We have provisionally found, pursuant to section 134(1) of the Act, that there are features of relevant markets, which alone or in combination prevent, restrict or distort

competition in the supply of retail PPI, and accordingly there is an adverse effect on competition within the meaning of section 134(2) of the Act. The features are those that we have identified in paragraphs 143 to 181 and which are summarized in paragraph 182.

184. We concluded that the detrimental effects on consumers of these features were higher prices for retail PPI policies than would be expected in a well-functioning market.