

# Market definition for payment protection insurance

## Introduction

- 1 Further to the publication of the Competition Commission's (CC's) Emerging Thinking, and to the hearing with Cattles plc (Cattles) held on 6 March 2008, Cattles would like to present to the CC further evidence and views on the market definition for payment protection insurance (PPI). Cattles has significant concerns with the CC's emerging position in this area, in particular in the context of the Non-standard sector in which Cattles operates.
- 2 We point out a number of areas in which the CC's market definition is inconsistent with the realities of the PPI market as a whole. We then explore specific features of the non-standard sector, and suggest that in this area it is particularly inappropriate to consider PPI to be in a separate market to the underlying credit product.

## Executive summary

- 3 In its Emerging Thinking, the CC suggested that the retail market definition for PPI might be a series of separate "brand-specific product markets". The Emerging Thinking states that "It would therefore seem appropriate to define a series of individual markets such that each PPI distributor has a monopoly over its own credit customers at the point of sale."<sup>1</sup> Cattles believes that this market definition would completely misrepresent the competitiveness of the market in which it operates, and is concerned that it would create a highly misleading impression that could damage the reputation of the industry. In particular, it leads to the perception that PPI distributors are making excess profits from sales of PPI, when we do not believe this is the case and present separate evidence to support this assertion.
- 4 In order to reach its emerging thinking on market definition, the CC relies on the fact that each PPI distributor has an advantage in selling PPI to its own credit customers. Without considering this point of (credit) sale advantage we do not believe the CC could arrive at the conclusion that an individual provider of PPI in a hypothetical competitive market would be able to raise prices profitably above the prevailing competitive level. Customers would simply switch to other providers, rendering such a price increase unprofitable.
- 5 The point of (credit) sale advantage relied upon by the CC arises because PPI is a secondary product and because the sale of this secondary product occurs at the same point at which the primary credit product is sold. However, whilst being central to the CC's finding of brand-specific product markets, this fundamental link between the credit and PPI products is ignored entirely in the CC's current approach to the SSNIP test. This is inconsistent. In particular, in the CC's application of the SSNIP test there is no consideration of the interrelationship between prices of PPI and credit, or of the nature of competition to which PPI distributors are exposed through the credit product.
- 6 Based on our understanding of the SSNIP test, we believe that the CC should consider whether a monopoly seller of the PPI associated with its own credit products would be able to raise prices in a competitive market. Because it is appropriate to consider the linkages between the primary and secondary products, and because only by acknowledging this linkage is it possible for the CC to contemplate a finding of brand-specific monopoly, any realistic consideration of the market should explicitly consider the linked products, and the interaction between the individual prices of the credit and PPI products respectively, and the aggregate price for the system package.

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<sup>1</sup> Competition Commission, Payment Protection Insurance Market Investigation, Emerging Thinking, 6<sup>th</sup> November 2007. Paragraph 175.

- 7 Looked at in this linked framework, we believe the SSNIP test properly applied would lead to different conclusions to that in the CC's Emerging Thinking. We consider that the current market is competitive, and that we would not be able unilaterally to raise credit, PPI or system prices profitably. In contrast, the CC's proposed SSNIP test appears to require considering whether PPI distributors would be able to raise prices from the (hypothetical) level of a standalone PPI provider in a competitive market of similar standalone providers. We believe that this is entirely artificial as this price level would never occur in a market where the fundamental link between PPI and the primary credit products is recognised. Given that the CC explicitly acknowledges this link, and indeed relies on it for its analysis, we believe that the CC's brand-specific product market definition is inconsistent. Furthermore, this market definition is likely to lead to perverse conclusions. We believe that the CC should recognise the fundamental link between PPI and credit products in its market definition.
- 8 The CC has indicated that PPI providers tend to benchmark their prices against those of other suppliers, which implies that they do not feel that they can price independently of the rest of the market. In our experience, this is necessary because, due to the strong competition between suppliers of PPI and credit, it is important to make sure that the prices of the different elements of the package (PPI and credit) are in line with the market. Furthermore, it has become increasingly easy for customers to consider the combined price of the credit and PPI when deciding where to take out a loan, with price comparison websites growing rapidly, and regulatory changes encouraging greater price transparency.
- 9 Notwithstanding our concerns about the inconsistency in the CC's market definition, in our experience there is significant competition for the package of PPI and credit and because of this the CC's emerging thinking on market definition is particularly inappropriate for the non-standard sector. This is for three main reasons.
- (a) **The importance of PPI to non-standard customers:** Non-standard borrowers are more likely to value the protection offered by PPI. For example they are less likely than mainstream borrowers to be in secure jobs; they are less likely to be able to pay for unanticipated expenses out of savings; and they are less likely to have employment benefits such as long notice periods and salary paid during periods of sickness.  
[CONFIDENTIAL: excised]
- (b) **Experience of non-standard borrowers:** Many Cattles customers have previous experience with credit, and with PPI, and the evidence suggests that customers who have taken out loans in the past (many of whom will have also taken out PPI) have a higher PPI penetration than those that have not. This would not seem consistent with our interpretation of the CC's view that PPI is sold to a captive market of customers who do not understand the benefits on offer.
- (c) **Importance of monthly payments:** Non-standard customers are more likely than other borrowers to need to manage their finances carefully. This often means living within a limited monthly or weekly budget. As such, these customers are more likely than others to consider, and be sensitive to, the level of monthly payments, which includes the cost of PPI. Survey data confirms that overall monthly payment levels are what is important to Cattles' customers – much more so than the APR or the price of the insurance.
- 10 The CC is faced with a choice of two alternative market definitions, one very narrow (credit provider-specific monopolies), and one broader (the market for the combined credit and PPI product). Although it will be difficult for the CC to prove its market definition either way, much of the evidence points to a wider market. The CC has already recognised the need to take into account the interaction between the demand for credit and PPI products. Given the need to recognise these wider dynamics, we suggest that it would be pragmatic for the CC carry out its analysis in the context of a wider market definition, as it did in the store cards market investigation.

## Market definition for PPI in general

### The CC's emerging thinking on downstream market definition

- 11 The CC's emerging thinking on the retail market definition for PPI is that the relevant product market may be "a series of brand-specific product markets". This means that, for example, one distributor's personal loan PPI (PLPPI) would be in a separate market to another distributor's PLPPI.
- 12 The CC suggested that there was insufficient evidence of any constraint on the price of PPI products to conclude a wider market than the market for each distributor's PPI on its own credit customers. It considered evidence on whether PPI prices were constrained by the following:
- the prices of PPI or PPI and credit of different brands;
  - the prices of different categories of PPI or PPI and credit (e.g. MPPI and PLPPI);
  - the prices of other products (e.g. income protection insurance and stand-alone PPI); and
  - complementarity with the underlying credit product.
- 13 In each case the CC said that it had not seen evidence of a price constraint. In some cases there was documentary evidence that a constraint did not exist, although little empirical evidence was presented.
- 14 In this section we argue that the hypothetical test carried out by the CC makes no sense in the context of the real-world market for PPI.

### The realities of the credit and PPI market

- 15 The CC's market definition exercise is carried out from the "narrowest conceivable market definition", which it says is that there are a series of markets for each PPI distributor's individual PPI policies.<sup>2</sup> This market definition requires there to be a link between the distributors PPI and credit products. It is clear that the market definition would be different if this link did not exist, and the SSNIP test was carried out for a standalone PPI product. However in the rest of its market definition exercise the CC chooses to ignore this crucial link, and carries out its analysis as though there were no inter-relationship between credit and PPI. It seems to us that no meaningful conclusions could possibly be drawn from this apparently inconsistent thought experiment.
- 16 Our understanding of the SSNIP test is that the CC must decide whether a hypothetical monopolist of a certain set of products could raise prices above the 'competitive' level. From the CC's published analysis it is not clear whether it regards current PPI prices to be at or above the competitive level, or what a competitive price for PPI means in the context of the fundamental link between PPI and credit products. Cattles believes that the market for credit and PPI is currently highly competitive, and that therefore current prices for PPI should be considered as competitive. For consistency we maintain that the CC should consider the competitive conditions that a lender selling PPI to its own customers faces and it should keep in mind that these competitive conditions relate to the market as a whole, and not just the PPI product alone.
- 17 We accept that in a competitive market for credit and PPI, where the fundamental link between PPI and credit products is recognised, the price for PPI will be above the level it would be at in a separate competitive market for stand-alone PPI. The main reason for this is that so long as

<sup>2</sup> Competition Commission Working Paper on Market Definition, published alongside emerging thinking, 6th November 2007.

customers react less to an increase in the PPI price than to an increase in the price of credit, it will be profitable to use an increase in the price of PPI as a means of reducing the price of credit and drawing in a larger volume of customers (some of whom will take out PPI). This interaction is crucial in the decision that we make about the relative prices of PPI and credit. The price of PPI will be raised until a further increase would mean that either the volume of customers overall, or the PPI penetration fell too far for the increase to be profitable. This interplay between the prices of PPI and credit should be recognised in the market definition.

- 18 For these reasons we suggest that it would not make any sense for the CC to continue to present a market definition based on the starting point of a specific brand of PPI to a lender's own customers. Instead, it should start from the point of view of a competitive market for the combined credit and PPI product. From this point of view, we strongly believe that the CC would find that different suppliers compete intensively with one another.
- 19 The CC is asserting, on the basis of documentary evidence, that PPI sellers are not constrained by changes in the volume of credit demand. This is not consistent with our experience. [CONFIDENTIAL: excised]
- 20 The CC has recognised that PPI providers benchmark their prices against those of other suppliers. The CC's working paper on market definition states that "[its] evaluation of the distributors' internal documentation ... showed that there is evidence that distributors assess their market position, and that they benchmark their prices against those offered by other firms". This is consistent with our view that we cannot move our overall package prices too far from those set by other distributors[CONFIDENTIAL : excised]
- 21 The CC seems to have based its finding on the assumption that consumers make separate decisions regarding first, which credit distributor to use and second, whether to then take out PPI or not. This perception of a two-step buying process drives the CC's view that there is an asymmetric relationship between PPI and credit i.e. that higher credit prices will lead to a fall in PPI sales (due to a fall in credit market share) but higher PPI prices will not affect credit sales, only the sales of PPI. In reality our experience is that many consumers who are considering taking out a loan and purchasing a PPI product do not make these two decisions separately. Many consumers consider the affordability of the overall PPI and credit package, particularly in the non-standard sector, where penetration of PPI is high. Customers often have previous experience taking out loans and PPI, and the level of monthly payments is particularly important to our customers.
- 22 There is evidence to suggest that many customers take the decision as to whether to purchase PPI prior to arriving at the point of sale. Customer research published by the OFT suggests that 55 percent of those who took out PPI had thought about it and decided to do so before they went to take out the product. This compares to only 37 percent who had not thought about it previously but still decided to take out the product.<sup>3</sup> In addition, research published by the CC suggested that 52 percent of respondents stated that they had considered taking out PPI before approaching the lender/intermediary. This research suggested that 13 percent had "employed the internet to research PPI in general or to check out available products". This does not seem consistent with a view of the market where PPI is sold to captive customers who are uninformed about the alternatives available to them.<sup>4</sup>
- 23 The CC should also take into account the changing nature of the market for PPI and credit. In particular, a number of regulatory changes and industry initiatives have been, or are in the process of being, implemented. For example FSA comparative tables are being expanded to include PPI and unsecured personal loans, so that consumers can clearly compare the cost of making a joint purchase. In addition, changes to Consumer Credit regulation introduced in 2005 now ensure that pre-contractual information on the details of lending are provided in

<sup>3</sup> OFT 869b, Research into Consumers' Experience of Payment Protection Insurance, produced by GfK NOP October 2006.

<sup>4</sup> Competition Commission/BMRB, Payment Protection Insurance Market Investigation Qualitative research into consumer experience, October 2007

good time for customers to absorb, and that a separate signature is required for the purchase of any additional insurances, which might include PPI.

- 24 In addition to changes brought about by regulators, internet comparison sites are becoming more prevalent, and are attracting increasing volumes of traffic. Moneysupermarket.com allows users to compare the prices of loans with and without optional PPI. Traffic on such sites has been increasing rapidly over the last few years, with hits to moneysupermarket.com reaching 5m per month in July 2007.<sup>5</sup> The Association of British Insurers (ABI) has also been active in promoting transparency and competition. In its submission to the CC, the ABI points out that its work programme has included improving transparency over refund policies to better enable switching, and creating a consumer guide to PPI, available before and after the point of sale.<sup>6</sup> These changes suggest that over time the complementary relationship between credit and PPI is likely to grow stronger.
- 25 We do not believe that the CC will be able to prove that its emerging thinking on market definition is correct; however we may not be able to find conclusive proof to the contrary. It may be the case that more than one market definitions could be supported, depending whether the CC starts from the PPI product or PPI and credit together. The CC's own guidelines state that in some cases the process of market definition may not give a clear-cut answer, and that disproportionate resources should not be devoted to resolving this if it will have no substantial implications for the analysis.<sup>7</sup>
- 26 However, we would like to point out that the impact of the CC's market investigation on the industry will be very different depending on which market definition is adopted. Even if the analysis that followed were the same, and the same remedies imposed, the effects on suppliers would be significantly worse if PPI suppliers were labelled as 'monopolists'. The CC's emerging thinking has already stated that *"It would therefore seem appropriate to define a series of individual markets such that each PPI distributor has a monopoly over its own credit customers at the point of sale."*<sup>8</sup> This type of commentary could be extremely damaging to the industry. It could be reported in such a way as to lead the general public to draw conclusions about the market that are entirely wrong, for example that lenders are making excess profits from sales of PPI. Cattles believes that as the CC's guidelines<sup>9</sup> suggest that proportionality and cost should be considered in setting remedies, it would be illogical for the CC not to take this into account in considering the effects of its market definition.
- 27 Finally, Cattles would like to express its concerns over the CC's decision to use separate brands as a starting point for its market definition exercise. Cattles' understanding is that market definition should be carried out from the starting point of a particular product, and not a brand. Using brands instead of products could lead to the CC defining separate markets for brands in a whole range of markets where prices of the same product are different from one another. This could suggest competition problems in a huge number of markets where none existed.
- 28 The CC should define markets for PPI linked to each type of credit product. This would follow the CC *Store cards* market investigation, where the CC rejected a single store market definition (where store card finance of each individual store would be considered to be a separate market) and concluded that the appropriate definition should be the consumer credit through store cards.

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<sup>5</sup> Financial Times, Online price comparison services - THE BEGINNERS' GUIDE TO...: Demystifying personal finance. Steve Lodge, 7 July 2007.

<sup>6</sup> Association of British Insurers, Written representation to the Competition Commission in response to the statement of issues of 12 April 2007 regarding the market investigation into the supply of payment protection insurance services in the UK. 11<sup>th</sup> May 2007.

<sup>7</sup> Market Investigation References: Competition Commission Guidelines, June 2003. Section 2.6.

<sup>8</sup> Competition Commission, Payment Protection Insurance Market Investigation, Emerging Thinking, 6<sup>th</sup> November 2007. Paragraph 175.

<sup>9</sup> Market Investigation References: Competition Commission Guidelines, June 2003. Section 4.1.

## Characteristics of the non-standard sector

- 29 Cattles finds the CC's emerging thinking on PPI market definition to be particularly inappropriate for the non-standard sector.
- 30 The UK non-standard credit population is thought to have increased in 2006, for the first time in many years. According to research produced by Datamonitor, around 7.0 million people of working age in the UK would have been refused credit by mainstream lenders in 2006.<sup>10</sup> Peter Crook, Chief Executive of Provident Financial, put the broader UK non-standard lending market at 10 million customers.<sup>11</sup> Cattles itself estimates that with the proposed regulatory changes and tightening of lending criteria it is possible that up to [x<] million customers (equivalent to about one in [x<] of the working population) might soon be denied access to mainstream credit<sup>12</sup> These consumers may be unable to obtain credit from mainstream providers, however they still have credit requirements. Indeed for many of these customers credit can be particularly important as it enables them to better manage peaks and troughs in their expenditure. Cattles customer research suggests that its direct repayment customers generally have a positive attitude towards credit, with customers in general agreeing with the statement "credit has allowed me to do or buy things which I would not have been able to otherwise".<sup>13</sup>
- 31 The number of people who may seek access to non-standard credit is strongly affected by macroeconomic conditions. The current economic context is leading to increasing numbers of people moving into the non-standard sector. Cattles itself has seen a significant increase in application numbers since 2006. Press commentary has suggested that this has resulted from increasing numbers of customers moving out of the mainstream borrowing, for example the Financial Times stated that "an increase in the numbers of loan applications from customers rejected by mainstream banks helped lift annual profits" at Cattles, and that "unsecured personal loan volumes at Welcome Finance, its consumer finance operation, rose 57 per cent". This trend is likely to continue due to a number of factors including principally:
- the expected slowdown in the economy (UK GDP growth is forecast at 1.8 percent in 2008, dropping from 3.1 percent in 2007);<sup>14</sup>
  - rising household bills which are in part due to increases in the cost of energy (for example Scottish Power customers experienced a price increase of, on average, 14 percent in February 2008);<sup>15</sup> and
  - tightening credit conditions in the mainstream market due to the ongoing 'credit crunch' (for example internet bank Egg has announced that it will be withdrawing the credit cards of about 160,000 of its riskier customers).<sup>16</sup>
- 32 It is also becoming easier for lenders to obtain more information regarding the background of customers due to greater data sharing. Three major initiatives will impact on the availability of data in the near future, which may have a significant impact on the size of the non-standard credit population. First, credit card providers are in the process of implementing measures to increase sharing of behavioural data on credit card borrowing.<sup>17</sup> Second, BERR has recently

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<sup>10</sup> Datamonitor, The UK Home Collected Credit Market 2007, July 2007.

<sup>11</sup> Dow Jones Newswire, Provident Fincl FY Pretax Pft GBP115.2M, 4 March 2008.

<sup>12</sup> [CONFIDENTIAL: excised]

<sup>13</sup> [CONFIDENTIAL: excised].

<sup>14</sup> HM Treasury, Forecasts for the UK economy: A comparison of independent forecasts, January 2008.

<sup>15</sup> Financial Times, "Scottish Power raises prices by 14%", Ed Crooks, 2 February 2008.

<sup>16</sup> Financial Times, "Egg cracks down on 'riskier' credit card customers", Jane Croft, 2 February 2008.

<sup>17</sup> APACS report marks progress on transparency in credit card industry. Press release 25 October 2006.

published its response to the consultation on “non-consensual data sharing”<sup>18</sup> and has recommended that an expert working group be set up to look into this further. Finally, from June 2008 home credit providers will share data on customer payment records (as a result of an earlier CC market investigation into home credit). This may improve access to credit for customers with good payment histories but in some cases access to credit may be reduced as data sharing increases transparency.

- 33 We consider that the CC’s emerging thinking on market definition is particularly inappropriate for the non-standard sector since consumers in this area are more likely to make purchasing decisions based on the total price for the combined credit and PPI package. This is the case because: a) PPI would appear to be more important to non-standard customers, and therefore constitutes an integral part of the overall package; b) non-standard borrowers are often more experienced at buying credit than customers in the standard sector, and therefore have greater experience and knowledge of PPI; and c) non-standard customers are particularly likely to consider the affordability of the combined product based on the overall monthly payments than other customer groups. In addition we briefly discuss competition in the non-standard credit sector, and consider whether any inferences can be made about the level of competition from data on switching rates.
- 34 Evidence in all of these areas suggests that the PPI product is sold in a competitive market, where consumers choose between suppliers of PPI and credit. This view is supported by survey evidence. Potential Cattles customers who had applied for a Cattles loan and were successful but subsequently decided not to take out the loans were asked why they had not done so. Those interested in secured loans gave answers which implied that the overall package cost including PPI was critical in [%] percent of cases (compared to [%] percent who mentioned interest rates). Monthly payment cost was cited in [%] percent of cases, and ‘overall cost’ in [%] percent. High insurance costs were quoted specifically in [%] percent of cases. Those interested in unsecured loans mentioned PPI specifically or the overall package cost [%] percent of the time (compared to [%] percent mentioning interest rates). High monthly repayments were mentioned in [%] percent of cases, and ‘overall costs’ in [%] percent. In [%] percent of cases high insurance costs were mentioned specifically ([%]).

[CONFIDENTIAL: excised]

- 35 This evidence indicates that a large proportion of our customers consider the overall cost of the credit and PPI package as a whole and that many customers switch between distributors in the light of relative price differences. We would expect that if our prices were to move out of line with those of our rivals, the degree of switching would increase significantly.
- 36 In the rest of this section we explore the characteristics of the non-standard sector in more detail, and consider how these may lead to particularly strong conclusions on market definition for non-standard lending compared to the credit market as a whole.

### **Importance of PPI to non-standard customers**

- 37 This section explores the degree to which PPI is an integral part of the loan package to many non-standard customers.
- 38 Many, though not all, non-standard borrowers have certain characteristics which mean that they particularly value the cover provided by PPI. In particular, non-standard customers:
- are less likely than mainstream borrowers to be in secure jobs;
  - are more likely to be employed in low wage or declining industries with little scope for promotion;

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<sup>18</sup> This consists of credit taken out before permission for lenders to share data would routinely be obtained.

- are more likely to experience fluctuations in their income;
  - are less likely to be able to pay for unanticipated expenses out of income or savings;
  - are more likely to use overtime and bonuses as an essential part of their income;
  - are less likely to have employment benefits such as longer notice periods or salary paid for short periods of sickness;
  - may need to manage tight household budgets.
- 39 Typical Cattles customers are [CONFIDENTIAL: excised]. Although these customers may have characteristics which make them more sensitive to changes in income, Cattles customers [X], for example owning a car or having a multi-channel television service. The following statistics apply to Welcome Financial Services customers:<sup>19</sup>
- (a) [X] percent are in socio-economic groups C2DE ([CONFIDENTIAL: excised] – [X] of customers are now C1 compared with [X] in 2004/05);
  - (b) [X] percent have net monthly family income of more than £1000 per month and [X] have more than £2000 per month [CONFIDENTIAL: excised]
  - (c) [X] percent own their own houses;
  - (d) [X] percent own a car;
  - (e) [X] percent have home or household insurance; and,
  - (f) [X] percent have satellite, cable or digital TV services
- 40 PPI covers the repayments on a loan if a borrower is unable to pay due to accident (A), sickness (S), or unemployment (U) or death (life cover, L). This cover would not be essential for many borrowers in the standard sector, who often have long notice periods, sick pay, and who may have substantial savings, but could be vitally important to some borrowers, who would otherwise have to make important sacrifices in terms of their other day-to-day expenditures to be able to continue to meet credit repayment obligations in the event of A, S or U. This is consistent with our survey evidence, which shows that [CONFIDENTIAL: excised] of Cattles customers who took out PPI cover cited 'reassurance' (unprompted) as their reason for doing so.<sup>20</sup>
- 41 The importance of PPI to non-standard customers is [CONFIDENTIAL: excised] In 2006 Cattles had an overall PPI penetration of [X] overall on its loan sales. On personal loans it had penetration of [X], survey data presented by the CC shows that average PPI penetration on personal loans was 38 percent.<sup>21</sup> The same survey data suggests that in general PPI penetration is lower for higher socio-economic groups. While PPI penetration was, on average, 19 percent for AB borrowers, it was 43 percent for C1, 39 percent for C2, 52 percent for D, and 42 percent for borrowers in socioeconomic group E.<sup>22</sup>
- 42 PPI penetration on Cattles loans [CONFIDENTIAL: excised]. In more recent years this [X] can be explained by a combination of factors including [CONFIDENTIAL: excised], the regulation of

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<sup>19</sup> [CONFIDENTIAL: excised]

<sup>20</sup> Source: [CONFIDENTIAL: excised]

<sup>21</sup> [CONFIDENTIAL: excised].

<sup>22</sup> Working paper on Characteristics of consumers of PPI, published alongside emerging thinking, 6th November 2007.

PPI by the FSA from early 2005 and more recently an increase in the negative publicity surrounding PPI. Cattles does not have specific data on how this decrease in penetration has affected customers who suffer the kind of life events that would usually trigger a PPI claim. However, we believe that there will inevitably be an effect on customer repayments, as customers who might in the past have taken out PPI are no longer protected.

- 43 The circumstances of the customers who take out credit with Cattles means that PPI is a very important part of the overall package for many of them. This is evidenced [CONFIDENTIAL: excised]. PPI is clearly a strong complement to credit for these customers. The demand for credit will be influenced by the price of PPI as some customers may be unwilling to take out credit without the protection provided by PPI. The CC's own research shows that those customers who had recently undergone a change of circumstances, and those who were particularly anxious about personal finance were more likely to have thought about taking out PPI prior to taking out a loan.<sup>23</sup>
- 44 The CC has indicated that it wishes to consider the extent to which lenders themselves benefit when borrowers are protected by PPI.<sup>24</sup> It is true that customers who do not have PPI do not have the opportunity, under any circumstances, to use PPI to cover their loan repayments, whereas protected customers do. In this sense protected customers are less likely to slip into arrears on a medium-term basis than they would be if they hadn't taken out PPI. However, the financial value to Cattles is small compared to the value to the individual borrower. For a borrower, when an incident occurs that could trigger a claim, PPI cover could make the difference between maintaining financial stability and a suffering a serious financial crisis[CONFIDENTIAL: excised]. Moreover, it should be taken into account that Cattles expends considerable effort and cost supporting customers who make claims on PPI.
- 45 The evidence presented in this section suggests that for many Cattles customers PPI is an important part of the loan package. As such, their demand for loans will be influenced by how cheaply insurance is available. The implication is that the price of PPI would be constrained by its influence on the overall demand for the credit and PPI together.

## Experience of non-standard customers

- 46 Many non-standard customers have more experience in purchasing credit than customers in the standard sector. This may be because they need to take out small loans regularly in order to cover peaks in their expenditure (loans issued by Cattles are small compared to the size of loans in the mainstream sector, with the average unsecured loan in 2006 standing at £1,900 and the average secured loan at £8,700).<sup>25</sup>
- 47 Each year Cattles issues around [X] loans. Of these, [CONFIDENTIAL: excised] Therefore, these customers have recent experience of taking out a loan and being offered PPI. [CONFIDENTIAL: excised] more experienced customers, who one would expect to be better informed, are more, not less, likely to take out PPI.
- 48 Cattles sales data shows that for new customers of unsecured loans in 2006 PPI penetration was [X], whereas for [X] penetration is [X]. For customers who take out secured loans there is a [X] penetration [X] to [X]. For new customers of hire purchase loans (HP) Cattles has penetration of about [X] percent, while for [X] the penetration is close to [X].
- 49 [CONFIDENTIAL: excised], with customers who have taken out more loans with Cattles in the past being more likely to take up PPI. This may be because customers who take out loans more often may be more aware of the risks associated with A, S and U, and how these may impact on their ability to meet loan payments

<sup>23</sup> BMRB research cited in CC Emerging thinking, paragraph 109.

<sup>24</sup> CC, Working paper on the profitability of PPI, 28 January 2008. Paragraph 53.

<sup>25</sup> See Cattles annual report

- 50 Customers who have taken out loans and bought PPI in the past are more likely to be familiar with the processes involved, and to be aware of the implications of taking out PPI for the level of their monthly repayments. In addition, Cattles annual customer satisfaction surveys, which cover some [X] annually, found shows that many Cattles customers have current experience of other credit products which may have PPI:
- [X] percent had a credit card facility;
  - [X] percent were currently using another credit company;
  - [X] percent were homeowners (the typical age range of customers suggests that many of these will have a mortgage, and therefore will have been exposed to MPPI even if they have chosen not to purchase it);
- 51 Given that Cattles tends to have [CONFIDENTIAL: excised] across its customer base (see paragraph 41), most of its [CONFIDENTIAL: excised]. As such, they are well informed about the benefits of taking out PPI, as well as having prior knowledge of the cost. Since the entry into force of the revised Consumer Credit Regulations on 31 May 2005, a separate signature has been required for all customers purchasing PPI, making the decision to purchase PPI a separate and explicit part of the agreement. This is in addition to the disclosure requirements of the FSA during and after the sales process.
- 52 Many customers may also have experience of borrowing from other lenders. Surveyed customers stated that they were taking out a loan [CONFIDENTIAL: excised] in [X] percent of cases.<sup>26</sup> In a separate survey, surveyed customers taking out a loan with Cattles were looking [CONFIDENTIAL: excised] in [X] percent of cases for secured borrowers and [X] of cases for unsecured borrowers.<sup>27</sup> In some cases customers will have bought PPI cover for their previous loans, and are therefore particularly well placed to judge the competitiveness of the package price offered by Cattles.

### Importance of monthly payments to non-standard customers

- 53 As previously explained, non-standard customers are more likely to need to manage their finances within a tight budget than other borrowers. This implies that careful financial planning is required in order to ensure that costs are only incurred within the allowable level of weekly or monthly expenditure. This explains much of the borrowing that actually takes place. For example, a significant proportion of unsecured borrowing is used to cover discretionary expenditure ([CONFIDENTIAL: excised]).<sup>28</sup>
- 54 Customers who manage their finances on a weekly or monthly budget are much more likely than other borrowers to consider the overall monthly cost of credit and PPI. When customers who took out loans with Cattles were asked what the main reasons why they had done so were, [X] percent of secured loan borrowers mentioned the suitability of the overall monthly payments. This is higher than the proportion who mentioned that interest rates on the loan were reasonable ([X]). For unsecured loan customers, [X] percent mentioned the suitability of the monthly payments (compared to [X] percent who mentioned the interest rate). For [X] customers, [X] percent mentioned the monthly repayment (and [X] percent the APR).<sup>29</sup>

Figure 1: [CONFIDENTIAL: excised]

Source: [CONFIDENTIAL: excised]

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<sup>26</sup> [CONFIDENTIAL: excised]

<sup>27</sup> [CONFIDENTIAL: excised].

<sup>28</sup> [CONFIDENTIAL: excised]

<sup>29</sup> [CONFIDENTIAL: excised].

- 55 Secured borrowers are particularly likely to consider the package cost in terms of the overall monthly payment. In Cattles experience, the primary motivation for doing this will be to reduce the level of overall monthly payments to a level that fits within customers' budgets.
- 56 At the point when they make a decision over whether to purchase credit and PPI, customers are presented with clear information on the level of the monthly payment. Sales scripts prescribe that [CONFIDENTIAL: excised]. If a customer, after being assessed for eligibility and [CONFIDENTIAL: excised]. As such, consumers clearly make their purchase decision on the basis of the affordability of the overall package.

### Competitiveness of the non-standard credit sector

- 57 The previous sections provide clear evidence that in the non-standard sector consumers consider the combined price of credit and PPI before deciding whether to take out a loan, and whether to include PPI. Therefore the competitiveness of the market in which Cattles operates depends on the competitiveness of the underlying credit market.
- 58 Our experience is that the credit market is highly competitive in all sectors, with several of our competitors having been forced to exit the market in recent years (for example London Scottish announced that it would be withdrawing new lending in February 2008,<sup>30</sup> in addition Kensington Secured Loans announced the temporary withdrawal of its high risk secured loans in September 2007<sup>31</sup>).
- 59 There have also been examples of significant entry into the non-standard sector, including Everyday Loans, and Real Personal Finance, owned by Provident Financial. It is particularly easy for banks in the mainstream sector to begin lending to non-standard customers (this is often done under a different brand name, for example Beneficial Finance is a subsidiary of HSBC).
- 60 The competitiveness of the credit market in which we compete can also be seen by looking at customer behaviour. Survey data shows that [X] percent of potential secured customers, and [X] percent of potential unsecured customers said that the reason that they did not take up a loan with Cattles was because they found a 'better deal elsewhere'.<sup>32</sup> Another question on the same survey indicated that [X] percent of both secured and unsecured customers who did not take out loans with Cattles had accepted or were considering another offer from elsewhere. Cattles annual customer satisfaction surveys found that:
- The proportion of customers who "agree strongly that it "pays to look around" when selecting a credit provider has risen from [X] percent in 2003/04 to [X] percent in 2006/07;
  - [X] percent of customers said that they agreed with the statement that "they did look around".
- 61 The competitiveness of the market is demonstrated by [CONFIDENTIAL: excised]

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<sup>30</sup> Financial Times, FT.com site : London Scottish gives up on consumer lending, 26 February 2008.

<sup>31</sup> The Daily Telegraph, SUB-PRIME CREDIT CRISIS 07 Kensington halts loans to higher-risk borrowers, 23 November 2007.

<sup>32</sup> [CONFIDENTIAL: excised]

## Switching behaviour

- 62 The CC has pointed to the lack of switching between PPI providers during the course of a customer's loan as evidence for a lack of competition. This is misconceived for two important reasons:
- Customers who take out PPI consider it to be part of a package containing both PPI and credit, as such, competitive pressure will not manifest itself in high levels of switching after PPI cover has already started.
  - It is unusual for consumers to switch between providers once cover has started on many different types of insurance product, and PPI is no exception to that rule.
- 63 There is plenty of evidence to suggest that consumers tend to purchase PPI from the distributor who provides them with the underlying credit. This is because they tend to make a combined decision about whether to purchase credit and PPI at the same time (this is not to say that all customers will necessarily choose to purchase both products).
- 64 Customers who do not purchase PPI alongside their credit rarely go on to purchase a stand-alone product. A report into the market published by the OFT suggested that although market shares are not readily available, stand-alone PPI providers 'appear to be minor players in the market'<sup>33</sup>. Other research supports this view, finding that 88 percent of all PPI customers took out cover at the same time as they took out their loan. This figure was even higher for secured loan customers (98 percent).<sup>34</sup> This may be because after the decision about credit has been made, the need for PPI is no longer at the forefront of borrowers' minds (although it may also be because PPI is not suitable for some customers). Similarly, it is unusual for customers who have already purchased PPI to consider looking for another provider. Evidence shows that PPI customers are generally satisfied with the PPI product once they have purchased it, which is consistent with low switching rates (for example OFT research showed very high customer satisfaction levels with PPI).<sup>35</sup>
- 65 PPI is not unusual in this respect. While consumers of other insurance products such as car or travel insurance may switch providers at the end of the insurance term, it is not common for them to do so before the cover has expired unless this is prompted by a specific incident. For example insurers suggest that customers of household insurance area most likely to change insurance provider if they moved to a new area with a higher insurance premium, and buyers of motor insurance might change insurer when they buy a new car for which cover is more expensive.
- 66 The CC has pointed out that refunds are not offered to single premium PPI customers on a pro-rata basis. They suggest that this acts as a deterrent to customers switching between PPI providers. However, as we have already pointed out,<sup>36</sup> the risks associated with borrowing are higher at the start of the loan term, in part since the size of the outstanding loan is higher at that point but also because there are higher claims for A, S, U and L in earlier periods. For other products, the expected value of a claim may be more constant throughout the period over which cover is offered, for example motor insurance, which generally pays out on repairs on cars, tends to pay out more evenly over the duration of cover. Nonetheless pro-rata refunds do not occur for many of these insurance products, as is the case for PPI. We are unaware of any suggestion that these markets are anything other than competitive. Therefore the fact that

<sup>33</sup> OFT 869a Annex A, Research into Payment Protection Insurance in the UK, London Economics, October 2006.

<sup>34</sup> OFT 869b, Research into Consumers' Experience of Payment Protection Insurance, produced by GfK NOP October 2006.

<sup>35</sup> OFT 869b, Research into Consumers' Experience of Payment Protection Insurance, produced by GfK NOP October 2006.

<sup>36</sup> See for example [3<].

pro-rata refunds are not offered for PPI should not be taken to imply any lack of competitiveness.

- 67 Motor insurance, like the PPI product offered by Cattles, is sold on a single premium basis. Like PPI, refunds are not offered on a strict pro-rata basis.<sup>37</sup> Information received from [X] suggests that there are very low levels of switching during the term of the insurance. Motor insurance is usually sold on an annual basis (whereas PPI cover is held for up to five years). In this sense turnover of customers might be expected to occur more frequently, although we understand that in practice customer retention rates of motor insurers are very high (insurers told us that they aim to retain [X] percent of customers on renewal). Despite low levels of switching motor insurance has not been the subject of intense regulatory scrutiny as PPI has, and the OFT used motor insurance claims ratios, along with those of other insurance products, to benchmark against those for PPI.
- 68 Single premium policies are a very important feature of PPI in the non-standard sector. They allow customers to pay for PPI cover up front, at the time that the loan is taken out (the premium is covered by part of the loan). In this way customers preclude the possibility that cover will cease due to a missed payment during the repayment period. If regular payments were required in order to maintain cover, there is a strong likelihood that many customers would miss payments just at the time when cover was most likely to be needed (i.e. after an event that would normally trigger a claim, such as movement into unemployment). With a single premium policy, no matter how many loan repayments are missed, the borrower will still have PPI cover (for the duration of the PPI agreement). Customers in the mainstream sector would be more likely to be able to meet regular payments out of savings or other sources of income in such circumstances.
- 69 In summary, the low level of switching does not imply that the market for PPI is not a competitive one. As discussed above, the price of PPI is constrained by competition in the market for the combined credit and PPI package, and not by switching between products after cover has commenced. This in turn suggests that the lack of pro rata refunds on single premium PPI policies is not a barrier to competition in this market.

## Summary/conclusions

- 70 The CC is currently leaning towards a narrow market definition in which each provider of PPI is a monopolist to its own credit customers. This market definition completely ignores the link between PPI and credit, even though that link is necessary for the CC to find that any PPI provider has market power. Cattles believes that a finding such as this would be extremely damaging to the industry as a whole, leading to a perception that lenders are making excess profits from sales of PPI, [CONFIDENTIAL: excised]
- 71 Changes in the nature of PPI regulation and increased transparency are also contributing to increased competition between providers on the basis of the combined credit/PPI price. FSA comparative tables are being expanded to include PPI and unsecured personal loans, and changes to Consumer Credit regulation introduced in 2005 mean that a separate signature is required for insurance purchases associated with lending. In addition traffic to internet price comparison websites is increasing and the ABI has been active in promoting transparency and competition.
- 72 The CC's current thinking on market definition is particularly inappropriate for the non-standard part of the market, where PPI is an integral part of the credit product for many customers. These customers are more likely than mainstream borrowers to *need* the cover provided by PPI in the event of a claim, due to a lack of savings or alternative streams of income. Therefore

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<sup>37</sup> Cattles was told by [X] that if a customer cancelled their policy during the first year of motor insurance cover they would effectively not get a pro-rata refund. This is because they would have paid two months of premiums in advance at the start of the insurance period, which would not be refunded. A break in payments at the end of the first year means that in later years if a policy was cancelled and payments ceased, the customer would effectively get a pro-rata refund.

they are likely to have actively considered it in the choice of distributor of the credit/PPI package. This is reflected in the higher take-up of PPI for non-standard customers. Many Cattles customers have prior experience of taking out credit, and will usually have knowledge about PPI. Evidence shows [3]. Finally, non-standard customers often need to plan their finances more carefully than mainstream borrowers. This means that they will be more likely to focus on whether the monthly repayments (including the price of PPI and credit) fall within their budgets, than considering the APR (which gives an idea of loan cost but in a theoretically way that is difficult for consumers to understand). For these reasons it is clear that a narrow market definition which ignored the link between PPI and credit would be inappropriate in non-standard finance.

- 73 Cattles would encourage the CC to rethink its position on market definition based on the evidence and arguments presented in this submission.