



FLA response to the Competition Commission's 'Emerging Thinking' on the PPI market

Introduction

1. This paper is the Finance & Leasing Association's (FLA) response to the Competition Commission's (CC) report of its emerging thinking on Payment Protection Insurance (PPI), published on 6 November 2007.
2. The FLA represents the asset finance, consumer credit and motor finance industries. Our members provide a range of credit and financing services to individual consumers and businesses of all sizes. Some also provide general insurance, including Payment Protection Insurance (PPI).

Summary

3. The FLA welcomes the CC's research finding that PPI is a valuable product, particularly for lower income customers, that customers value the security it offers, and that they feel reassured by it, regardless of their original purchase intentions. This finding supports the argument we have previously advanced, that prompting at the point of credit sale is the most effective way of encouraging customers to protect themselves against the risks of borrowing. We urge the CC to continue to take this into account as their work continues.
4. As previously argued, and as further documented below, the FLA believes the retail PPI market is competitive, and shows price sensitivity and substitutability. We also believe that current and recent initiatives in the retail PPI market from the Financial Services Authority (FSA) and the industry itself should be allowed to bed in before any further action is contemplated. Many of these initiatives, including those aimed at increasing consumer knowledge of PPI, the new approach to single premium refunds, the FSA's forthcoming comparative tables, and the Insurance Conduct of Business Rules (ICOB), are all likely to enhance competition in this market. They need time to take effect.
5. The FLA would like to have the opportunity to comment on the CC's thinking about the retail PPI market as it develops and before publication of any provisional findings.

The Commission's key findings and the FLA's response

The retail market

6. The FLA notes that the CC believe that the evidence they have so far gathered supports the existence of separate markets for PPI and credit.



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As noted in our submission of the 5 July 2007¹ the FLA does not share this view. We believe that the credit and PPI are linked products which are best sold, for both economic and behavioural reasons, at the point of sale (POS) for the credit. If this were to change, PPI would be likely to become more expensive (due to adverse selection) and be less widely taken up (because consumers are much more likely to think about their insurance needs at the POS).

7. The CC's report goes on to suggest that POS PPI may be price-insensitive, perhaps indicating an absence of competitive forces like substitutability. It is argued that an increase in PPI prices may not affect credit sales. This in turn is taken to suggest that each distributor may enjoy a *de facto* monopoly over sales of PPI to its own customers.
8. As noted in our submission of 27 September², evidence from our member companies suggests that PPI is in fact price sensitive. Sales of both PPI and the linked credit can be lost if consumers believe the cost of the PPI is too high. There is also evidence showing that innovative PPI products are increasing their market share, again suggesting competition in the market.
9. Our submission of 27 September also provided evidence from our member companies of competition between PPI and other forms of insurance and non-insurance products, which therefore function as substitutes for PPI by covering the risks associated with credit purchases. The insurance market includes stand-alone PPI, life cover, income protection, and critical illness policies. Consumers are also known to decline insurance in favour of other ways of covering debts.
10. Research by our member companies shows that price plays a key part in consumers' decisions. Customers who consider PPI too expensive will look elsewhere, and often for the loan as well. Member company research also shows that consumers are often aware of PPI offers elsewhere in the market, indicating a propensity to shop around for the best deals.
11. It is also worth pointing out that much of the CC's emerging thinking is based on historical market data. It is clearly important that provisional findings are based on as up-to-date a view of the market as possible. For example, current and recent initiatives by the industry and the FSA (e.g. the FSA comparative tables, Trade Association PPI guides, significant changes in selling practices, single premium refunds etc) will have a positive effect on competition and this needs to be factored into the CC's thinking.
12. The CC says it has seen little evidence that consumers compare different "bundles" of PPI and credit or of customers switching between

¹ FLA response to the Competition Commission's Issues Statement.

² Letter from Stephen Sklaroff, Director General of the Finance & Leasing Association, to Anthony Pygram, the Competition Commission's PPI Inquiry Director.

PPI products. The FLA questions the focus on switching. As we have previously argued³, switching in the retail PPI market is not necessarily an unalloyed good, as customers may be left without cover for periods of time.

13. The FLA notes the CC's comments about the price of PPI. The CC report states that "taking out PPI can entail a significant financial outlay; the price of personal loan PPI can be more than the interest payable on the loan taken out". The CC also voices concern about price variations between what appear to the CC to be similar PPI policies, and that the prices of PPI policies sold alongside credit products are significantly higher than those sold on a stand-alone basis. This is taken to imply a lack of competitive pressure.
14. It is not clear to the FLA that the ratio between the cost of the PPI and the interest on the loan is necessarily significant in competitive terms.
15. Moreover, and as we have stated in the past, there are clear and important differences between the linked and stand-alone product. Linked PPI has benefits which the stand-alone product does not (for example, relating to the state benefit and tax systems). Similarly, stand-alone PPI cannot be specifically tailored to the loan, so the consumer is likely to be either over or under insured at any point in time. Stand-alone cover also often has more restrictions than the POS product, so as to address the problems of adverse selection we have discussed previously with the CC. In addition, because the largest part of the risk, and therefore the greatest cost of cover, arises early in the life of the policy, switching comparisons are by definition difficult. Genuine comparisons would need to be done on a like-for-like basis.
16. This is an area where the FSA's proposed PPI comparative tables should in principle help. It is also worth noting that the market is changing, and that price competition is increasing with time as innovative products and the recent market initiatives mentioned above take effect. There will be a time lag before the results are clear, and this should be taken into account before deciding on any possible further action.
17. The FLA would also like to bring to the CC's attention the FSA's recent work on pricing and product design. These seem to us to fall squarely within the remit of the CC's inquiry. We would urge the CC to ensure that the FSA does not duplicate its own work or – worse – take a different approach to the same issues.

Profitability

18. The CC appears to believe that profits are high in the retail market: "There is evidence suggesting that, for the market as a whole, high

³ See, for example, the FLA's Issues Statement response of the 5 July 2007.

profits earned on PPI alone in recent years been partially offset by lower profits or even losses at the credit product level”.

19. The FLA continues to believe that it is the total transaction cost, and not its allocation between the product elements, which should matter to the customer. It is likely that a different allocation of costs would impair the market by making the credit product more expensive for all consumers and, therefore, less attractive. It is also important that the CC properly takes into account distribution and other relevant costs – e.g. compliance costs – when considering profitability in this market.

The Underwriting Market and Vertical Integration

20. The FLA welcomes the CC’s findings on the underwriting market and vertical integration. These are consistent with the OFT’s earlier findings and backed up by FLA member company evidence to the CC.

Some factual errors in the ‘Emerging Thinking’ documents

21. The CC repeatedly describes PPI as covering loss of earnings due to accident, sickness or unemployment. In fact, accident and sickness claims on most PPI policies do not depend on a loss of earnings. Policyholders can claim if they are sick or have an accident, regardless of sick pay received.
22. In the regulation working paper, there are references to the impact of PPI on state benefits where the insurance benefits are related to income. But PPI covers debt payments, not income. It is important the two are not confused.
23. Gross Written Premium (GWP) is defined in the CC’s Glossary as the amount the customer pays for the insurance. However, many companies define GWP as the premium after Insurance Premium Tax (IPT).
24. In paragraph 36 of the main report it is stated that accident and sickness benefits are usually for a maximum of 12 months. It should be noted that this is less true of single premium products, where the benefit is often paid until the end of the loan term. This is an advantage of single premium policies, and one of the reasons it is dangerous to compare single and regular premiums.
25. In paragraph 158 of the main report, the CC says “if consumers are able to switch easily between bundles of credit and PPI, we would expect to see a relationship between PPI prices and sales of credit. This is because an increase in price would induce customers to switch to another, lower-priced, bundle of PPI and credit”. This argument appears flawed in that prices do not increase once the insurance is taken out for single premium. We would point out that the reasons for switching are usually credit-related (e.g. debt consolidation) and that

price emerges as a driver once a decision to borrow more has been made.

Conclusion

26. The FLA urges the CC to avoid new draconian market interventions, including any further layer of regulation. The CC should take full account of the FSA's current and planned work on PPI (including the new ICOB rules) and co-ordinate any recommendations where appropriate.

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