

The Inquiry Secretary (PPI market inquiry)
Competition Commission
Victoria House
Southampton Row
London WC1B 4AD

21 December 2007

Dear Sirs

Legal & General Response to Competition Commission Emerging Thinking in relation to it Market Investigation into the supply of PPI.

Legal & General aims to provide high quality products at affordable prices. To enable this, markets need to be effectively competitive in terms of both features and price. We believe in selling products in a way that is transparent; making clear to customers the purpose, features and price of each independent product so that they are in a properly informed position when they make their decision whether or not to take the product offered.

We believe that the sale of Personal Loan PPI (PLPPI) should be clearly differentiated from the sale of the associated credit product. It should be transparent and clear to the customer that the loan is not conditional on PLPPI being taken, and that PLPPI is also available from alternative providers.

The point of sale would appear to be the key point at which change can be achieved. Legal & General would strongly support a requirement for a separated sales process much as we currently use for the sale of mortgage related PPI. We would also support the use of comparative tables in the selling of PLPPI much as they are used in the marketing and sale of the credit products themselves. We believe such measures would: a) assist in increasing consumer awareness and price sensitivity, so encouraging shopping around; b) drive greater competition amongst existing providers; and (c) provide incentive for more provider firms to offer alternative products.

Current situation

Legal & General believes that there are a number of factors in play in the PLPPI market that collectively result in a lack of real competitive effect on the prices charged to consumers. This results in a barrier to entry to this market by independent underwriters who are unwilling to sustain high consumer prices through the payment of unreasonably high commissions and profit share arrangements.

The root cause that enables this market power to be exercised is the lack of understanding by consumers of the fact that PPI is a distinct product separate from the loan; that it is (usually) not a condition of the loan; and also that it may be available from a different provider at a more competitive price. The result is that where consumers are motivated to take PLPPI cover they are most likely to take the product offered at the point of sale. When combined with sales and marketing documentation that do nothing to assist consumer understanding of their options,

* When a member of our staff applied for a loan online with a major bank recently, they were required to decline PLPPI at 2 different points in the application process. It was then not possible to complete the application online. Instead, a `phone call was received from the bank in an attempt to convince the applicant to take PLPPI before the loan was approved (PLPPI was not taken).

and sales techniques that can make it difficult for consumers to decline cover*, we are left with a situation where the point of sale advantage is significant almost to the exclusion of alternative products and providers.

A further consequence of this lack of engagement by consumers is a lack of price sensitivity as observed through the evidence received by the CC.

This results in the ability of downstream providers to exert market power to a significant degree.

The CC has argued that this market power lies with the distributor and is not a consequence of, or influenced by, vertical integration. We would argue that the momentum in the market is created by the largest players (which are the 5 vertically integrated firms which control some 60% of the market), for whom the profits traditionally made through the sale of PPI are significant even in the context of their wider business. The control exerted over such a high proportion of the market provides little or no motivation for the smaller players to compete on price, when higher prices can easily be sustained, with the consequent high profits.

We therefore believe that there is harm created through vertical integration, due to the incentive to generate and retain significant profits made possible by the downstream market power generated by the point of sale advantage and lack of consumer awareness. We believe that were consumer prices to be genuinely competitive, the levels of profit available would diminish significantly, possibly to the point that sustaining the administrative costs of operating a vertically aligned provider would no longer be viable, thus opening up what is currently an effectively closed portion of the market to truly competitive market forces.

Historic similarities

The current situation bears many similarities to how both the Travel Insurance and Household Buildings & Contents Insurance markets used to operate.

In the 1980s it was usual for lenders to offer mortgage products that were conditional on the consumer taking the bundled household contents and buildings cover. Even where this condition was not absolute, significant barriers to the consumer going elsewhere were often imposed, such as annual fees for the approval of alternative cover.

This power was enhanced by a lack of transparency as to the consumer's options, lack of consumer awareness and a similar lack of price sensitivity to that which we see today with PLPPI.

The requirement for lenders to 'unbundle' this cover from mortgage loans, and the wide reporting of the fact that lenders would no longer make such insurances a condition of a particular mortgage deal, led rapidly to higher consumer awareness, greater price sensitivity, the proliferation of alternative products and consequent lower commissions and prices.

Similarly, the travel industry has historically bundled travel insurance along with packaged holidays. Now that the industry can no longer make their own choice of policy compulsory, consumer awareness is higher, there is greater price sensitivity, and alternative products have proliferated resulting in lower commissions and prices.

Whilst there are clear differences between the household and travel markets of the past and the PLPPI market today, in that the industry is clear that the offered PLPPI product is not compulsory, there is little effort to make this clear to consumers. The resulting consumer 'ignorance' leads to a status quo very much in favour of the distributor.

Legal & General's Experience

In 2005 Legal & General started the development of a new creditor product. The aim was to make available to the lender market an alternative product that was built on the principles of Treating Customer Fairly by producing a high quality product at a fair price.

The product developed for use with a personal loan was to be offered at a rate of £10 per £100 (against an industry average at the time of £15 - £20 per £100) with commission of ~65%. This commission was to be made up of a proportion of guaranteed commission (~50%) with an additional potential ~15% of profit share. Premiums were to be payable monthly to avoid the additional interest cost associated with single premium products being added to the loan. This would also give the consumer greater flexibility with the ability to cancel without the imposition of cancellation charges.

Negotiations were held with a number of banks and building societies, but despite a desire to offer a more 'consumer friendly' product, none felt able to enter into a distribution arrangement. A reason often cited was the potential 'hit' on profits that would result from the lower commission (a combination of the lower commission rate and substantially lower premiums) and profit share.

We have therefore been unable to enter this particular market at this time, with a product that we are comfortable with.

Alternative Products

The Commission has acknowledged that there are a number of alternative products available that go some way towards providing the cover offered by PPI, but that none are direct substitutes for PPI. Legal & General agree with this position; each of these products provides for a different particular need.

It is notable that each of the alternative products identified is a Life Assurance contract as opposed to a General Insurance contract, which PPI is.

One significant difference between these types of contract is the profits available to distributors, in particular the commission that is typically paid.

To give an example, a Legal & General Income Protection product would pay commission based on an initial 4 year period of cover, followed by renewal commission for the remaining life of the policy. The commission actually paid for the initial 4 year period (on a policy with a term of 12+ years) would equate to about 31% of the premiums paid. Subsequent renewal commission is paid at a much lower rate (~2.5%), meaning that commission received as a proportion of premiums paid actually reduces over time the longer the policy is in force. A policy taken out for a 5 year term (the shortest term available), would pay commission equivalent to 16% of premiums paid. It should also be noted that if the customer were to cancel the policy before the end of the first 4 years there would be no cancellation charge to the customer, and a proportion of the commission paid would be reclaimed from the distributor.

When compared to typical PPI commission on a single premium policy of 60% - 80% there is a significant difference, even before profit share arrangements (which are not available on Life Assurance products) are taken into account.