

Lloyds TSB Group plc

Submission in response to Emerging Thinking document and Working Papers

1. INTRODUCTION

1.1 This submission comprises Lloyds TSB Group's response to the Emerging Thinking document and the nine working papers published by the Competition Commission on 6 November 2007.

1.2 In the short time available for response, we have focussed our submission on:

- (i) Responding to the CC's thinking on key issues such as market definition, the extent of competition in the relevant markets etc.;
- (ii) Inviting the CC to reconsider evidence already available to it which bears on some of those key issues;
- (iii) Correcting various errors of fact in the documents published by the CC.

Please note that, where we cross-refer to evidence already submitted by Lloyds TSB to the CC, the references to such evidence are not to be taken as a waiver of confidentiality in respect of such evidence. Please note also that we intend to submit further evidence on some of the issues identified by the CC as requiring further investigation, but we have been unable to collate all the relevant evidence within the timetable for submission of this response.

1.3 We do not intend to comment on the CC's analysis of the state of competition in the underwriting of PPI, nor on the effects of vertical integration between underwriters and distributors of PPI. Lloyds TSB substantially agrees with the CC's current thinking¹ that it need not undertake any further analysis or inquiry into these elements of the overall market. However, if the CC were to decide to investigate these matters further, we would wish to make further submissions in respect of them.

1.4 In summary, Lloyds TSB's submission is as follows:

- (i) The CC's proposed definition of the relevant retail markets is too narrow. Bearing in mind that market definition is intended to be a tool to facilitate an examination of the conditions of competition among suppliers, it would be more useful and appropriate to identify wider markets – for example, a single market for the distribution of PLPPI, another market for the distribution of MPPI etc. If, having investigated the matter further, the CC were satisfied that there is a strong linkage between the pricing of PPI and its related credit product, it would be more useful and appropriate to adopt a market definition which took fuller account of the related credit products too. In this regard, Lloyds TSB will submit additional evidence to assist the CC in evaluating (among other things) the extent to which firms discount the price of personal loans by taking into account PPI revenues.

¹ Competition Commission, Payment Protection Insurance Market Investigation, Emerging Thinking, 6 November 2006 (hereinafter referred to as the "Emerging Thinking"), paras 20 - 21, 34, 141 – 144, 215 – 216.

- (ii) On examination, the market for the distribution of MPPI is effectively competitive and does not appear to exhibit features which are appreciably restrictive of competition. There is no case for imposing competition law remedies in this market.
- (iii) The CC has underestimated the extent of competition, and the evolution of competition, in the market for the distribution of PLPPI. The evidence cited by the CC as to product differentiation/choice, product innovation, the significance of advertising, profitability etc. should not be taken as showing that the market is uncompetitive.
- (iv) We note that the CC intends to keep under review the extent of competition among providers of credit card PPI, and the effectiveness of stand alone CCPPI products, as a substitute for card-specific policies offered by credit providers. We will await further developments in the CC's thinking on these issues, before offering any detailed response.
- (v) The CC needs to give due weight to the benefits offered by PPI to consumers, with these benefits being particularly significant for vulnerable customers.
- (vi) The CC has failed to give due weight to the effect of the FSA's ICOB regime and its effects on competition in the retail markets for the distribution of PPI.

1.5 Lloyds TSB's submission on these issues is structured so as to address the following matters:

- (i) Retail market definition;
- (ii) Nature and extent of competition;
- (iii) Profitability of distribution;
- (iv) Benefits of PPI;
- (v) Comments on working papers; and
- (vi) Appendix of comments on factual accuracy.

2. RETAIL MARKET DEFINITION

2.1 The CC devotes a significant part of its Emerging Thinking and the accompanying working papers to a discussion of market definition. This reflects the potential significance of this issue to the overall framework for the CC's investigation. In recognition of this, Lloyds TSB also discusses retail market definition in detail in this section of its reply.

2.2 The CC summarises its emerging thinking on retail market definition as follows:

"Initial indications on product market suggest that, if the further evidence to be gathered and analysed is in line with the evidence seen to date, then the relevant market would be a series of brand-specific product markets – so, for example, a distributor's PLPPI is in a separate market from another distributor's PLPPI. Similarly early indications are that the relevant geographic market is the UK".²

² Emerging Thinking, para 183.

Under such a definition, “the supply of Lloyds TSB-branded PLPPI” would be defined as a relevant market. Lloyds TSB would be a monopolist in this market, as it would be in other markets including the “Lloyds TSB-branded CCPPI market”, “C&G-branded MPPI market” and the “Lloyds TSB-branded SMPPI market”. Further separate markets would be identified for "Black Horse PPI" sold through Black Horse financial centres etc.

2.3 The CC notes³ that:

- (i) If it were to receive further persuasive evidence to the effect that consumers shop around among different bundles of "credit plus PPI", then that might justify a conclusion that there are separate markets for "mortgages plus PPI", "credit cards plus PPI", "personal loans plus PPI" etc.; or
- (ii) If it were to receive further persuasive evidence to the effect that consumers compare different PPI products offered by different distributors, and will switch from one PPI provider to another, to get a better deal, then that might justify a conclusion that there is a single market for the supply of MPPI, another market for the supply of CCPPI and another market for the supply of PLPPI etc.

2.4 Lloyds TSB is examining what further evidence is available in respect of these matters. For the time being, however, it would draw the CC's attention to the fact that there is already significant evidence that:

- (i) Many customers taking out a credit product (e.g. a personal loan) and related PPI will terminate their loan well before its scheduled maturity date.⁴ Often customers refinance the loan with another lender, in order to obtain a better overall package, which is likely to mean a better value for money combination of personal loan plus PPI, as offered by another credit provider.
- (ii) In deciding what form of PPI policy to offer (in terms of risks to be covered, exclusions, benefits, waiting periods etc.) and what price to charge, distributors of PPI take account of rival products offered by other distributors, in order to ensure that their own product is comparable.

We note that the CC does not consider the evidence provided to date on these matters to be sufficient to justify the adoption of a wider market definition. We aim to submit shortly additional evidence as to these and other factors which suggest that a wider market definition would be appropriate.

2.5 At this stage, however, we focus instead on considering whether the CC's present thinking on retail market definition is appropriate in principle, even in the light of the evidence available to date.

2.6 In short, Lloyds TSB submits that the CC's present thinking on market definition (which proposes narrow distributor-specific market definitions) is unsatisfactory, and we would urge the CC to reconsider its initial thinking on this issue, regardless of what further information comes to light. Our concerns are fourfold:

³ Emerging Thinking, paras 162, 168, 173, 176 and 185.

⁴ [Excised – commercially sensitive information]

- (i) First, the CC's approach does not provide a meaningful insight into the competitive dynamics of the provision of PPI and therefore fails to meet the key objective of market definition, which is to provide a useful framework for competition analysis.
- (ii) Second, the CC's proposed market definition does not sit easily with its own Guidelines on the subject.
- (iii) Third, it is at odds with the approach taken by the CC in analogous cases.
- (iv) Finally, there are other candidate market definitions which would be materially superior to the CC's current approach.

We set out the basis for each of these points below.

Absence of insight into competitive market dynamics

2.7 In examining the CC's emerging thinking on market definition, it is worth identifying some of the key characteristics of the market which Lloyds TSB (and others) have identified in their submissions to the CC. Those characteristics are as follows:

- (i) First, there is effective competition in the supply of all kinds of personal credit products. A wide range of firms compete to offer credit across the range of credit products under scrutiny, using a variety of different business models and different means of distribution (e.g. the traditional high street branch network, telephone or internet sales, or third party retail/dealer outlets).
- (ii) Second, intense competition to offer lower credit prices has, in some sectors of the market (particularly personal loans), driven lenders to rebalance their credit and PPI prices, leading to higher PPI prices and lower credit prices.⁵
- (iii) This is not to argue that there is no constraint on the prices which lenders may charge for PPI. Once offered PPI at the point of sale of a credit product, a consumer will think carefully about whether he/she wishes to buy the PPI product on offer, taking account of the benefits it confers and the price at which it is offered. Lenders are keen to ensure that they offer good quality PPI products, relative to other lenders (so as, for example, to attract good ratings in independently generated league tables).
- (iv) Given that borrowers are generally more sensitive to the price of the credit offer than to the price of the associated PPI, it is commercially rational for lenders to price in this way.
- (v) Given that many consumers tend not to think actively about buying PPI (or which PPI product to buy) before approaching their chosen credit provider, credit providers have an advantage in promoting sales of their own PPI, which stand alone providers find it hard to challenge.

⁵ We note that the CC remains undecided as to the extent to which lenders discount the price of credit, to reflect their expectation of earning revenues from the sale of related PPI. It appears that, in order to be persuaded on this point, the CC might expect to see evidence going back longer into the past of a systematic relationship between PPI prices/margins and credit prices. The CC might also expect to see evidence that credit providers deliberately took account of PPI revenues, and the relationship between the supply of credit and the supply of PPI, in setting their credit prices. See further section 4 below.

2.8 All the while that the CC is considering to what extent these factors bear on the supply of credit and PPI products, it is important that the CC should keep open the possibility that some other wider market definition will be more useful to it in examining the state of competition in the sectors under investigation, and how (if necessary) competition could be rendered more effective.

2.9 The CC's presently-proposed market definitions are unlikely to be useful for this purpose, since:

- (i) it provides no obvious means of testing or taking account of the linkage between the pricing of credit and the pricing of PPI; and
- (ii) it provides no means of testing or taking account of the extent to which individual lenders are incentivised to offer better PPI products than their rival lenders.

2.10 There are other problems with the CC's proposed brand-specific product market definition.

- (i) More generally, brand-specific market definition does not provide a useful platform for assessing how a market functions or the "extent of competition between suppliers", which the CC wishes to examine after reaching a view on the relevant market(s) for the sale of PPI.⁶ For example, the number of competitors in a market defined as "Lloyds TSB-branded PLPPI" will be limited to one and Lloyds TSB is unavoidably a monopolist in this market; by definition there will be no "intra-market rivalry" or "competition between suppliers" in the relevant product markets provisionally defined by the CC.⁷

Such a definition also provides no useful basis for assessing *potential* competition in a market – it is unclear how, for example, the extent of competition between Lloyds TSB-branded CCPPI and the new CCPPI policy to be offered by Barclays could be evaluated under the CC's current proposed market definition.

Indeed, it is not at all clear from the CC's Emerging Thinking document what is the market in which stand alone retailers of PPI operate.

- (ii) One of the chief purposes of market definition is to identify a range of products or services which are supplied under similar market conditions. By identifying separate markets for the supply of PPI by different distributors, the CC effectively imposes upon itself the burden of examining separately the conditions of competition in each of these separate markets.

It would not appear to be sufficient merely to note that each distributor is a monopolist in its own market, since consumers in these different markets will exhibit different propensities to shop around/switch, and different degrees of knowledge of the various products on offer. These factors would need to be taken into account in determining the degree of market power (if any) enjoyed by the monopoly distributor in each such market.

⁶ Emerging Thinking, para 28.

⁷ The section of the CC's Market Investigation Guidelines dealing with "assessment of competition" focuses on intra-market rivalry.

Even where a particular distributor was found to enjoy market power in its own market, it would be necessary for the CC to consider the extent of detriment ensuing from that state of affairs, taking account of the significance of that particular market, in deciding whether to impose remedies. For example, it might be disproportionate to impose remedies on very small distributors (e.g. small motor dealers selling only small volumes of PPI).

But, by approaching each market separately in this way, and disregarding competition among distributors to sell packages of credit plus related PPI, the CC would risk imposing remedies on some distributors and not others, in a manner which would distort competition in the supply of the relevant credit products.

- (iii) There are also tensions between the CC's approach to product market and geographic market definition: is a small, local PPI distributor (e.g. a local, independent motor dealer) really competing in a UK-wide market, given that his brand-specific products are only likely to be available in a very limited geographic area? Before concluding that he is, it would appear to be necessary to consider whether he could readily expand his business to operate UK-wide. This will depend on a number of factors unrelated to the supply of PPI (but turning, for example, on the costs of expanding his presence in the motor distribution sector).

The very fact that the CC notes that PPI prices appear to be uniform across the UK suggests that national distributors of PPI have a direct influence on prices charged by local distributors (e.g. small car dealers), which is itself suggestive of a single national market in which all distributors participate.

- (iv) Moreover, it is clear from a reading of the Emerging Thinking document as a whole that the CC does not itself appear to proceed on the basis of its own narrow market definitions: the CC effectively examines the nature and extent of competition in the retail market(s) on an aggregate basis (i.e. factors affecting the distribution of MPPI, factors affecting the distribution of CCPPI, factors affecting the distribution of PLPPI) in a manner which assumes that all distributors of any one of these products are subject to similar conditions of competition. This effectively belies the suggestion that they operate in separate distributor-specific markets.

In short, the CC's currently proposed retail market definition appears to give rise to significant difficulties and to take no account of what are, on any analysis, important features of how the overall market functions.

Tension with the CC's own Market Investigation guidelines

- 2.11 The CC's emerging thinking on retail market definition involves what is, at best, a rather mechanical application of the "SSNIP test". By adopting such an approach, the CC risks ignoring the principles laid down in its own guidelines.⁸

⁸ Competition Commission, Market Investigation References: Competition Guidelines, CC3, June 2003.

2.12 For example, these guidelines state:

"the Commission sees competition as a process of rivalry between firms or other suppliers...seeking to win customers' business over time. This rivalry may occur in a variety of ways".⁹

"the Commission will consider the extent to which rivalry in the market will ensure that all firms in the market are open to challenge, that no firm's position or market share is insulated from competitive pressure and that none can exert market power."¹⁰

2.13 Thus the guidelines appear to contemplate that the CC will define markets in a way which then enables it to examine the extent of competition within the market. By implication, the examination of potential entry from rival markets is of less significance. But, in this case, the CC's proposed market definition already effectively decides that there is no competition within any of the identified markets, and forces the CC to look only at the possibility of potential entry into each of its identified markets, without providing it with any useful framework within which to examine such possible entry.

2.14 In Lloyds TSB's view, it would be more useful to identify a single market in which all distributors are active and, if necessary, to consider what steps might need to be taken to ensure more effective competition among distributors in that market. We suggest that this would be a more pragmatic approach.

2.15 The need for pragmatism is explicitly recognised in the CC's guidelines.

"As noted earlier, the Commission does not regard market definition as an end in itself, but rather as a framework within which to analyse the effects of market features. The definition of the relevant market is a useful tool for identifying the competitive constraints present in the market. There is inevitably an element of judgment involved in defining the market and the Commission will adopt the methodology most appropriate in the context of the investigation."¹¹

2.16 In Lloyds TSB's view, "competitive constraints" and "the effects of market features" are both best assessed through the use of a market definition which allows an examination of the key characteristics which determine how competition occurs in the market in question, rather than one which effectively prejudices the extent and effectiveness of competition by identifying all market participants as monopolists at the outset.

At odds with the approach taken in analogous cases

2.17 The CC's currently-proposed approach is also at odds with the conclusions reached on market definition in analogous cases.

2.18 The clearest analogy is with the recent *Store Cards* market investigation.¹² In *Store Cards*, the CC examined whether an individual store card programme should be defined as a relevant market in much the same way that the CC is currently considering whether there should be brand-specific relevant markets in its investigation of PPI.

⁹ Ibid, para 1.16.

¹⁰ Ibid, para 1.18.

¹¹ Ibid., para 2.2.

¹² Competition Commission, *Store cards market investigation*, 7 March 2006.

- 2.19 The possibility that the relevant market in Store Cards might be programme-specific was based on the observation that one store card was not a good substitute for another, in the sense that a store card issued by (for example) Top Shop was not a substitute for one issued by (for example) Next, given that a store card could only be used to purchase goods in the chain which issued it. The CC conceded that a mechanical application of the SSNIP test could imply that markets were very narrow:

"A formal application of the tools of market definition would not, in our view, result in a market wider than an individual store card programme..."¹³

- 2.20 However, the CC decided to define the relevant downstream market in this case as "consumer credit through store cards". It gave three reasons for this view:

"(a) We regarded this inter-comparison between retailers [where retailers monitor relative APR levels] as being the most significant factor constraining APRs in this industry from rising;

(b) Various parties put it to us that we should regard such a constraint as being important for market definition; and

(c) A narrow market, limited to each store card programme, did not, in our view, best meet the purpose of market definition as set out in our Guidelines."¹⁴

- 2.21 The parallels to the PPI investigation are clear. In the same way that retailers monitored their relative APR levels, providers of PPI monitor the relative cost of their PPI policies in conjunction with the loan as well as on a PPI-only basis.¹⁵ Lloyds TSB is clearly not the only provider to draw the CC's attention to the importance of this constraint.¹⁶

- 2.22 For the same reason, in the *Extended Warranties* investigation,¹⁷ the CC chose not to find separate markets for the retail supply of extended warranties via each retail chain selling domestic electrical goods. It appeared to the CC to be more useful to find a wider market, including the supply of extended warranties via independent retail distributors, whilst recognising that the retailer of the domestic electrical goods had a competitive advantage in the wider market, through being able to offer an extended warranty at the point of sale of the primary product¹⁸.

¹³ Ibid, para 6.175.

¹⁴ Ibid, para 6.176.

¹⁵ [Excised – commercially sensitive information]

¹⁶ Emerging Thinking, paras 150 – 151.

¹⁷ Competition Commission, *Extended Warranties* investigation, December 2003

¹⁸ *Extended Warranties* report, paragraph 2.258

Availability of other market definitions

- 2.23 Lloyds TSB submits that the most appropriate approach to market definition is one which takes full and appropriate account of the inter-relationship between PPI and the underlying credit products to which the PPI relates. This would lead to a conclusion that, where there is a pronounced link between the sale of a particular type of credit product and its related PPI (e.g. personal loans), the CC should examine the case by reference to a single market for the supply of such credit products plus their related PPI. In respect of other credit products where consumers show more propensity to shop around among rival PPI providers, separately from their choice of credit provider (e.g. mortgage PPI), the CC should proceed by reference to a single market for the distribution of PPI to accompany such credit products.
- 2.24 However, even if the CC were to conclude that the evidence as to linkage between credit and PPI products, or as to consumers' propensity to shop around, did not justify the adoption of such market definitions, Lloyds TSB considers that there are other reasons which would justify adopting wider retail market definitions than those which the CC is currently contemplating.
- 2.25 One such approach would be to apply the logic of the Store Cards inquiry. In the same way that the CC concluded in that case that “consumer credit through store cards” was a relevant market, it is open to the CC to find that “PPI sold in conjunction with a [given type of credit product]” is an appropriate approach, thus defining separate PPI markets for the retail supply of personal loan PPI, mortgage PPI, credit card PPI etc.. There are several attractions to this approach:
- (i) First, unlike the CC’s current proposed approach, it enables the CC to conduct a meaningful analysis of the nature and extent of competition or potential competition among suppliers in the various markets defined. It avoids the conclusion that even the smallest market participants and new entrants should be regarded as monopolists in the supply of PPI to their own customers. It facilitates (if ultimately necessary) the adoption of remedies to apply to all distributors, in a manner which avoids restricting competition among them. It also allows the CC more readily to consider the overall opportunities for, and role of, entrants and standalone providers in these markets.
 - (ii) Second, it allows for the CC to take into account differences in the nature of competition in the various underlying credit products. Lloyds TSB has, for example, noted that the take-up of MPPI is affected by factors which are not present in other credit product categories, and the CC also notes features of the provision of MPPI which distinguish it from other forms of PPI.¹⁹
 - (iii) Third, it permits the CC to avoid a detailed assessment of the competitive dynamics of the underlying credit products (which might well be necessary if markets were defined to include the underlying credit product as well as the associated PPI), while at the same time allowing the CC to take account of these markets when assessing how prices are set for each PPI product.

¹⁹ For example, the CC notes that search costs appear to be lower for MPPI than for other forms of PPI (Working Paper on Retail Market Definition, para 51).

3. NATURE AND EXTENT OF COMPETITION

General comments

3.1 The CC notes in its Emerging Thinking document that "[o]nce we have reached a view on the relevant market(s) for the sale of PPI, we shall look at the extent of competition between suppliers".²⁰ This statement highlights the difficulty examined in the previous section of this submission: if the CC concludes that there are separate distributor-specific retail markets, it follows that there is no competition among distributors within these markets. For the reasons given above, Lloyds TSB finds it more appropriate to consider the nature and extent of competition among all distributors of a particular kind of PPI, by reference to a market definition which takes account of such competition. In the remainder of this section, we comment separately on the extent of such competition in respect of the supply of each MPPI, CCPPI and PLPPI.

Extent of competition in market for supply of MPPI and related credit products

3.2 The CC notes that the distribution of MPPI exhibits certain different characteristics from the distribution of other kinds of PPI. For example, there are lower search costs for consumers in shopping around to compare the prices and terms of different MPPI policies, relative to the cost of doing so in respect of other kinds of PPI.²¹

3.3 Lloyds TSB considers that the CC is correct to distinguish the conditions of competition affecting the distribution of MPPI. In particular:

- (i) Customers who are taking out a mortgage are generally conscious of the substantial financial implications of their purchase decision. Accordingly, they exhibit a greater propensity to shop around for the best product, both in respect of the mortgage product itself, and any ancillary insurances (buildings and contents insurance, life cover, MPPI).²² They may also consider a wider range of products as substitutes for MPPI, such as long-term life insurance, permanent health insurance or critical illness insurance, as part of a more wide-ranging review of their financial position than would be practical when making a credit card or personal loan application. Because some of these transactions must necessarily be concluded in order to enable the house purchase to proceed (notably, the mortgage and any life and buildings insurance required by the mortgagee), the consumer may well choose to concentrate on putting those arrangements in place first, and defer taking out MPPI or other products till later, if at all.
- (ii) The data cited by the CC in its Working Paper on Characteristics of Consumers of PPI showed that, in the MPPI sector, some 39% of persons in socio-economic groups A and B who take out a mortgage also take out PPI. This is a markedly higher percentage than is observed in relation to the proportion of these groups taking out credit card PPI (13%) or personal loan PPI (19%). It is likely that these buyers will be relatively well-informed and the necessity for suppliers to respond to their demands will generate competition for the benefit of consumers generally.

²⁰ Emerging Thinking, para 28.

²¹ Working paper on downstream market definition, para 44.

²² [Excised – commercially sensitive information]

- (iii) Again, because of the significance of the mortgage purchase decision, a substantial proportion of consumers take professional advice before deciding which mortgage and related insurance products to buy. In Lloyds TSB's experience, a majority of consumers purchase such products through an independent financial adviser, who acts as a mortgage and insurance broker. By way of illustration, for the period 1 January 2007 to date, [over 50%] by volume and [over 50%] by value of Lloyds TSB Group's new mortgage business was introduced by IFAs. Across the market as a whole, the relevant percentage (by volume) is [between 50% and 75%]. Intermediaries will shop around for MPPI for their customers and, where they offer advice, FSA rules require them to recommend the most suitable product for the customer. Typically, the IFA will work with a panel of mortgage lenders from whom he will select mortgages and one or more insurance providers from whom he will select relevant insurance products. This means that IFAs will generally offer "stand alone" PPI, rather than a single provider's package of mortgage plus PPI.
- (iv) Even where consumers do not use the services of an IFA to assist them in choosing a mortgage product and, if appropriate, a PPI policy, the availability of this option serves to impose a competitive constraint on distributors such as Lloyds TSB, who also offer mortgages and PPI via their own branch networks. Where a consumer chooses to purchase a mortgage directly from Lloyds TSB, he/she will not be offered a choice of different providers' PPI policies, but the consumer is nonetheless likely to take account of the overall cost of the mortgage plus MPPI package, albeit that some customers may be willing to pay a premium for the ease of dealing directly with his/her existing bank and buying both the mortgage and related PPI from its trusted provider.²³
- (v) It is also notable that there is less scope for mortgage lenders to discount the price of the mortgage credit they offer, by reference to prospective PPI revenues from related PPI sales. This reflects the fact that the penetration rate of MPPI is generally lower than for other kinds of PPI (for the period from 1 January 2007 to date, the penetration rates achieved by Lloyds TSB Group's various direct distribution channels were approximately [0 – 25%]). Since the mortgage term generally runs to 25 years, whilst PPI may be cancelled from one month to the next, the pricing of the mortgage credit over the life of the loan is unlikely to be influenced to any material extent by the prospective revenues to be earned from PPI.
- (vi) Because the savings to be achieved by switching from one mortgage provider to another are large in absolute terms, it is common for consumers to refinance their mortgages quite frequently. Whenever a consumer refinances his/her mortgage, he/she is likely to take the opportunity to reappraise his/her related insurances, including MPPI. This creates a further source of competitive pressure among MPPI providers.
- (vii) MPPI policies are typically monthly premium products. Accordingly, a consumer may terminate his policy simply by deciding not to make further monthly payments. Thus, the costs of switching from one policy to another are low.

²³ Please note that this behaviour is characteristic of some but not all customer segments within the Lloyds TSB customer base.

- (viii) Many MPPI policies are now "portable" – that is, they provide effective cover for mortgage repayments, without being tied to any particular mortgage. Lloyds TSB is itself planning to introduce such a product. This facilitates the purchase of MPPI separately from the mortgage and enables the consumer to switch his mortgage without switching his MPPI or vice versa.

In the light of these factors, Lloyds TSB submits that it would be appropriate for the CC to conclude that there is a single market for the retail supply of all MPPI products, that that market is effectively competitive, and that there are no features of the market which appreciably restrict competition to the detriment of consumers.

Extent of competition in market for supply of CCPPI and related credit products

- 3.4 We note that the CC intends to keep under review the extent of competition among providers of credit card PPI, and the effectiveness of stand alone CCPPI products, as a substitute for card-specific policies offered by credit providers. We will await further developments in the CC's thinking on these issues, before offering any detailed response.

Extent of competition in market for supply of PLPPI and related credit products

- 3.5 We noted above that the CC is not yet satisfied that there is sufficient evidence to justify its concluding, on the basis of its reasoning to date, either (a) that there is a single market for the supply of packages of personal loans plus PLPPI; or (b) that there is a single market for the supply by distributors of PLPPI. The CC has helpfully identified what evidence it would consider relevant to demonstrating that one or other of these market definitions is correct.²⁴ We are presently examining what further evidence might be available to assist the CC in this regard.
- 3.6 However, quite apart from what such further evidence might demonstrate, we would invite the CC to adopt the wider market definition proposed in paragraph 2.23 above, for the reasons outlined in that paragraph.

Insights into the extent of competition

(i) *Range of different products on offer*

- 3.7 The CC explains in its Emerging Thinking document and the supporting working papers that it will examine a number of matters to assist it in evaluating the extent to which different distributors of PLPPI compete with one another in the retail supply of PPI.
- 3.8 It notes that one of the matters it will consider is the extent to which firms compete to offer different ranges of cover (e.g. by offering products which insure just one risk, rather than a combined ASU risk).²⁵ It is not clear what insight the CC will gain into the state of competition in the market from such an examination. At a simplistic level, it might be assumed that, in a competitive market, distributors would offer a wide variety of different products, allowing consumers to buy such combinations of cover as they wish, on a pick and mix basis. But there are good reasons why such an intuition is likely to be incorrect:

²⁴ Emerging Thinking, paras 162 and 176.

²⁵ Ibid., para 187.

- (i) Lloyds TSB's evidence shows that there are real advantages in offering a combination policy with a rich range of benefits, since it is quite common for a customer to buy a PPI policy in order to cover one head of risk, and then to claim successfully under another head of risk.

[Excised – commercially sensitive information]

This supports Lloyds TSB's view that offering a range of cover is important to ensure ongoing customer satisfaction with a PPI product, including at the point at which a claim is made.

- (ii) It should also be borne in mind that a customer's ex post perception of an insurance product is often affected by his experience when making a claim. A customer who finds that a policy does not cover his claim under a particular risk will often be disappointed in the policy, even if it covered other risks for which he did not claim. This does not necessarily mean that the customer misunderstood the risks covered by the policy at the time it was purchased; it is a common feature of many financial services products that consumers do not retain a detailed knowledge of all those features of a product of which they are informed at the time of purchase. Such disappointment may adversely affect his loyalty to the supplier and his propensity to buy from the same supplier in future.

Accordingly, in a competitive market, a distributor may have a legitimate interest in offering as full a range of policy coverage as he can, consistently with offering his policy at an affordable price.

3.9 *[Excised – commercially sensitive information]*²⁶

(ii) *Innovation*

3.10 The CC also intimates that it will examine the extent of innovation in product features, as potentially indicating the state of competition in the retail supply of PPI.²⁷ However, the CC fails to provide any indication of how much and what kind of innovation would be required to satisfy it that, in this respect, the market is or appears to be competitive.

3.11 We have already provided evidence of a large number of product innovations introduced by Lloyds TSB to its PPI products in recent years.²⁸ We would point out that the scale of innovation (in the form of significant revisions to existing types of policy) compares favourably with the record of product innovation in other insurance sectors which are unquestionably competitive – the supply of household insurance, or the supply of motor insurance. Sources of comparative data, such as the Defaqto rating scheme, provide further impetus for suppliers to compete by introducing product innovations, in order to improve or sustain their comparative rating.

²⁶ *[Excised – commercially sensitive information]*

²⁷ Competition Commission, Working paper on downstream market definition, paras 60-61.

²⁸ *[Excised – commercially sensitive information]*

- 3.12 We have also provided evidence of various new PPI products introduced by Lloyds TSB notably the new Lloyds TSB “Homeowner Loan Protection” products. These were developed to support the launch of three new second charge secured loan products.²⁹ Consistently with Lloyds TSB’s submission that the supply of PPI is inextricably linked with the supply of the related credit products, it is unsurprising that new PPI products tend not to be launched independently, but tend to accompany new credit products.
- 3.13 The CC appears, however, to be somewhat dismissive of many of these innovations³⁰, on the basis that they are largely driven by responses to customer surveys, rather than by response to competitor activity. This concern appears to be misconceived: it is only in competitive markets that firms need to be responsive to customer preferences, so evidence that Lloyds TSB amends its product design to reflect customer feedback is good evidence of the competitiveness of the market.
- 3.14 Even if these arguments are not accepted, it should be borne in mind that an excessive proliferation of insurance products in a given sector is not necessarily conducive to effective competition. Competition law has, in other contexts, favoured promoting price competition by reference to standard policy terms and conditions, in order to enable consumers to understand more easily what they are being offered, and to facilitate comparisons among different policy offers.³¹
- 3.15 Likewise, it should be noted that, whilst firms are still incentivised to offer innovative products, the introduction of the FSA’s ICOB rules has tended to reduce, at least to some extent, incentives to launch new products, particularly where products are sold via advised sales, by making it more difficult and costly to market new products.³² Where a new product is introduced, staff who will sell the product will need to be extensively trained to sell it in compliance with ICOB. This will entail training staff to elicit and record all the information relevant to assessing a particular consumer’s demands and needs, relative to what the policy covers, and, where a range of different levels of cover are on offer, for example in relation to Lloyds TSB’s Asset Finance Division’s PPI cover to motor dealers, training staff to select and recommend the most appropriate level of cover from the range. Such a sales process needs to be supported by appropriate IT systems and compliance monitoring. The costs and lead time associated with these matters tends to reduce the incentive to introduce innovative products, whose appeal to consumers is often uncertain.
- 3.16 The introduction of minor amendments to existing PPI policies also introduces additional complexity and costs into the handling of claims by the underwriter, since the underwriter’s staff will need to be trained, and systems will need to be developed, to ensure that, when a claim is received, the claimant’s entitlement is assessed by reference to the correct version of the policy for that particular claimant. This may militate against the introduction of minor product changes, where the competitive advantage they bring is offset by additional claims handling costs.

²⁹ *[Excised – commercially sensitive information]*

³⁰ Working paper on downstream market definition, para 52.

³¹ Commission Regulation on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, 27 February 2003 (358/2003/EC).

³² *[Excised – commercially sensitive information]*

(iii) Advertising

- 3.17 The CC has examined the extent to which firms advertise their PPI products.³³ It has, to date, found few examples of firms actively promoting PPI. Again, we would urge the CC to be wary of drawing adverse inferences from this fact.
- 3.18 Where firms offer complex products, the benefits of which need to be "sold" to consumers, widespread marketing is unlikely to be effective in promoting sales. This is particularly true of products which are, by their nature, a secondary product, the demand for which cannot be settled until the consumer has chosen his/her primary product.³⁴
- 3.19 A decision not to engage in widespread marketing does not suggest that inadequate steps are taken to provide product information (including price and details of cover) to customers. We would encourage the CC to take account of evidence that has already been provided by Lloyds TSB on this issue.³⁵
- 3.20 The CC also appears to infer that firms are reluctant to quote a "bundled" price for their loans plus PPI, and that this may explain why they do not require PPI to be taken out as a condition of offering a loan.³⁶ If the PPI were compulsory, CCA regulations would require the lender to quote the APR on a PPI-inclusive basis.³⁷
- 3.21 In fact, this is a misreading of Lloyds TSB's motivation for leaving it to the customer to choose whether he wishes to take out PPI. Lloyds TSB considers that it offers a high quality product which offers real benefits to consumers: its PLPPI product enjoys a 5 star Defaqto rating.³⁸ Whilst it is perfectly appropriate for Lloyds TSB to promote the sale of its PPI product at the point of sale of related credit, there is no good reason for it to make the taking out of such PPI compulsory. Lloyds TSB would be reluctant to require consumers to buy PPI, when this would appear to be inconsistent with the spirit of the Banking Code. (However, Lloyds TSB would emphasise that it would have no objection to requirements that the package price of credit plus PPI be advertised whenever the credit-only price is advertised. But, if such a requirement were to be introduced, it would need to be applied to all suppliers and it would be important to ensure that customers were also made aware of the difference in benefits offered by different distributors' PPI policies.)
- 3.22 The CC also refers to submissions made by several parties that marketing PPI away from the point of sale of credit has become easier due to increased use of the Internet by consumers and that customers are increasingly shopping around for the bundle of credit and PPI, taking account of price comparison websites, amongst other things, to find the best package.³⁹ It also notes that standalone providers are using such websites to attract customers.⁴⁰

³³ Emerging Thinking, para 110; Competition Commission, Working paper on downstream market definition, paras 35 and 60.

³⁴ [Excised – commercially sensitive information]

³⁵ [Excised – commercially sensitive information]

³⁶ Emerging Thinking, para 48.

³⁷ See further Lloyds TSB's comments on Emerging Thinking, paras 13 and 87 in the Appendix to this submission, where Lloyds TSB comments on the CC's statement that the price of PLPPI can be more or less than the interest payable on a loan when bundled together, depending on a range of variables.

³⁸ Likewise, Lloyds TSB's Asset Finance Division's PLPPI product enjoys a 4 star Defaqto rating.

³⁹ Emerging Thinking, paras 77 and 108.

⁴⁰ Ibid., para 78.

3.23 Lloyds TSB supports the submissions made by these parties concerning the growing importance of Internet comparison websites and consumers' increasing tendency to consult them. We would also draw the CC's attention to the fact that comparison websites are starting to become involved in the supply of personal lending, offering both personal loans and PLPPI, which supports the view that appropriate account should be taken of the inter-relationship between PPI and the underlying credit products to which the PPI relates. The CC anticipates that evidence of customer search behaviour will come from Internet comparison sites and we would certainly urge the CC to take full account of such material.⁴¹

(iv) *Rebates*

3.24 The CC appears to be concerned that distributors' practices in respect of the calculation of refunds on single premium policies which are cancelled before their expiry date, may operate as a barrier to switching.⁴²

3.25 *[Excised – commercially sensitive information]*.⁴³

4. PROFITABILITY OF DISTRIBUTION

4.1 The CC's thinking on the profitability of PPI distribution is clearly at an early stage of development.⁴⁴ Lloyds TSB intends to expand upon its present submissions when the CC's working paper is published. However, we consider it important at this stage to comment on several issues of relevance to the CC's consideration of the level of profitability earned by firms from the distribution of PPI and how this may be taken into account when assessing the competitive process in the market(s).

Commission rates

4.2 The CC takes as its starting point the commission income earned by the distributor from selling PPI.⁴⁵ We agree that this is the appropriate measure of the distributor's gross income (which should be subject to adjustments for profit share, rebates for early cancellation etc.). There is no reason to believe that any additional profit is "concealed" in the underwriting business in vertically integrated firms, since, as the CC notes, there is effective competition among underwriters to win the opportunity to underwrite a distributor's products, and any "surplus" profit is generally fed back to the distributor via profit sharing arrangements.⁴⁶

4.3 However, it does not follow that one can altogether ignore the role of the underwriter in vertically integrated firms, in assessing the profitability of the distribution activity. We return to this point below.

The cost of supplying PPI relative to revenues

[Excised – commercially sensitive information]

⁴¹ Ibid., para 156.

⁴² Ibid., paras 99 and 172.

⁴³ *[Excised – commercially sensitive information]*. We comment in the Appendix to this submission on the CC's illustrative calculations of rebates.

⁴⁴ Emerging Thinking, paras 189 – 197.

⁴⁵ Ibid., para 190.

⁴⁶ Ibid., para 142. Competition Commission, Working paper on the underwriting market, paras 59, 70-72.

4.4 [Excised – commercially sensitive information].^{47 48}

4.5 [Excised – commercially sensitive information]^{49 50}

4.6 [Excised – commercially sensitive information]

4.7 [Excised – commercially sensitive information]

4.8 [Excised – commercially sensitive information]

4.9 [Excised – commercially sensitive information]

4.10 [Excised – commercially sensitive information]

(ii) *Other relevant costs*

4.11 It should also be borne in mind that, in a vertically-integrated firm such as Lloyds TSB, it may well be that, for historic or other reasons, certain functions which are properly to be regarded as distribution functions are carried out by the underwriter part of the firm, and the related costs not recognised in the distributor's accounts.

4.12 Within Lloyds TSB Group, Lloyds TSB GI division is responsible for designing PPI products in consultation with Lloyds TSB UKRB, for distribution by the UKRB distribution businesses, for assisting in the design of training for sales staff, for handling and recording customer complaints (including complaints in respect of the sale of PPI) and for calculating and administering rebates.⁵¹ In a non-vertically integrated firm, these activities would be undertaken, to a substantial extent, by the distribution business.
[Excised – commercially sensitive information]

Relationship with credit pricing

4.13 We note that the CC remains undecided as to the extent to which lenders discount the price of credit, to reflect their expectation of earning revenues from the sale of related PPI.⁵² It appears that, in order to be persuaded on this point, the CC might expect to see evidence going back longer into the past of a systematic relationship between PPI prices/margins and credit prices. The CC might also expect to see evidence that credit providers deliberately took account of PPI revenues, and the relationship between the supply of credit and the supply of PPI, in setting their credit prices.

4.14 Lloyds TSB would invite the CC to keep these matters under review in the light of such further evidence as may become available.

4.15 As to whether the CC should expect to see evidence of a subjective recognition on the part of credit providers of such a linkage, we would point out that, in many markets, individual suppliers simply follow a downward movement in prices initiated by other suppliers, until prices fall to a level at which it is no longer profitable to reduce them further.

⁴⁷ Emerging Thinking, para 189ff.

⁴⁸ Ibid., para 191.

⁴⁹ Ibid.

⁵⁰ [Excised – commercially sensitive information]

⁵¹ [Excised – commercially sensitive information]

⁵² Emerging Thinking, para 194.

- 4.16 Firms will not always articulate in their internal documents precisely why it becomes unprofitable, beyond a certain point, to reduce prices further, but ex post analysis may reveal that (in the case of credit/PPI), the explanation lies in an examination of the point at which the combined revenues earned from sales of credit plus PPI, taken together, ceased to cover the total expected costs of supplying the products, taken together. Indeed, third party commentators appear to recognise that this is what was happening in the market, even if individual credit providers did not describe their pricing strategies in this way.⁵³

The price of stand-alone PPI compared with the price of PPI bought at point of sale

- 4.17 The CC compares the price of PPI sold by credit providers such as Lloyds TSB with the price of allegedly similar "stand alone PPI" and finds that the former tends to be more expensive, possibly thereby contributing to excessive profitability on sales of PPI by credit providers.
- 4.18 Lloyds TSB considers that the supposedly comparable stand alone products are, in fact, quite different from, and inferior to, the products offered by Lloyds TSB. In a competitive market, one would expect them to be offered at a substantial discount to the prices charged by Lloyds TSB. For example, many income protection products (in contrast to PPI) do not cover critical illness and life risks. Moreover, they offer cover for only 12 months (not the term of a longer loan), and may be re-priced at any point. Income protection policies tend to offer reimbursement of a fixed amount of income, which would not necessarily cover the liabilities accruing from time to time under a particular loan agreement. By way of illustration, Lloyds TSB's 5 star PLPPI product scores highest in the market, with a score of 106 points. In contrast, British Insurance's 3 star income protection product scores only 78 points, because it does not offer critical illness or hospitalisation benefits.

5. BENEFITS OF PPI

- 5.1 Because the CC's Emerging Thinking focuses on features of the market which might be restrictive of competition in the supply of PPI, it has to date neglected to address the important benefits offered by PPI products.
- 5.2 We have previously emphasised that it is important not to underestimate such benefits, particularly in economic conditions which have until very recently been favourable, in that relatively few policyholders have suffered prolonged unemployment and the financial hardship it may bring.
- 5.3 The current uncertainty in the economic environment is a forceful reminder that an economic downturn can occur suddenly, resulting in a substantial increase in the risk of unemployment and exposing many borrowers to the prospect that they will be unable to service and repay their loans. The magnitude of this consideration is well-illustrated in the extracts from the presentation attached as Annex 1.
- 5.4 Likewise, consumers who presently enjoy good health always face the risk of a future illness or accident leaving them unable to work.

⁵³ See, for example, Redburn Partners LLP, UK Banks Payment Protection Insurance regulatory risk: Storm in a tea-cup, 27 January 2006, which refers to "compelling evidence that lenders price their loans on the basis of achieving a certain number of PPI cross-sells", p. 4, a copy of which is provided in Annex 2 of this submission.

- 5.5 Consumers exposed to these risks enjoy substantial benefits from holding PPI, including in the form of "peace of mind", even if they have not claimed on it to date and if they are fortunate enough never to have to do so. Mintel research has shown that consumers who have purchased PPI value the peace of mind offered by the product, and the FSA acknowledges that PPI offers real benefits to customers, where it is appropriate to the customer's circumstances.⁵⁴ We note that, in its Working Paper on Characteristics of Consumers of PPI, the CC observes that "the survey found that consumers who buy PPI to cover mortgages (MPPI, credit cards (CCPPI) and personal loans (PLPPI) are more likely to come from socio-economic groups C and D".⁵⁵ This evidence suggests that the types of consumers who typically buy PPI are those who are likely to benefit most from the product, e.g. because they may be expected to have lower incomes, little or no savings, or in some cases fewer employment benefits (such as sick pay or holiday benefits) and are therefore more likely to need to have recourse to PPI in the event of an accident, sickness or unemployment.
- 5.6 We would therefore urge the CC to take account of such benefits, as being relevant to consideration of any regulatory intervention that might make it significantly harder for distributors such as Lloyds TSB to market PPI to consumers who stand to benefit from having it. Consideration of the benefits of PPI will therefore certainly be relevant at the remedies stage of the CC's investigation (if it proves necessary to consider remedies at all).
- 5.7 However, it is also informative as to the nature and extent of competition in the market to examine the extent to which firms offer high quality products. We would therefore urge the CC to take full account of:
- (i) The extent to which distributors are motivated to offer high quality PPI products by virtue of the fact that poor quality PPI products (or products which are not perceived as offering good value for money) would adversely affect future sales of PPI and/or credit products and/or other banking products;
 - (ii) The extent of non-price competition between suppliers, e.g. in relation to the extent of coverage and benefits offered by a package;⁵⁶
 - (iii) The extent to which customers express themselves to be satisfied with PPI, not only when purchasing a PPI policy, but when making a claim;⁵⁷
 - (iv) The extent to which customers who buy PPI principally because they value one type of cover (e.g. unemployment) often claim under another type of cover (e.g. sickness).⁵⁸

⁵⁴ Mintel, *Creditor Insurance*, Financial Intelligence (January 2007), p. 83; Financial Services Authority, *The Sale of Payment Protection Insurance – results of follow-up thematic work* (October 2006), p. 3.

⁵⁵ Competition Commission, *Working paper on characteristics of consumers of PPI*, para 4. See also para 7.

⁵⁶ *[Excised – commercially sensitive information]*

⁵⁷ *[Excised – commercially sensitive information]*

⁵⁸ See para 3.7 above.

6. WORKING PAPERS

Payment protection insurance and its alternatives

- 6.1 The CC states that "the differences between short-term income protection and stand-alone PPI are limited, and we shall be looking further at the extent to which these are separate types of policy or the same type of policy branded for different uses."⁵⁹
- 6.2 Lloyds TSB considers that this understates the differences between the two products. When comparing monthly short term income protection with single premium PPI it is important to note that:
- Monthly short term income protection tends to offer protection for up to 12 months rather than for the term of the loan;
 - Premiums can change at any time on monthly products;
 - Short term income protection products provide a cash benefit to help pay regular monthly outgoings (which is not restricted to but could include a credit product payment), whereas PPI usually offers protection against a specific credit product; and
 - Although both short term income protection and PPI tend to offer benefit payments following similar events, such as accident, sickness and unemployment, PPI often includes additional cover for critical illness and life.
- 6.3 These factors suggest that short-term income protection and stand-alone PPI are separate types of policy and we would question the extent to which it would be appropriate for them to be viewed as substitutes.

Payment protection insurance and its regulation

- 6.4 Lloyds TSB is disappointed by the way in which the CC has failed to integrate its description of the FSA's regulatory regime into the main body of its emerging thinking.
- 6.5 The working paper provides an outline of the regulatory framework and rules that affect the provision of PPI to consumers. In particular, Parts 1 and 2 describe the regulatory responsibilities of the OFT and FSA, give an overview of the FSA's treating customers fairly (TCF) initiative and outline the ICOB rules concerning product disclosure, cancellation and claims and the specific requirements applicable to advised sales. There is also an overview of the consumer credit regime, including the methodology for calculating annual percentage rates (APRs) and general consumer protection legislation.
- 6.6 Although the working paper provides a fair description of the regulatory framework and rules, the Emerging Thinking as a whole fails to take into account the implications of the rules for the process of competition in the supply of PPI to consumers. We consider that the CC should ensure that, in pursuing its investigation further, it takes full account of the following:

⁵⁹ Emerging Thinking, para 52.

- (i) The FSA's approach to monitoring compliance with its regulations has been to conduct a thematic review, carried out in a series of three phases since 2005, of the sales processes and systems and controls around the sale of PPI. The third phase of this work is still ongoing. It may therefore be expected that the full impact of the requirements to comply with the TCF initiative and ICOB rules has yet to be seen. It is important to note that the analyses underpinning the super-complaint by Citizens Advice, which was received by the OFT on 13 September 2005, and the market study commenced by the OFT in April 2006, were to a considerable extent based on evidence concerning the supply of PPI in the period before general insurance became subject to the FSA's regulations in January 2005.
- (ii) One of the chief objectives of the ICOB rules is to enable consumers to gain a good understanding of the products being offered to them, and to make well-informed choices about what to buy. If the ICOB rules are successful in this objective, one would expect that, over time, their effect would be to increase customers' willingness and propensity to shop around, and to consider in advance whether they will wish to purchase PPI. Thus, indirectly, the ICOB rules may be expected to generate more effective competition at the point of sale of credit and PPI products. We would invite the CC to consider to what extent such a further evolution of the market is to be expected, as the ICOB rules bed down and achieve their effects.
- (iii) ICOB rules require that the consumer be permitted to cancel his purchase of PPI during a cooling off period (14 days for general insurance contracts including PPI, although the PPI products offered by Lloyds TSB's UK Retail Bank offer a longer cooling off period of 30 days). The CC should consider to what extent this is likely to engender cancellations and switching, as customers become more aware of their right to reconsider any purchase decision made at the point of sale.
- (iii) Likewise, the CC should consider whether an increased awareness of cancellation rights would also reinforce customers' understanding that there is no obligation to take out PPI in order to obtain credit.
- (iv) As a result of the FSA's thematic review, it has become clear that single premium PPI policies are required to provide for a refund upon early cancellation and attention has been drawn to the need to comply with TCF and ICOB requirements when disclosing information on the amount of the refund payable for early termination of a PPI policy.⁶⁰ In Lloyds TSB's submission, these factors suggest that single premium policies should not be viewed as a feature of the market which may adversely affect competition. The fact that the changes to rebate policies brought about by the FSA's thematic review have taken place relatively recently should also be taken into account.
- (v) There are a number of initiatives currently being undertaken by the FSA which are of relevance to the issues under consideration by the CC, including initiatives to produce comparative pricing tables⁶¹ and its recent review of approaches to

⁶⁰ The FSA contended that nil refund clauses may be unfair under the Unfair Terms in Consumer Contracts Regulations 1999: see Financial Services Authority, *The sale of payment protection insurance – results of thematic work* (November 2005), paras 5.9 – 5.10.

⁶¹ [*Excised – commercially sensitive information*] Lloyds TSB is participating with other industry members in the project to introduce comparative PPI pricing tables on the FSA website.

rebates.⁶² The CC has, for example, noted that although submissions have been made that consumers think that taking out PPI is mandatory, the FSA's recent thematic review demonstrates that distributors are telling consumers that the product is optional.⁶³ We would invite the CC to give further consideration to the extent to which these initiatives could contribute to addressing its concerns regarding the state of competition in the market.

7. COMMENTS ON COMPLETENESS AND ACCURACY

- 7.1 We have set out in the Appendix to this paper our comments on specific factual inaccuracies in the Emerging Thinking document and the accompanying Working Papers.

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⁶² Financial Services Authority, The sale of payment protection insurance – Thematic update (September 2007), p.13, which states that the FSA will "ensure that refunds firms provide are calculated in line with their obligations to treat customers fairly. We will follow up with those firms where we believe this is not the case." See also details of the FSA's agreement with the PPI industry aimed at ensuring customers are given a refund if they cancel a single premium PPI policy at <http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/043.shtml>.

⁶³ Emerging Thinking, paras 48 and 112.

APPENDIX

Factual corrections to CC's Emerging Thinking document and Working Papers

Emerging Thinking	
13, 87	<p>The CC states in para 13 that the price of PLPPI can be more than the interest payable on the loan taken out. It refers to data provided by Which? in para 87 in support of this proposition.</p> <p>Lloyds TSB also considers that the CC has attached undue weight to the difference between the price of PLPPI and the interest payable on the loan taken out, as these figures cannot be compared on a like for like basis. Contrasting the interest paid on a credit product with the price of insurance cover does not create a useful comparison, as the factors taken into account when pricing interest rates and insurance premiums are not identical.</p> <p><i>[Excised – commercially sensitive information]</i></p> <p>It is also not clear whether the data provided by Which? on the average total amount consumers would pay for a loan with PPI included the interest payable on PPI premium as part of the calculation of loan interest (to show total interest) or the PPI premium (to show the total cost of PPI) or, indeed, if it excluded the interest payable on the PPI premium from the calculations altogether. This should be clarified or corrected, particularly given the prominence awarded to this evidence, in the CC's news release, for example.</p>
96	<p>CC refers to evidence cited by Which? that a customer "may end up paying interest on premium even though they are no longer covered, because PPI policy covers a shorter period of time than the total loan period."</p> <p>Lloyds TSB only offers PPI policies which match the original term of loans taken out, so that customers are never required to pay interest on a policy that no longer covers them. PPI can either be paid in a lump sum up-front or can be loaned to the customer, in which case interest is charged on it.</p> <p>In addition, it is important to note that the terms of Lloyds TSB's PLPPI policies take into account the following circumstances:</p> <ul style="list-style-type: none"> • For Buy Now Pay Later loans (BNPL) the loan term and the accompanying PPI is extended by 3 months to cover the period when customers delay repayment. • For any customers taking repayment holidays, their loan term and accompanying PPI is extended to cover the holiday. • For any customers going into Collections, the PPI is extended to match the length of any revised loan term. • For any Lloyds TSB customers who reach 65 years old whilst holding a loan with PPI, there is a change in cover, and employment cover is no longer

	included. <i>[Excised – commercially sensitive information]</i>
97, 98	<p>In paragraph 97, the CC notes that rebates "reflect a greater risk for insurers early in the life of the policy because of the higher insured balances outstanding, the initial expenses of the policy and the higher risk of default due to adverse selection – so a customer cancelling a policy a quarter the way through its life is likely to get somewhere nearer a half of the premium refunded".</p> <p><i>[Excised – commercially sensitive information]</i></p>
103	<p>The CC has observed that the price of PPI can vary significantly within a policy type and quotes the OFT's comment that "differences in PPI price might not always explain difference in cover".</p> <p>We note that a wide variety of factors may explain differences in PPI price. Based on the fact that PPI is bundled with the loan, variances in price might be due to differences in the way a lender credit scores and the resultant APR, the structure and coverage of the product, channel of distribution, claims experience of the underwriter and also commission payable to the distributor. It is important to note that the relationship between cover and price is not necessarily linear: differences in price can also result from differences in quality (e.g. quality of sale process, quality of claims experience and post sales service)</p> <p><i>[Excised – commercially sensitive information]</i></p>
104	<p>The CC states that "the price of standalone PPI was significantly less than the price of PPI bought at the point of sale".</p> <p>It is submitted that there may be differences in the price of standalone PPI to the price of PPI bought at the point of sale because standalone PPI pricing reflects long term risk when compared to single premium, <i>[Excised – commercially sensitive information]</i> Moreover, standalone PPI does not provide customers with tailored cover and, in some cases, does not offer as comprehensive cover as PPI sold at the point of sale. Lloyds TSB's PPI also provides flexible cover that can change with a customer's circumstances.</p> <p>The CC quotes data from Defaqto concerning the price per £100 of cover for a selection of PPI providers, with a median of £17.82. It is important to note that this is one example (using £5,000 over 4 years, at 10.9% for Lloyds TSB), and selecting different amounts, terms, APRs and <i>[Excised – commercially sensitive information]</i> would generate different examples.</p> <p>We have concerns about the way in which this comparison table has been constructed, as the method of comparing price per £100 of benefits does not compare like with like. Lloyds TSB's aim is to satisfy the demand for loan and PPI products from as many of our customers as possible. By using a typical APR, those in the market that choose to sustain low headline rates by only serving a narrow segment of "best risk" consumers will be unfairly advantaged. Similarly, those in the marketplace that focus on "best price" for PPI by offering minimum protection benefits again might be</p>

	<p>unfairly advantaged if benefits content is not well documented (we note that Defaqto’s table only describes benefits in terms of policy structure, rather than types of cover included). Additionally, Defaqto’s table does not specify which channel was used for each competitor (which potentially impacts APR), nor what age loading may have been applied by some competitors.</p> <p>We believe that Defaqto’s calculation of benefit per £100 is inappropriate, because it uses monthly cost of PPI (without interest) as a proportion of monthly loan repayment (excluding PPI). However, because customers are lent the PPI premium, and therefore their PPI cover would pay out against the total amount (loan and PPI) the calculation should instead be monthly cost of PPI as a proportion of total monthly repayment (loan and PPI). <i>[Excised – commercially sensitive information]</i></p> <p><i>[Excised – commercially sensitive information]</i></p>
Working Paper on downstream market definition – Appendix B	
2(b)	<p>Para 2(b) indicates that the findings within the paper are based on 34 credit card products derived from five distributors. However, figure 2 (below para 15) shows the coefficient of variation for only 33 credit card products. The CC should either correct para 2(b) or else indicate why one product has not been shown in figure 2.</p>
3a, 6, 9	<p>In several paragraphs, the CC refers to PPI prices staying flat or not varying over time. In all such cases, to improve accuracy, the CC should clarify that prices remained flat or did not vary in nominal terms. If prices remained flat in nominal terms between January 2002 and December 2006, this implies that they declined in real terms by approximately 15% over the period (calculated from RPI all items which increased from 173.3 in January 2002 to 202.7 in December 2006, series ref CHAW, downloaded from http://www.statistics.gov.uk <http://www.statistics.gov.uk>).</p>