

MBNA EUROPE BANK LIMITED

**INITIAL COMMENTS ON THE COMPETITION COMMISSION'S "EMERGING THINKING" IN ITS MARKET
INVESTIGATION INTO PAYMENT PROTECTION INSURANCE**

28 NOVEMBER 2007

INTRODUCTION

1. This document sets out the initial views of MBNA Europe Bank Limited ("MBNA") on the emerging thinking document and the accompanying working papers published by the Competition Commission ("CC") on 6 November 2007 in relation to its market investigation into payment protection insurance ("PPI").
2. The CC has asked for views on its emerging thinking by 27 November 2007, ie within only three weeks from the publication of the documents. MBNA therefore reserves the right to make further submissions and to provide further evidence to the CC as the investigation progresses. MBNA notes that the CC's current administrative timetable provides that the deadline for interested parties to make submissions prior to the CC notifying its provisional findings is not until February 2008.
3. References in this document to paragraph numbers are to paragraphs in the CC's emerging thinking document.

SCOPE OF THE CC'S INVESTIGATION AND THIS RESPONSE

4. The CC has concluded that it does not currently propose to pursue further analysis or inquiry into (i) the underwriting market for PPI and (ii) vertical integration in the supply of PPI. MBNA supports these conclusions for the reasons set out in its comments of 11 May 2007 on the CC's issues statement and at its hearing with the CC on 26 June 2007.
5. The CC's emerging thinking therefore focuses on the retail market. The CC makes clear that it is still at a very early stage of its investigation.
6. This response focuses mainly on **credit card PPI**, since this is the only type of PPI under investigation that MBNA now offers, having taken the decision earlier this year to cease offering new unsecured personal loans (and associated PPI) and to run down its loans business. MBNA notes that the CC acknowledges that there are different types of PPI, reflecting the differences in the underlying credit product to which they are related, but that the CC's emerging thinking does not indicate whether or to what extent the CC considers that competitive conditions differ with regard to each type of PPI under investigation.
7. MBNA has set out its main comments below. More detailed comments on specific paragraphs in the emerging thinking document and in the working papers are set out in Appendix 1.

MARKET DEFINITION

The CC considers the issues surrounding definition of the relevant product market for PPI at the retail level at paragraphs 145 to 185. The CC makes clear that its analysis is at a very early

stage and its views about the relevant product market are described as no more than "initial indications".¹

The CC states that none of the evidence received so far indicates that customers' choices in the primary market for credit products are affected by prices in the secondary market for PPI. The CC also states that the distributor's advantage as the "only business able to access customers at the point of sale of the credit product"² hinders any demand or supply side substitution. On this basis, the CC considers that if the further evidence to be gathered and analysed is in line with the limited evidence seen to date, the relevant product market would be a series of brand-specific product markets, (ie MBNA's credit card PPI would be in a separate market from Lloyds TSB's credit card PPI, etc).³ However, the CC acknowledges that it has not received the data it has requested from a sufficient number of parties to enable it to carry out a full analysis to help it to define the relevant market at retail level. The CC also sets out the type of evidence that might lead to a wider market definition.

The CC states that the current indications are that the relevant geographic market is UK wide.⁴

(a) Introduction

8. For the purposes of market definition (and also to understand the extent and nature of competition between suppliers) it is important that the CC understands and analyses the different types of credit/PPI package. There are, for example, particular characteristics of credit cards and credit card PPI which need to be taken into account in considering the relevant market and competitive constraints. The emerging thinking generally deals with all types of credit/PPI collectively, but it is important to draw out the distinctions.
9. The analysis may well differ between different types of credit and PPI products. Credit cards and credit card PPI display a particular range of characteristics that are very similar to store cards and store card PPI, but which differ from a number of other types of credit products and associated PPI. By way of example:
 - (a) the PPI cover (and premium) tracks the customer's credit balance, which will normally change from month to month, rather than being a set monthly amount;
 - (b) at least so far as MBNA is concerned, the PPI cover is designed around the credit card product; so, for example, changes to the credit card monthly minimum payment lead to changes to the PPI cover;
 - (c) the price of credit card PPI is very transparent - it is shown each month on the customer's statement;
 - (d) the PPI is calculated and paid monthly and the customer can switch the PPI on and off as he or she wishes; the monthly premiums simply cease, with no need to calculate any refund of premium;
 - (e) a customer will often have more than one credit card -- and so can choose to spend more (or less) on a particular card at any time; and
 - (f) customers can take out a new credit card (and associated PPI) without cancelling an existing card (or associated PPI), and easily transfer balances from the existing to the new card.

¹ Emerging thinking, paragraphs 26 and 183.

² Emerging thinking, paragraph 25.

³ Emerging thinking, paragraphs 26 and 183.

⁴ Emerging thinking, paragraphs 26 and 183.

10. These characteristics are likely to be relevant when considering the relevant product market and when looking at how competition takes place.
11. For example, the CC's emerging thinking states that the vast majority of PPI sales are made at the point of sale of the underlying credit product.⁵ This is not the case for credit card PPI. In 2007 (year to date), [x<] % of MBNA's sales of credit card PPI were made at the time the customer applied for the credit card.⁶ In relation to MBNA credit card PPI, a customer may purchase it at the following different stages:
 - (a) on application for the credit card product;
 - (b) at the welcome stage;
 - (c) at the card activation stage;
 - (d) at any other time while the customer continues to hold the card – the customer may approach MBNA to obtain PPI by calling customer services or by applying on-line, or may choose to take up PPI on being offered it by MBNA at any time.
12. The CC seems to regard stages (a) to (c) all as 'point of sale' (see paragraphs 106 to 113). There is time between each of the stages identified above for the customer to research so-called "stand-alone" PPI products and other insurance products. Only stage (a) can properly be regarded as the point of sale. [x<] % of MBNA's customers in 2006 activated their credit cards more than [x<] days after the account was opened.
13. Whilst there is an obvious benefit to consumers in being able to purchase PPI at the same time as the underlying credit product if they so choose, the CC should be careful not to overstate the so-called "point of sale advantage" in relation to credit card PPI, as regards a customer's ability to compare and explore various options before deciding to take out PPI.

(b) Product market
14. MBNA considers that PPI is generally not regarded as a stand-alone product either by customers or by suppliers, and that PPI and an underlying credit product are closely related in terms of both their design and the customer's perception. Given this, MBNA considers the relevant market to be that for packages of underlying credit and PPI, eg credit cards with associated PPI ("credit card/PPI packages") or unsecured loans with associated PPI ("unsecured loan/PPI packages"). This is the case even if a customer may decide not to buy the PPI product, or to buy it later.
15. MBNA considers that providers of other types of insurance (income protection, personal accident insurance, critical illness, life assurance and so-called "stand-alone" PPI) also provide a competitive constraint, since a customer can choose to rely on any of these alternatives in place of PPI.
16. From the customer's perspective, MBNA believes that customers purchase PPI as an add-on to the credit product rather than as a self-standing product. More specifically PPI is only purchased if:
 - the customer also obtains (in the case of MBNA) a credit card which gives rise to an obligation to make regular payments to pay off the debt; and

⁵ Emerging thinking, paragraph 167.

⁶ Data provided to the OFT in response to its market study questionnaire; referred to during MBNA's hearing with the CC on 26 June 2007 and in MBNA's subsequent submission dated 3 October 2007.

- the customer wants the comfort of knowing that he will be able to meet those payments even where there are unexpected changes in his circumstances (to the extent that he feels that this ability is not already safeguarded through some other form of insurance, such as income protection or critical illness cover).
17. A customer will therefore tend to consider whether he wishes to obtain PPI when he is thinking about obtaining the primary product, eg a credit card (and sometimes only after the primary product has been purchased).
18. In terms of supply, the option of taking out PPI is an integral part of MBNA's credit offer, which contains a number of components or elements which customers use in different proportions. Some customers use their credit cards to obtain cash advances, while others use them only for purchases. Some customers pay off their outstanding balances at the end of each month, while others make use of the extended credit functionality of the card. Some customers avail of low interest on balance transfers, while others maintain an outstanding balance even after that period. And some customers decide to protect their monthly repayments by taking out PPI while others do not. All parts of MBNA's business are involved in the provision of the package, including product design and sourcing; business development; marketing; sales; fulfilment; portfolio risk management; claims and administration; and the control environment. PPI is fully integrated across MBNA's business. Indeed, as PPI is considered an integral part of its offerings, MBNA does not currently assess the performance of its PPI business on a stand-alone basis (in the same way that it does not assess the performance of its cash advance business, say, on a stand-alone basis). Instead, the financial performance of PPI is contained within each of the products with which it is associated. For example, PPI associated with credit cards in the UK is included under the UK credit cards product heading.⁷
19. Given these features of the demand and supply of PPI, MBNA considers that the relevant market is therefore likely to comprise competing credit products which include optional PPI components.
20. MBNA also considers that it is necessary to identify all the competitive constraints that may bear on the provision of such packages. MBNA recognises that there is a complex web of competitive constraints. Nevertheless, the key here is to understand the likely effects of the different competitive constraints.
21. In MBNA's view, many consumers are able and willing to substitute between different forms of primary credit. A consumer wanting to obtain credit has a wide range of choices including, amongst others:
- arranging an overdraft facility on his or her current account;
 - taking out a credit card;
 - obtaining an unsecured loan;
 - obtaining a secured loan; or
 - taking out or extending a mortgage.
22. Consumers face a considerable choice of providers of credit card/PPI packages in the UK; and these providers offer a diverse array of products. In MBNA's experience, consumers are willing to change credit providers. Indeed, this is an innovative sector,

⁷ Although notionally some elements of cost categories could be seen as related to the provision of PPI activities, these are not generally allocated to a PPI header but to the credit products only.

which has seen new entry over the years, MBNA being a good example of a later entrant, which gained market share by offering a different product.

23. Once a credit line has been opened, where the consumer then wants to protect repayments related to the primary credit, the options include, amongst others:
- taking out a PPI product associated with the underlying credit product;
 - taking out a "standalone" PPI product from a third party provider (although there are providers of so-called "standalone" PPI products, MBNA considers that these should properly be regarded as income protection products since they are not tied to the underlying credit product and any claim is paid to the customer rather than to the credit provider);
 - taking out an income protection product;
 - taking out some other form of insurance (eg critical illness or life cover); or
 - relying on existing insurance (for example the consumer may already have income protection/critical illness/life insurance and may decide that this cover is sufficient to protect against the additional risk posed by taking the new credit product).
24. Overall, this means that the package of credit product and PPI needs to be priced so as to be competitive with other providers of credit and PPI packages. In addition, the PPI element needs to be designed and priced so that it is an attractive option for consumers, considering not only competing packages but also alternative options for protecting the ability to make repayments. Consumers are not 'captive' to the brand-specific PPI in the way that, for example, customers of Hugin cash registers need Hugin spare parts (see Case 22/78 *Hugin v Commission* [1979] ECR 1869), customers of Volvo cars need Volvo spare parts (see Case 238/87 *Volvo v Veng* [1988] ECR 6211), or customers of Hilti nail guns need Hilti nails (Case C-53/92P *Hilti AG v Commission* [1994] ECR I-667); the PPI provider does not wield significant power in the secondary market. First, it is not *necessary* to take out PPI at all (in the way that nails are needed for a nail gun or paper is needed for a photocopier). Second, the PPI can be cancelled or the customer can choose to switch to a different credit product with associated PPI. These two options are particularly easy in the case of credit cards and credit card PPI, far easier, for example, than buying a new car or a new photocopying machine.
25. MBNA therefore considers that a finding of brand-specific markets would completely ignore the competitive constraints that it faces.

(c) New evidence

26. The CC states that the evidence that may change its current thinking and lead to a wider market definition to include the underlying credit product would include:
- evidence that increases in PPI price in the past have resulted in diminished sales of credit; and
 - evidence that customers are responding to higher PPI prices by cancelling both credit and PPI and switching to another combination of credit and PPI.⁸
27. MBNA is currently considering what further evidence it may be able to provide to assist the CC in relation to market definition.

⁸ Emerging thinking, paragraph 162.

28. The CC states that the evidence that may change its current thinking and lead to a wider market definition to include multiple brands of PPI may include:
- evidence that customers search between different PPI policies and will purchase PPI and credit separately in response to high PPI prices;
 - evidence of customers switching between different PPI policies after the point of sale, without switching their underlying credit product.⁹
29. Even if one were to contemplate that PPI is in a separate market to the underlying credit product and that the evidence identified in paragraph 176 might therefore be relevant, MBNA would point out that it has already provided the CC with the [X] (see response to Question 37 of the Market & Financial Questionnaire). This showed that [X]% of those taking out PPI with a personal loan had conducted research beforehand and [X]% of those who decided not to take out PPI had conducted research beforehand. Moreover, the [X] notes that when asked about the provider of their PPI policy, [X]% of holders said they had not taken out the policy with the same company as the provider of the loan. This suggests that a considerable proportion of consumers do carry out research before taking out a PPI policy – and that people do take out policies with providers other than the provider of the underlying loan.
30. MBNA has also provided the CC with information on existing credit card customers who ring up and ask for information about PPI. Over the six months prior to October 2007, MBNA sent out [X] PPI information packs following such calls.¹⁰ This again demonstrates that consumers are searching for information about PPI.
31. The rate of cancellation of PPI (without switching their underlying credit card) amongst MBNA's credit card PPI customers is [X]% per month.¹¹ This [X] level of cancellation indicates that PPI customers actively research and manage their PPI products and are open to cancelling their PPI and perhaps switching to other insurance products or indeed switching to a competing credit card/PPI package.

(d) Geographic market

32. MBNA concurs with the CC's preliminary view that the market is likely to be national.

THE EXTENT OF COMPETITION BETWEEN SUPPLIERS

The CC goes on to set out the issues it may consider in assessing the extent of competition between suppliers once it has reached a view on the relevant market.¹² These include: the extent to which distributors offer a choice of PPI package; whether different PPI markets have differing degrees of competitive intensity; customers' search patterns and the cost of searching; switching costs; levels of commission earned; price comparisons between credit/PPI providers and providers of stand-alone PPI; and the profitability of supplying PPI. MBNA provides initial views on some of these below.

(a) Customers' search patterns

33. The CC refers to research carried out by the OFT (paragraph 154) and to research carried out by BMRB (paragraphs 109 and 159), relying on this to indicate that the prevalence of customer searching between bundles of credit and PPI is low. The CC makes no reference to the [X] provided by MBNA which showed that [X]% of personal

⁹ Emerging thinking, paragraph 176.

¹⁰ MBNA submission to the CC dated 3 October 2007.

¹¹ This figure is derived from a sample of MBNA's customers.

¹² Emerging thinking, paragraphs 28 and 186 to 197.

loan PPI holders had researched PPI before purchase (and that [x<] % of those who decided not to take PPI had also conducted research).

34. MBNA considers that searching is becoming ever easier, with the increasing use of the internet and the development of comparison sites. In the case of credit card PPI, customers are able to use websites such as www.moneysupermarket.com and www.confused.com to compare packages offered by providers (a number of other websites - for example www.uswitch.com and www.easyquote.co.uk - also present PPI information focused on PPI associated with other credit products such as loans or mortgages.) One recent development has been the FSA's proposed comparison website for PPI products, which is expected to allow consumers to compare details of different providers' PPI policies including: provider, product name, available from, cover period, first payment, monthly cost per £100 of cover, monthly cost per £100 of benefit, percentage of balance covered, backache excluded, stress excluded, other exclusions, details of cover for pre-existing conditions, additional benefits available (such as life cover, critical illness cover etc), and restricted availability.¹³

(b) Switching costs

35. It is particularly easy for consumers to switch from one credit card/PPI package to another or to cancel credit card PPI and rely on some other form of insurance. Many people hold more than one credit card¹⁴ and so can easily adjust the level of spending from card to card depending on particular terms and conditions (including for PPI) available at the time. They can also apply for a new credit card with accompanying PPI if they choose, without necessarily cancelling their existing credit card/PPI package. Cancelling PPI cover is easy, simply involving a call to the provider. Since credit card PPI premium is paid monthly, calculated on the outstanding balance each month, cancelling PPI cover simply means that no future payments need to be made. It is not necessary for the provider to reimburse previous payments made (as is the case for example where PPI premium is paid up front in a lump sum). Indeed, as noted in paragraph 31 above, the rate of cancellation for MBNA's credit card PPI customers is [x<].

(c) Levels of commission

36. The CC refers to "typical commission rates" of 50 to 80% on personal loan and credit card PPI and around 40 to 65% on mortgage PPI.¹⁵ The CC refers to the fact that the OFT found evidence that these levels were higher than for other types of general insurance, although it does acknowledge that the parties have argued that this is not a fair comparison as the markets are very different.¹⁶
37. It is important for the CC to understand that (as least as far as MBNA is concerned) the relationship with the underwriter differs very substantially from a standard broking arrangement. In a standard broking arrangement, the distributor's role is essentially confined to referring customers to an insurer in return for the payment of a commission. The insurer then "owns" the customer relationship. The situation here is very different. MBNA "owns" the customer relationship and drives the creation of the PPI product in terms of both product design and pricing. MBNA asks underwriters to tender to provide the input into the product that MBNA is unable to provide itself. In essence, MBNA outsources the underwriting and claims handling part of the provision of PPI to an underwriter and carries out the rest of the provision of the product itself.

¹³ FSA consultation document, "Payment protection insurance and unsecured personal loan comparative tables" (July 2007).

¹⁴ The average number of credit or charge cards in the UK is 2.4 cards per card holder (Source: APACS).

¹⁵ Emerging thinking, paragraph 190.

¹⁶ Emerging thinking, paragraph 190.

38. MBNA considers that it is particularly important that the PPI product is designed in such a way that it matches the underlying credit product, and that necessary changes to the PPI product that might arise from changes in the underlying credit product can be made quickly and efficiently. In MBNA's experience, close co-operation between insurer and distributor on product design and decisions on terms and conditions facilitates this level of product design.
39. MBNA's underwriter holds no information about individual customers until a claim is made (at which point MBNA provides customer specific information to enable the underwriter to handle the claim). This clearly differs from a scenario where an underwriter manages the customer relationship, relying on distributors only for the primary distribution of the product. This model also contrasts with other banks that have an integrated underwriting and distribution business.
40. The premium income received from customers is shared between MBNA and the underwriter. Whilst MBNA's share may be referred to as "commission", it would be totally inappropriate to regard this as "commission" in the ordinary sense, or to compare PPI "commission rates" to commission MBNA receives, for example, on the sale of travel, motor or home insurance products. MBNA has previously provided details of the financial arrangements with both its current and previous PPI insurers. These are included in Appendix Q16i of the response to the Market & Financial Questionnaire dated 1 June 2007.
41. It should be noted that MBNA's input into the PPI products it supplies is not fully reflected in the CC's "Value Chain" paper published with its emerging thinking. A further copy of MBNA's submission on this issue is included as Appendix 2.

(d) Assessing profitability

42. MBNA recognises that the emerging thinking is just that -- the CC has not at this stage reached any firm conclusions. MBNA requests that the CC shares its proposed methodology for undertaking any analysis of distributor profitability so that interested parties can make comments before any such analysis is undertaken.

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APPENDIX 1

DETAILED COMMENTS ON THE COMPETITION COMMISSION'S EMERGING THINKING

Para 25 – The CC states that it has looked to see if different brands of PPI constrain each other. It is unclear whether by "brand", the CC is referring to a particular distributor – or to actual brands. MBNA, for example, provides PPI associated with a variety of brands (MBNA itself, Virgin, Alliance & Leicester, etc).

Para 39 – The CC refers to the benefit payable as a percentage of the outstanding balance on the credit card at the time of the claim or the monthly statement issued prior to the claim (and says that the percentage varies between providers from 3 to 10%). This does not take account of other features of the cover provided. For example, MBNA pays the monthly benefit until the customer returns to work or until the full balance at date of claim has been paid. Many other providers have a limit of 12 monthly benefits for this element of cover. Some providers also exclude cover for back pain, stress and the self-employed. MBNA provides cover, provided there is appropriate evidence to support the claim. Please see further MBNA's response to Question 29 of the Market & Financial Questionnaire.

Para 44 – The CC points out that market GWP numbers provided to them are significantly lower than previous OFT/Mintel numbers. Without detailed information on the methodology adopted by Mintel, it is difficult for MBNA to proffer views on the possible reasons for such differences. However, in the case of the figures presented to the CC by parties, MBNA understood the required GWP figures to be net of refunds and of insurance premium tax. One or both of these adjustments could possibly prove to be the source of the differences.

Para 47 (and 106) – The CC states that PPI is typically¹⁷ purchased at the same time as the credit product and that in the case of credit card PPI this is either at the time at which the credit card is sold or when it is activated. Some cardholders activate their cards a very considerable time after applying for the card -- in 2006, for example, around [3<]% of MBNA's new customers activated their cards more than [3<] days after the account has been opened. These customers will have had plenty of opportunity to look around for different forms of insurance before choosing to take PPI with the credit card provider (if indeed they do). Insurance cover can be purchased at any time during the period that the cardholder holds the card.

Para 48 (and 112) – The CC states that it has not come across any instances where purchase of PPI is actually a condition of credit being given, but that evidence from the CC's qualitative survey showed that some customers were under the impression that purchasing PPI was a condition of obtaining the credit. It is clear that credit cardholders who choose to purchase PPI at any point after applying for the card cannot believe that their credit application will be affected by their decision to purchase PPI (note that, in 2007 year to date, [3<]% of MBNA credit card PPI policies were purchased at a later stage).

Para 76 – The CC states it has only come across one provider (Paymentcare) offering a stand-alone credit card PPI policy and that sales have been very small. It also mentions that Barclays is in the process of introducing a credit card PPI policy that can be used to cover other credit cards. Given the particular characteristics of credit card PPI, especially the need to track the outstanding balance, it is not surprising that there are so few providers of "stand-alone" credit card PPI. Indeed, as MBNA has previously explained to the CC, providers of so-called stand-alone PPI products are in fact likely to be providing an income protection product (ie a product under which claims are paid to the customer rather than to the credit card provider, as is the case with PPI). However, there are other options open to credit cardholders: they could take out an income protection product for an amount based on an average monthly outstanding balance, or

¹⁷ Note that the CC also refers to OFT research which suggests that around 80% of PPI policies are taken out at the same time as credit – ie 20% are not – see paragraph 90.

rely on other insurance products they already have, or switch to another credit card/PPI package from a host of competing providers.

Para 80 – MBNA certainly has very considerable input into its PPI policies. Please see further the response to Question 15 of the Market & Financial Questionnaire.

Para 87 – The CC refers here to a study by Which? MBNA does not have a copy of this and has been unable to identify it amongst the various papers published in relation to the CC's investigation. MBNA would therefore be grateful if the CC would provide a copy.

Para 88 – MBNA provides consumers with a considerable amount of information prior to point of sale of the credit product. Please see further responses to Questions 67 and 68 of the Market & Financial Questionnaire.

Para 89 – The CC refers to the various channels through which PPI can be sold (face-to-face, telephone, the internet and by post). MBNA differs from many other providers of credit products in that it does not have a High Street presence, nor does it have established relationships with consumers, eg through the provision of current accounts. MBNA has traditionally focussed heavily on issuing affinity cards – and now has over [3<] partnerships in the UK.

Para 96 – The CC refers to an example given by Which? that a customer may end up paying interest on the premium even though the customer is no longer covered because the PPI policy covers a shorter period of time than the total loan period. This is not the case for MBNA. MBNA personal loan PPI was always provided for the same period as the underlying loan. [3<].

Paras 100 to 104 – There appears to be confusion in these paragraphs between the price for PPI (which for credit card PPI is often expressed as a price per £100 of outstanding balance) and benefits provided -- see in particular paragraph 104.

Para 105 – The CC asks for evidence to explain "large price variations between what appear to be often very similar PPI policies". MBNA has previously provided evidence of the differences between competing policies which may explain the price variations that the CC has found. See further the response to Question 29 of the Market & Financial Questionnaire.

Para 108 – The CC notes conflicting evidence on whether or not customers shop around for PPI. MBNA considers that customers do shop around for PPI and undertake research covering both PPI and the underlying credit product. Customers can review a variety of price comparison sites which give information on the products offered by credit and PPI providers. In the case of credit card PPI, customers are able to use websites such as www.moneysupermarket.com and www.confused.com, to compare packages offered by providers (a number of other websites - for example www.uswitch.com and www.easyquote.co.uk - also present PPI information focused on PPI associated with other credit products such as loans or mortgages.)

Para 110 – MBNA provides consumers with a considerable amount of information prior to point of sale of the credit product. Please see further the responses to Questions 67 and 68 of the Market & Financial Questionnaire.

Para 165 – MBNA does indeed check to see what its competitors are doing. It focuses mainly on competing providers of credit card/PPI packages and looks at what they are offering on both elements of the package. MBNA also checks what providers of so-called "stand-alone" PPI are offering.

Para 171 - The CC refers to low sales rates of PPI by providers who do not offer credit card products and says that one of the reasons suggested for this difficulty is lack of knowledge of ability to switch (as well as the cost of doing so). However, FSA regulations require that

customers are made aware of their cancellation rights. Credit card PPI cardholders can cancel PPI at any time simply by making a telephone call -- premiums then cease.

Para 192 - The CC suggests that an alternative to calculating the cost of supplying PPI is to compare the selling price of PPI offered at point of sale with the selling price of stand-alone PPI. The CC states that there is evidence that the prices of PPI policies sold alongside credit card products are significantly higher than those sold on a stand-alone basis. A generalised comparison of this nature takes no account of the particular business models and cost structures of different providers of credit card/PPI products.

Para 197 - The CC states that firms tend to manage and analyse the financial performance of PPI underwriting and distribution separately even when vertically integrated. MBNA would reiterate that all aspects of its business are involved in the provision of the credit card/PPI package. [3<].

Working paper: PPI and Regulation

The CC working paper outlines the regulatory framework and rules that affect the provision of PPI. In particular, it highlights the role of the Financial Services Authority ("FSA") and the OFT. It notes that the regime requires annual percentage rates ("APR") to be used as the main comparator by firms and that the cost of taking out PPI has to be included in the APR calculation where it is provided as a condition to the provision of credit. It also notes the fact that PPI does not affect the amount of state benefits payable to policyholders.

US regulations:

In addition to being regulated by the FSA and the OFT, MBNA is also regulated by the US Office of the Comptroller of Currency ("OCC"). [3<]. This in turn will have implications for MBNA's design of its PPI products.

Disclosure rules:

Whilst the CC notes that in cases where PPI is provided as a condition to granting credit its price must be included within the APR calculation, it does not make reference to the disclosure rule (rule 5.5.14) set out by the FSA within its Insurance Code of Business ("ICOB"), which requires that providers must disclose the price of insurance components irrespective of whether or not it is a condition to providing credit. ICOB Rule 5.5.14 is set out below (emphasis in bold added):

"A statement of price must include the following information:

- (1) the total amount of the premium for the non-investment insurance contract or, if the premium cannot be indicated, the basis for the calculation of the premium enabling the retail customer to verify it;
- (2) for non-investment insurance contracts of more than one year, details of the period for which the premium is valid, whether it will be reviewed at a certain time or at set periods and, if so, when it will be reviewed;
- (3) fees, administrative charges and taxes payable by the retail customer via the insurance intermediary in addition to the premium. Fees and administrative charges include any interest payable on the premium, including where the premium is paid by way of a credit agreement taken out either for payment of the premium only or for the purpose of purchasing goods or services as well;
- (4) a statement identifying separately the possibility of any taxes not payable via the insurance intermediary;

(5) where the non-investment insurance contract is purchased in connection with other goods or services:

(a) the premium for the non-investment insurance contract, separately from all other prices in relation to the other goods or services, if an additional price is charged; and

(b) whether purchase of the non-investment insurance contract is a requirement of purchasing the other goods or services or not; and

(6) the total price to be paid by the retail customer for the non-investment insurance contract."

Given this rule, MBNA does not consider that a package price may be presented to customers and thus evidence cannot be presented to the CC in relation to "...the extent to which [a PPI policy] ... has been priced as part of a combined competitive offer with the underlying credit product" (paragraph 150 of the Emerging Thinking), nor could the CC expect to "see evidence that firms set a bundled price" (paragraph 6 of Market Definition Working paper, evidence Appendix A).

Working paper: Downstream market definition (including Appendices A and B)

The CC working paper discusses its approach to market definition, the complementary nature of the products, substitution between and within brands and alternative insurance products. It considers PPI to be in a separate underlying market to its credit products as the CC finds little evidence that PPI prices affect credit sales. It also considers that alternative PPI products do not constrain PPI. In its two appendices to the working paper, the CC sets out evidence as provided by parties and an assessment of sales data of the providers in the market.

MBNA's views on market definition are set out above.

In relation to alternative products such as income protection and critical illness, MBNA considers that these bear many similarities to PPI and act as substitutes for it. These similarities are set out in Table 1 below, comparing PPI features with those of income insurance, critical illness, life cover and personal accident products.

Table 1:

PPI	Income insurance
Provides cover for a specific debt, e.g., monthly credit card or loan repayment	Provides cover for monthly income rather than specific debt or repayment
Amount of cover tailored to suit the primary credit product	Customer chooses a monthly amount to cover loss of income
Premiums charged on credit card or loan account	Premiums usually paid by direct debit
Claim payments made directly to credit card or loan account	Claim payments made directly to the customer
No impact on other benefits received by customer	Impacts other benefits received by customer
Life cover usually included as standard	Life cover not usually part of standard package. Some will extend to include but charge an additional premium
PPI is paid out regardless of any other protection policies or income benefit.	Income insurance may take into account other protection policies or income benefit.

PPI	Critical Illness
Monthly payment made as a percentage of the balance at time of claim (credit card) or monthly payment made (loan)	Provides for a fixed lump sum
All illnesses are covered except pre-existing and chronic conditions	Only certain illnesses are covered e.g. Alzheimer's Disease, Multiple Sclerosis
Premiums charged on credit card or loan account	Premiums usually paid by direct debit
Claim payments made directly to credit card or loan account	Claim payments made directly to the customer

PPI	Life cover
Provides cover for the outstanding balance at time of claim i.e. credit card or loan	Provides for a fixed lump sum
Premiums charged on credit card or loan account	Premiums usually paid by direct debit
Claim payments made directly to credit card or loan account	Claim payments made directly to the customer/estate
Fixed premium for smokers and non-smokers	Smokers generally pay higher premiums
Not individually underwritten	Usually individually underwritten (questionnaire and/or medical)

PPI	Personal Accident
Monthly payment made as a percentage of the balance at time of claim (credit card) or monthly payment made (loan)	Provides for a fixed lump sum
Premiums charged on credit card or loan account	Premiums usually paid by direct debit
Claim payments made directly to credit card or loan account	Claim payments made directly to the customer
Covers where off work due to an accident or sickness (monthly payment)	Covers permanent total disablement, loss of limbs and eyes (lump sum)
Life cover included	Accidental death included

In the working paper, the CC also notes that PPI prices vary less frequently than those of their associated credit products, and that this supports the view that price competition between PPI providers is limited (see paragraphs 58 and 59 of working paper). MBNA considers the provision of PPI and underlying credit to form a systems market, and it does not consider that differences in the relative frequency with which the prices of different components of the package change support any conclusion to the contrary. For example, the price elements linked directly to borrowing costs may vary more frequently simply because funding costs change more often.

In relation to the assessment of party sales data (see appendix to working paper), MBNA considers the trends presented by the CC to be [REDACTED].

The CC should also note that, [REDACTED].

Working paper: Features of PPI for different credit products

In this working paper, the CC sets out the main features of PPI for different credit products (including mortgages, loans and credit cards). The paper sets out what is covered, how it is paid for, exclusions and waiting periods and refunds.

MBNA has no comments on this paper, except to note that differences in the details of cover (as set out in the working paper on PPI characteristics) amongst different underlying credit products reinforce MBNA’s view that PPI associated with credit cards differs significantly from PPI associated with other types of credit products.

Working paper: PPI and its alternatives

In this working paper, the CC describes the main characteristics of PPI and alternative products.

MBNA considers these alternatives to bear many similarities to PPI (see response above on the working paper on market definition).

Working paper: Qualitative research into consumer experience

The CC commissioned BMRB Social Research Limited to determine the behaviour and attitudes of different consumer groups within the market. The findings were that participants were generally made aware of PPI, although understanding was limited to knowledge of the circumstances covered rather than specific terms and conditions. In addition, a range of factors was found to influence purchase of PPI including factors related to the sales process and personal factors.

MBNA considers qualitative assessment in general, and group discussions in particular, could be useful tools when attempting to assess consumers' knowledge and behaviour when there are limited sources of information or hypotheses, or where it is difficult to categorise behaviour. However, most of the statements made by BMRB relate to areas previously discussed (eg that consumers do not know much about exclusions) and that simple hypothesis could have been tested through more appropriate quantitative assessment. In addition, a number of the findings are not supported by quotes for respondents, so it is difficult to determine whether the findings are indeed well-founded. Most importantly though, BMRB infers that its 'findings' may be considered representative of the broader population. However, MBNA considers this is unlikely to be the case for credit cards customers at least, as only 17 credit card consumers were questioned through the discussions and this is not likely to capture the diversity across all credit card customers.

Working paper: PPI Policy Characteristics (including Appendix A)

The CC sets out in this paper the typical characteristics of PPI policies including what the policies cover, waiting periods and price.

The working paper notes in general terms the characteristics of PPI policies. MBNA has certain specific terms associated with its own products that differ from those of more "typical" PPI policies described by the CC. For example:

- MBNA provides cover to the age of 70 - although cover is more tailored between 65 and 70 with difference to life and hospitalisation cover for this population (see CC paragraphs 4 & 5);
- In relation to living and working abroad, MBNA does not automatically exclude this from its policies. Cover is provided if a customer is paying National Insurance Contributions (Class 1 or 2), even if they are living and/or working abroad (see CC paragraph 5);
- The MBNA PPI product pays 5% up to 20 months for Accident, Sickness and Disability (see paragraph 6);
- MBNA's products do provide cover for the self-employed; claims are considered provided that the customer provides evidence that he/she is without work owing to the business totally and permanently ceasing to trade as a direct result of being unable to pay its debts when they fell due and have declared this to the Inland Revenue (see CC paragraph 7);
- MBNA products include cover for back conditions (claims are considered subject to radiological evidence being presented) and cover for stress (claims are considered provided the customer is receiving treatment from a consultant psychiatrist) (see CC paragraph 8);
- MBNA's loans PPI product does not have a 12 month restriction on Accident, Sickness and Disability, but continues to pay until the balance is paid or customer goes back to work (whichever is the sooner) (see CC paragraph 9);

- MBNA's credit card PPI product pays more than the minimum card repayment each month – where a typical card repayment is 2.25% to 3% subject to a minimum repayment of £25. The MBNA monthly PPI benefit level is 5% or £30, whichever is the greater - for up to 20 months or until such time as the claimable event has passed (whichever is the sooner). MBNA also pays the benefit on a "constant rate", ie a percentage based on the balance at the date of claim, rather than a percentage of a decreasing balance (see CC paragraph 10);
- MBNA has a 30 day waiting period, albeit with the claim then backdated to day 1 (for both credit card and loan PPI). Given this, there is no exclusion period in the case of MBNA's products (except in the case of unemployment claims where a 60 day period is considered from the time the customer first takes out the policy). With regard to the time taken to make a payment, as long as the underwriter has received the claim form and the evidence required, payment is made directly to the customer's credit card or loan account within 3 working days (a term written into the St Andrew's service level agreement) (see CC paragraph 11); and
- MBNA's payment type is the third option presented by the CC (see Table 3), which is "30 day retrospective - benefits accrue monthly".

Finally, as noted in previous submissions to the CC [3<].

Working paper: The Value Chain

In this paper, the CC describes the value chain for PPI and the principal activities undertaken by underwriters and credit providers. The Commission has also identified what it considers to be common business models in providing PPI products to customers.

MBNA provided comments to the CC in response to an earlier draft of this paper (MBNA letter of 21 September 2007). For ease of reference a copy of this letter is enclosed at Appendix 2.

APPENDIX 2

MBNA COMMENTS ON THE VALUE CHAIN

Mr L Gardiner
Inquiry Secretary
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Your Ref: The Value Chain Paper (1)
19 September 2007

Dear Mr Gardiner

Payment Protection Insurance Market Investigation – The Value Chain Paper

Further to the email of Helcia Knap dated 13 September 2007, requesting comments on the draft Competition Commission paper on the PPI value chain, I set out some general and specific comments below on behalf of MBNA Europe Bank Limited.

General comments

Relationship between MBNA and St. Andrew's Group

The Competition Commission has identified what it considers to be the main types of participants in the market - underwriters, credit providers/lenders and intermediaries – and the typical activities undertaken by these. The Commission has also identified what it considers to be common business models in providing PPI products to customers.

MBNA's principal comment in relation to the draft paper is that the description of the activities undertaken by each of the participants, and of the various business models that might be used, does not reflect or capture the way in which MBNA operates in the market place. The description of activities undertaken by underwriters and lenders, and therefore of the business models, suggests that lenders distribute PPI on behalf of underwriters, whereas in MBNA's experience (and – based on the description of the tendering process – presumably the experience of at least some other market participants), it would be more appropriate to regard the provision of PPI as an activity that is largely driven by the lender. MBNA relies on outsourced underwriting and claims handling services rather than acting as a distributor of PPI products on behalf of an independent underwriter. These points, along with underlying rationale, have been made previously in response to the Commission's market and financial questionnaire (submitted on 1 June 2007) and during MBNA's hearing with the Commission (on 26 June 2007). Nonetheless, for ease of reference, we reiterate these points here.

MBNA does not underwrite the PPI products associated with its credit card (or unsecured personal loans products). However, its relationship with its insurer, St Andrew's, differs from standard insurance broking arrangements in that MBNA carries out or is involved in a number of functions which would normally be associated with or carried out by the insurer. For

example, MBNA has a significant input into product design and pricing. MBNA considers that it is particularly important that the PPI product is designed in such a way that it matches the underlying credit product, and that necessary changes to the PPI product that might arise from changes in the underlying credit product can be made quickly and efficiently. In MBNA's experience, close co-operation between insurer and distributor on product design and decisions on terms and conditions facilitates this level of product design.

Likewise, MBNA owns the customer relationship to the extent that St Andrew's holds no information about individual customers until a claim is made (at which point MBNA provides customer specific information to enable St Andrew's to handle the claim). This clearly differs from a scenario where an underwriter manages the customer relationship, relying on distributors only for the primary distribution of the product. This model also contrasts with other banks that have an integrated underwriting and distribution business.

A more detailed summary of the main tasks undertaken by MBNA and its insurer, St Andrew's, was submitted in response to question 15 of the Commission's market and financial questionnaire. An extract from this response is attached here at Annex I. This summary shows the extent to which MBNA performs activities that the Commission appears to consider as being undertaken by underwriters.

Standalone PPI

As a further general comment, and as noted in the response to the Commission's market and financial questionnaire, MBNA considers that references to standalone PPI products are not appropriate, as these products should properly be regarded as income insurance products. In MBNA's view, the characteristic feature of PPI is that it provides for a direct payment to the lender (i.e. a payment into a customer's MBNA credit card account) rather than to the customer (e.g. a payment into the customer's current account). PPI is therefore tied very closely to the underlying credit product, and, in the case of credit card PPI, it tracks the monthly balance. It cannot exist without an underlying credit product, whereas a stand-alone income protection product can.

Although income insurance may cover multiple repayments, or provide a certain monthly income independently of, and potentially on top of, any repayment obligations for outstanding credit, a customer may take out an income insurance policy for an amount that exactly corresponds to a particular repayment (e.g. a customer having taken out a loan that requires repayment of £200/month over a period of five years may take out a policy that pays £200/month). Such a policy would pay benefits directly to the customer, allowing him then to make loan repayments or pay off a credit card balance (which provides the customer with additional flexibility, though at the same time means insurance payments are taken into consideration when assessing the customer's entitlement to receive certain State benefits). However, regardless of the amount covered, such products should properly be regarded as income insurance rather than stand-alone PPI.

Specific Comments

Underwriters – Paragraph 3

The final sentence refers to exclusions being used in order to “restrict the circumstances under which a claim would be paid and thus reduce the level of the risk underwritten”. This may (wrongly) create the negative impression that the sole purpose of exclusions is to limit the amount that an underwriter would have to pay out, but does not reflect the fact that exclusions (together with other elements of the product design) address problems of adverse selection (e.g. by excluding payment for pre-existing conditions) or moral hazard (e.g. by excluding payment if the insured has accepted voluntary unemployment).

Underwriters - Paragraph 5, Paragraph 6 and mirrored in Lenders – Paragraph 10

As noted above, whilst this may represent the typical underwriter model, it does not reflect the MBNA model and MBNA's relationship with St Andrew's. It should be made clear that certain lenders take on additional responsibilities, which an underwriter might 'typically' own or carry out themselves. MBNA provides the PPI product, outsourcing some of the activities required. MBNA has significant involvement in product design; it collects the premium (which footnote 4 acknowledges to be a possibility, but which in MBNA's understanding is the rule rather than the exception, certainly for credit card PPI and unsecured loan PPI); MBNA handles the customer relationship; it keeps the customer records. Paragraph 6 suggests that underwriters choose distributors for their PPI services, though the reality is that, in the "independent underwriter model", lenders obtain underwriting services from an underwriter as shown by the tendering process (as set out in paragraph 22 f.).

Lenders - Paragraph 7

MBNA does not consider PPI to be provided “alongside” other products – a description which would better fit MBNA's provision of motor insurance – but rather it provides PPI as a package with an underlying credit product.

As noted above, ‘standalone PPI’ policies referred to are in reality ‘Income Insurance’ products which operate in a different way to traditional PPI products attached to the underlying credit product.

Lenders - Paragraph 10

As noted above, MBNA carries out far more than "branding, marketing and selling PPI products".

Intermediaries - Paragraph 13

As noted above, ‘standalone PPI’ policies referred to are in reality ‘Income Insurance’ products which operate in a different way to traditional PPI products attached to the underlying credit product.

Business models – Paragraph 14

As noted above, MBNA's business model of outsourcing underwriting activities is not presented here. Perhaps this should be introduced as a fourth option, or at least as one of two possible variations of the independent underwriter model (which may be differentiated according to whether underwriters obtain distribution services from lenders, or lenders obtain underwriting services from underwriters).

The vertically integrated model – Paragraph 15

In the first sentence, 'risks of the lender' should be replaced by 'risks of the credit customer'.

Tenders and contracts – Paragraph 22 f.

The description of the tender process suggests strongly that in most, if not all cases, the lender is the driving force behind the provision of PPI, i.e. that the lender chooses an underwriter rather than the underwriter choosing a distributor. This corresponds to MBNA's experience of the lender performing a much wider range of functions than is suggested by the independent underwriter model set out in the draft. MBNA is not aware of any instance where an underwriter has tendered for a distributor of PPI services, which strongly suggests that (a) the nature and design of PPI cover is closely tied to the underlying credit product and (b) the lender is much more than a mere distributor of insurance products created by the underwriter.

I trust these comments are helpful. Should you require any further information or clarification, please do not hesitate to contact me on [X].

Yours sincerely

[X]
[X]

Annex I: Extract from MBNA's Response to Question 15 of the Competition Commission market and financial questionnaire

Question 15: Please indicate the significant functions carried out by your PPI distribution business and its underwriters in relation to the provision of PPI, by completing Tables 2.1 and 2.2 below:

The significant functions carried out by MBNA's business are set out in Table 2.1 below. Table 2.2 below sets out the significant functions carried out by MBNA's insurers, St Andrew's. From this it is apparent that MBNA undertakes more functions than a traditional agent or broker distributing an insurer's products (who would not normally be involved in product design, record keeping, complaints handling, claims handling, ongoing contract administration etc.). This is also discussed in response to Q11 above.

Table 2.1 Functions carried out by your PPI distribution business

	Personal loans	MPP I	Credit cards	Second MPPI	Retail credit	Motor finance	Overdrafts	Other (please state)
Sales	[3]							
Marketing								
Input into product design								
Premium collection								
Record keeping								
Complaints handling								
Policy preparation and issuance								
Scheme corporate governance								
On-going policy admin								
Claims handling								
Other (please state)								

Table 2.2 Functions carried out by the underwriter of the PPI

	Personal loans	MPPI	Credit cards	Second MPPI	Retail credit	Motor finance	Overdrafts	Other (please state)	
Sales									
Marketing									
Input into product design									
Premium collection									
Record keeping									
Complaints handling									
Policy preparation and issuance									[X]
Scheme corporate governance									
On-going policy admin									
Claims handling									
Other (please state)									