



## **PPI INQUIRY**

### **RESPONSE TO EMERGING THINKING (Non-Confidential Version)**

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**4<sup>th</sup> DECEMBER 2007**

[Note: certain figures and text have been excised from this version of the document since they contain commercially confidential information. These are marked with the ✂ symbol]

## NATIONWIDE BUILDING SOCIETY

### RESPONSE TO COMPETITION COMMISSION'S EMERGING THINKING IN THE PAYMENT PROTECTION INSURANCE INQUIRY

#### SUMMARY

- 1 To date the CC has treated the main types of PPI – MPPI, CCPPI, SMPPI and PLPPI in the same way. Nationwide believes that the markets for these products together with their associated credit products, however defined, operate sufficiently differently to justify treating them separately. This will avoid the danger of inappropriately using evidence and assumptions from one market and applying it in another.
- 2 In this response we have focused on the mortgage and MPPI market given Nationwide's knowledge and position in this market, but have concerns with both the CC's market definition and its analysis of competition in all markets.
- 3 Nationwide believes that the CC's MPPI market definition is too narrow and is not adequately supported by the evidence the CC has received - which clearly demonstrates that both consumers and providers treat MPPI as a component of a wider combined mortgage and MPPI market.
- 4 Furthermore the CC's emerging thinking on market definition is assuming that there are only two discrete conclusions that can be drawn – either there is perfect two-way complementarity (leading to the conclusion that PPI and the credit product are in the same market) or if not, there must only be one-way complementarity (leading to the conclusion that the PPI product and the credit product are in separate markets). Nationwide believes that this is too black-and-white, and instead the CC should take account of whether there is some degree of two-way complementarity.
- 5 Irrespective of the CC's conclusion on the market definition, Nationwide believes that this should not be an end in itself, and the CC cannot ignore the interactions between the mortgage and MPPI product areas and the effect of these interactions on competition.
- 6 Each of these points is addressed in more detail below.

#### DIFFERENCES BETWEEN MPPI, CCPPI, SMPPI AND PLPPI

- 7 The CC should be careful not to generalise about MPPI, PLPPI, SMPPI and CCPPI, applying evidence relating to one product and using this to make assumptions about the other products. Instead Nationwide believes that given the significant differences between these products that the CC must find sufficient evidence in each area to underpin its conclusions, and that in doing so, the CC may reach different conclusions for each main type of PPI.
- 8 For example Nationwide believes that the following characteristics of the mortgage and MPPI market demonstrate that these product areas are different from personal loans, secured loans, and credit cards and need to be considered separately:
  - A significant proportion, around half, of mortgages are sold by independent intermediaries. Nationwide believes that this creates considerable pricing pressure on the combined package both in respect of mortgage interest rates and PPI premiums. Intermediaries will consider the total cost of all elements of the mortgage/MPPI package in relation to the affordability for the customer and in doing so create competitive pressure for suppliers;

- There has been considerable innovation in the provision of MPPI with the growth of PaymentShield, Select & Protect, D&D Homecare amongst others, whom many independent intermediaries use to provide MPPI rather than the mortgage provider. Indeed, the OFT's customer survey found that the majority (67%) of mortgage customers were aware that they could obtain MPPI from providers other than their mortgage provider;
  - A significantly greater proportion of customers in the OFT survey shopped around for MPPI than for CCPPI or PLPPI;
  - There is a larger proportion of mortgages sold face-to-face than for personal loans and credit cards. The consumer research highlighted how consumers who purchased PPI face-to-face were generally better informed since they had paid closer attention to the policy details. This was particularly true for MPPI sold through financial advisers (see paragraphs 36 and 40 of the qualitative research);
  - Mortgages are a very large financial commitment and the potential consequences to consumers from being unable to meet their monthly mortgage repayments are more severe than those associated with falling into arrears on a personal loan or credit card since they can potentially lose their home as a result. This is reflected in the comments from the qualitative customer research:  
  
*“For me it was the amount of the mortgage in that if the worst were to happen and I wasn't able to make a repayment through [un]employment, I could risk losing my home, so I weighed it up and that risk was uncomfortable...”*
  - Mortgages are longer term products than personal loans
- 9 The CC recognises that mortgages may be different from other credit products, for example in paragraph 51 of the market definition paper it mentions that search costs may be lower for MPPI, it may be easier to switch MPPI policies, and that mortgages typically involve a larger financial commitment than any other type of credit product creating greater incentives on consumers.
- 10 Personal loans also have different characteristics from other credit products. For example most PLPPI policies are paid in a single premium. This leads to other differences in terms of the lifetime cost to the consumer and the ease and incentives to cancel.
- 11 Credit cards are different from personal loans and mortgages in two further ways: firstly the balance on the account changes day-to-day and so a CCPPI provider needs to link to the credit card in order to provide the appropriate level of cover; secondly CCPPI is often not sold at the point of sale, but instead is sold subsequently for example at the point of activation of the card.
- 12 Second charge mortgages are a very different product area from first charge mortgages, and if anything closer to unsecured lending. Suppliers, customers, product characteristics, the product usage, credit risk, underwriting criteria and distribution channels are all very different between second charge and first charge mortgages. In the qualitative customer research the agency made the mistake of grouping mortgage PPI with secured loan PPI which reduces the reliability of their findings.

## MPPI: MARKET DEFINITION

### Consumer and Supplier Behaviour

- 13 At the core of market definition is evidence of how consumers and suppliers behave. Nationwide believes that the CC is starting with an artificially narrow hypothesis of market definition which does not take sufficient account of this evidence and then is inappropriately applying the SSNIP test to this market to prove its hypothesis. Instead, the CC should place greater emphasis on evidence of how consumers and suppliers behave - which shows that both groups believe that the two products are inseparable.
- 14 From the consumer's perspective the evidence is that MPPI is considered part of the same market as the mortgage:
- Consumers prefer to purchase MPPI at the same time as the associated mortgage since they regard these as closely linked products. Nationwide believes that for some consumers, there is a perception that if they purchase the MPPI from the mortgage provider there is more likelihood of them making a successful claim under such a policy than if they were to purchase the MPPI from a third party.
  - There is evidence that significant proportions of customers think about PPI before they purchase the credit product. These were categorised as “worriers”, “insurance addicts” and “recent change in circumstances” by the market research agency. These groups recognised the benefits provided by PPI, had considered the product in advance, and had shopped around for the provider, but had still decided to purchase both the PPI and the credit from the same provider. This indicates that informed customers consider that PPI and the credit product are in the same market.
  - The evidence that some other customers only think about PPI when they are purchasing the credit product may suggest that PPI is a facet or feature of the credit product.
  - Consumers see MPPI primarily as an “add-on” to the mortgage. For example some consumers in the CC's qualitative research considered that the MPPI was “tied” to the loan offered and that you couldn't shop around for it as a stand-alone product:  
*“It comes with what you buy, it comes with your mortgage or credit card”*  
*“I didn't think about shopping around [for PPI stand-alone]. I am not sure I thought you could...”*
  - Consumers in the qualitative research also had a perception that purchasing a PPI policy would ensure success of the loan application, even though the FSA has found that 92%<sup>1</sup> of the suppliers it visited in a recent mystery shopping exercise had made it clear that this was not the case. This issue was raised by the participants and was unprompted by the researchers.

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<sup>1</sup> Source: FSA, The sale of payment protection insurance, thematic update, September 2007

*“I thought I’ll get [the loan] if I say yes, and I did within three seconds, just like that. But I think if I’d said no, then I might have got that little thing that comes up and says you have to contact your bank”*

- 15 The CC’s emerging thinking is inconsistent on the point of whether PPI and the credit product are in the same market since it states that PPI is in a separate market even though it accepts that customers consider PPI may not be optional (see paragraph 112) and therefore effectively tied to the credit product. Nationwide believes that it cannot be the case that if customers believe the products are tied, that MPPI can be considered to be in a separate market from the mortgage.
- 16 The CC states (paragraph 24 of its market definition paper) that PPI and credit should not automatically be considered as a bundle since PPI is optional, penetration rates for PPI vary considerably, PPI and credit are not consumed or produced in fixed proportions, and PPI is technically available on a stand-alone basis. Nationwide believes that these factors do not necessarily argue against a conclusion that PPI and credit products are in the same market. For example, many customers are not interested in MPPI and will purchase a mortgage stand-alone; this does not mean that the other customers who do want to purchase MPPI do not consider it as a component of the mortgage. Although MPPI is technically available stand-alone, the CC’s own research shows that there are significant problems for suppliers in selling it stand-alone and that significant numbers of consumers do not want to buy it stand-alone. In this context it does not matter that many consumers are not interested in and do not take out MPPI, but only purchase the mortgage. It is the behaviour of those customers that are interested in PPI that drives the interaction between the MPPI and the mortgage.
- 17 Further evidence of consumer behaviour will be important in determining the definition of the relevant market, for example from the quantitative consumer survey commissioned by the CC. However Nationwide reiterates its concerns that the last version of the consumer survey it saw did not appear to ask consumers sufficient questions about their purchase criteria and purchase behaviour.
- 18 From the supplier’s perspective the evidence is also that MPPI and mortgages are treated as part of the same business unit and share distribution and other costs. The fact that there are very limited stand alone sales of MPPI, that a number of distributors have sought to offer a stand alone MPPI product but have withdrawn such a product because there is limited consumer demand for it, and that adverse selection issues mean distributors are unlikely to want to offer cover part way through the term of a mortgage all suggests that suppliers consider MPPI to be part of the same market as the mortgage.
- 19 Although MPPI was sold on a stand alone basis by 12 of the largest distributors during the period 2002-2006, such sales are still negligible accounting for less than 4% of total sales of MPPI. This again appears to support the contention that both customers and distributors view the mortgage product and the MPPI as a package.
- 20 The lack of advertising of PPI separate from the credit product (which the CC refers to) can be explained by the fact that both customers and distributors consider PPI and the credit product to be in the same market – PPI is linked with the credit product and is referred to in promotional materials describing the credit product in detail. As a result it would not make financial sense for a provider to attempt to advertise MPPI separately.
- 21 As part of their responsible lending requirements, the FSA requires distributors of credit products to include wording in KFIs inviting the applicant to consider how he/she would meet their repayments on the credit product in the event of accident, sickness or unemployment. The FSA believes it is important for responsible lenders to mention the

availability of insurance products to cover such eventualities, which creates further linkages between the two products for both suppliers and consumers.

- 22 Nationwide believes that the CC's emerging thinking that the market should be defined as a series of brand-specific product markets (such that Nationwide's MPPI is in a different market from another distributor's MPPI) is also artificially narrow. Although there are clear linkages from the consumer's and supplier's perspectives between MPPI and mortgages, the correct conclusion to draw from this is that these are in the same market, not that the supplier has an effective monopoly over MPPI as a stand-alone product. The CC's emerging thinking on this topic also does not fit with the role played by intermediaries who are substituting significant volumes of third-party MPPI in place of Nationwide's MPPI when they sell a Nationwide mortgage. It is clear from this that Nationwide does not have a monopoly over MPPI to its own mortgage customers.
- 23 The brand-specific market definition conclusion is also distorting the CC's analysis of competition. Nationwide would agree with the points made paragraphs 22 and 23 of the market definition working paper, that an artificially narrow market definition runs the risk of ignoring the significant effects of the interaction between PPI and credit products on competition.

#### **Potential for two-way asymmetric complementarity**

- 24 Nationwide has concerns about the CC's reliance on an all-or-nothing interpretation of the concept of complementarity – which appears to be that if there is insufficient evidence of fully symmetrical complementarity then that must mean that there is only one-way complementarity – which then leads the CC to conclude that PPI is in a separate market to the credit product. Nationwide believes firstly that this logic does not hold true, and secondly that the CC would need to positively demonstrate from the evidence that there is *no* complementarity between PPI and the credit product in order to prove its emerging thinking. Instead the CC should take account of the potential for two-way, albeit asymmetric, complementarity
- 25 The conclusion of one-way complementarity for MPPI fails to recognise that for mortgages, the cost of the MPPI cover is a small proportion of the overall monthly repayment on the mortgage plus MPPI package. Nationwide's average monthly mortgage payment is £[<] and the average mortgage PPI premium is £[<]. Therefore, in such circumstances, one can never expect there to be perfect complementarity such that a small increase in the price of the PPI cover significantly affects demand for the credit product and vice versa. A 5% increase in the price of MPPI is equivalent to less than [<]% increase in the price of the combined mortgage / MPPI package.
- 26 The CC refers to the SSNIP test and applies this test to PPI alone as a core part of its emerging thinking. Nationwide believes that it is inappropriate to apply the test in this way where there is potential for asymmetric two-way complementarity. For example, in a hypothetical market with a secondary product that is directly connected to the purchase of a primary product, and where it is not possible for customers to buy the secondary product without also buying the primary product from the same manufacturer due to technical reasons, but where the price of the secondary product is significantly lower than the cost of the primary product, it would be expected that customers would show less price-sensitivity to a 5% increase in the price of the secondary product than to a 5% increase in the price of the combined product. It would be incorrect to conclude in this example that the two products were in separate markets.
- 27 The results of the SSNIP test would be diluted still further by two other effects caused by the optional nature of the secondary purchase. Firstly if, say, only half the customers were interested in purchasing the secondary product, then a 5% increase in the price of

the secondary product would have no effect on the demand for the credit product amongst the other half of customers who are not interested in the secondary product. Secondly, even the customers who are interested in the secondary product may opt to continue with the purchase of the primary product alone following a price rise of the secondary product. These two effects, together with the impact of the relative price differential, mean that a 5% price rise of the secondary product may have only a very dilute effect on the sales of the primary product.

28 This situation is very different from the right shoe, left shoe example used by the CC in the Hearing with Nationwide since in the CC's shoe example, both products are of equal value and the purchase of the second shoe is not optional. However even in that example, a 5% increase in the price of the left shoe would only be equivalent to a 2.5% increase in the price of the pair and therefore may not pass the SSNIP test applied to only left shoes. This could lead to the conclusion that left and right shoes were in separate markets.

29 Consequently, Nationwide believes that the CC should be applying the SSNIP test to the credit product plus PPI package.

#### **Evidence to support market definition**

30 The CC states that it is considering three sources of evidence to determine whether credit products and PPI constrain each other:

- How suppliers operate their credit and PPI businesses and how they price PPI,
- Evidence of whether customers are looking principally at the price of credit or at the price of the credit and PPI combined, and
- Data from the parties requested as part of workbook LD04.

31 Nationwide believes that there is sufficient evidence on the first two of these points which demonstrates that both consumers and suppliers consider the market to be for the package of credit plus PPI.

32 On the first point Nationwide operates its mortgage and MPPI business together, and the CC's own review of documentary evidence concludes that the majority of other firms do generally operate their credit and PPI businesses together and there is some evidence that they do analyse the price of credit and PPI together (paragraph 152).

33 On the second point, the CC goes on to suggest (paragraph 185) that it could apply a wider market definition if there was evidence that there are significant numbers of customers searching for PPI before they reach the point of sale and therefore that customers search for and substitute between bundles of credit and PPI. Nationwide believes that the OFT's research - which showed that 75% of customers had thought about MPPI prior to the point of sale (of which 6% had decided not to take out the product) - provides such evidence as does the OFT's finding that 26% of MPPI customers had actively shopped around. In addition Nationwide believes that many mortgage intermediaries, who in total account for approximately half the mortgage market, also act in a similar way on behalf of their customers providing further evidence of active search behaviour.

34 On the third point, the analysis of workbook LD04 to understand cross-price elasticity, Nationwide is concerned about how robust this analysis is likely to be, for three reasons:

- The CC points out that there have been a very limited number of changes to the retail cost of PPI cover (for some, prices have not changed at all during the period 2002 – 2006) and therefore it is very difficult to draw any conclusions about price elasticity from this data. [X].
- There are many other factors driving the take-up and market share of both MPPI and the mortgages that will not be picked up by the CC's analysis including, the marketing activities of each competitor, the sales capability and productivity of each branch, changing distribution channel usage, changing intermediary relationships, timelags between mortgage application and completion, regional movements in house prices, promotional product offers, base rate changes, changing mortgage regulations, and the introduction, take-up and withdrawal of complicated mortgage pricing structures including discounted rates of varying lengths, fixed rate offers, and offers for first-time-buyers, remortgagors and home movers. It will not be possible to isolate all these effects.
- The relative price differential between the MPPI and the mortgage and the take-up rate of MPPI will dilute the effect of MPPI price changes on mortgage sales (as discussed above).

35 Despite examining a number of these sources of evidence, the CC is to date relying on a *lack* of clear evidence that a small but significant increase in the price of PPI, above competitive levels, would be rendered unprofitable to support its contention that MPPI is in a market of its own. The CC should avoid assuming that if the main parties to the inquiry are unable to produce sufficiently compelling evidence to contradict the emerging conclusions reached by the CC, those conclusions must be correct. Given the points above it is to be expected that it will be difficult to demonstrate that a small change in the MPPI price has an impact on sales of the mortgage or that this is an appropriate test. Instead Nationwide believes that the CC should focus on the evidence that is available which supports the view that MPPI and mortgages are in the same market.

36 The CC should be careful to take full account of the evidence it has received even where this may contradict or dilute its emerging findings. For example:

- The CC states that the qualitative consumer research found that in general participants “had not thought at all” about insurance protection when they chose their credit provider “although there were exceptions to this” (Paragraph 159). The research paper itself describes in more detail the customers who did consider PPI before they reached the point of sale, and yet this is not considered in detail by the CC. Even if they are in a minority, if there are sufficient numbers of consumers who do consider insurance protection as part of their choice of credit provider then this will place competitive constraints on suppliers and pricing.
- The CC believes that because customers view that PPI is an “add-on” to the credit product, this implies that PPI is “only considered once the choice of loan provider had been made and the credit application started” (Paragraph 159). The customer research does not make this link; conversely it states that customers view PPI as an add-on because they regard the two products as “tied”. This supports the view that the two products are in the same market.
- The CC is using limited documentary evidence taken selectively from Nationwide's board papers to support its emerging conclusions in relation to a

lack of price sensitivity on the part of consumers when it comes to PPI. The CC should put into context the quotes which are used by it to demonstrate a lack of price sensitivity by making clear that these price changes are likely to have had a negligible impact on the overall monthly repayment figure for the combined credit product and PPI package, and were within a range that did not change Nationwide's competitive positioning.

- The CC mentions that a number of parties told it that PPI is sold and not bought (although of the main suppliers this appears to be limited to Barclays, and many more suppliers appear to disagree with this point). However the CC goes on to suggest that this could mean that "most consumers have little knowledge of PPI prior to purchasing the credit product, and only consider purchasing PPI at the point of sale of the credit product". Nationwide does not believe that the CC has the evidence to conclude this, since even if some consumers do only consider purchasing PPI at the point of sale, this does not imply that they have little knowledge of the product prior to the point of sale.

### **MPPI: COMPETITION**

37 Irrespective of the CC's conclusions on market definition, Nationwide believes the CC should take greater account of the impact on competition of the interaction between the underlying mortgage and MPPI. In the emerging thinking the CC places little or no emphasis on the following characteristics of the mortgage (and the associated MPPI), all of which contribute to the competitive environment affecting MPPI:

- The prominent role of intermediaries in the mortgage market
- Evidence of customers shopping around based on price
- Extensive advertising for new customers and switchers
- Low search costs for consumers considering purchasing MPPI
- Frequent price movements on mortgages and evidence of declining margins as providers compete for volume
- Significant numbers of customers switching supplier, often by terminating their mortgage and MPPI early
- Evidence of many new entrants to the market, indicating low barriers to entry
- Below target levels of profitability for the combined product

### **Intermediaries**

38 Intermediaries create important competitive constraints on MPPI. The CC should consider the extent to which intermediaries shop around for PPI cover for their customers. Nationwide believes that a significant proportion of mortgage intermediaries will choose between multiple providers of MPPI in order to identify the product that is most appropriate for their clients' needs. As independent advisers it is to be expected that intermediaries will consider the combined monthly repayment on the mortgage plus MPPI package and will recommend the best value-for-money quote that meets their customers' needs. This creates competitive pressure on providers of MPPI

- 39 As a result of the availability of alternative suppliers of MPPI, the take-up rate of Nationwide's own MPPI product sold to intermediary introduced mortgage customers is currently around [X]% compared to c. [X]% through its branches.
- 40 The existence of independent providers of MPPI has created price pressure on mortgage providers when selling PPI through independent intermediaries. In turn, as a result of the overall scale of the independent intermediary channel, this has forced lenders to keep the price of MPPI and the mortgage package competitive for sales through their own distribution channels (e.g. branches, telephone, internet, etc.).
- 41 Irrespective of whether intermediaries themselves use a tied supplier of MPPI, consumers who use a financial adviser are generally better informed about the product and their ability to shop around. The CC's customer research states that participants who had used a financial adviser were aware that it was possible to shop around (see paragraph 47 in the customer research), and that the most informed policyholders were those who had bought their MPPI via a financial adviser.

### **Customer Search Behaviour**

- 42 The OFT's research showed that 64% of customers shopped around for their mortgage. Nationwide believes that a significant proportion of these customers will have shopped around by approaching lenders and obtaining an illustration from multiple suppliers, including the cost of the MPPI.
- 43 The CC's market definition leads it to believe that there is no opportunity for consumers to consider more than one supplier when selecting their MPPI and in effect that they are an entirely captive customer. In paragraph 167 it suggests that there is no competition at all between suppliers to win each others' customers. However the CC's own evidence from the customer focus groups and the OFT's survey showed that a significant proportion of customers do consider PPI before they approach a lender particularly for MPPI (75% had considered MPPI before approaching the lender according to the OFT survey).
- 44 The purchase of MPPI does not follow sequentially only after customers have completed the purchase of the mortgage. Customers will consider both in parallel at the point of sale and, as discussed above, some customers will approach multiple lenders for quotes covering both the mortgage and MPPI before deciding who to purchase the combined package from. This behaviour creates competitive pressure on both the mortgage and the MPPI price.
- 45 Consumers can also easily obtain quotations for the price of MPPI from numerous sources such as moneysupermarket.com, MoneySavingExpert.com and Protectiononline.co.uk
- 46 There is significant information available for the combined mortgage and MPPI which creates awareness amongst customers of MPPI, stimulates competition between suppliers and creates pressure on the pricing of both the mortgage and MPPI.

### **Switching**

- 47 The CC suggests in paragraph 168 that if it concludes that PPI is in a separate market from credit products, then the only type of switching activity it will consider is when customers switch PPI provider without switching loan provider. It goes on (e.g. paragraphs 169-171) to only consider switching activity of this type where the customer did not also switch the credit product. Nationwide believes this is illogical and is drawing an artificial distinction between switching with and without the mortgage.

Irrespective of the market definition, if customers switch MPPI at the same time as switching a mortgage, then they are still switching and this creates competitive pressures on MPPI. Moreover, if the CC does conclude that MPPI and mortgages are in separate markets it should therefore be irrelevant whether or not a switch of MPPI occurs at the same time as the switch of another unconnected product.

- 48 For this reason the qualitative consumer survey is of little value on this topic since it failed to ask the groups whether they had ever switched a mortgage with MPPI. Particularly given that the groups had already said they considered the MPPI to be tied to the mortgage, it is not surprising that they had not thought of switching MPPI without switching the mortgage.
- 49 Table 15 in the emerging thinking is also not a valid measure of the degree of stand-alone switching activity since where customers do choose to switch the MPPI stand-alone, they are likely to go to a stand-alone MPPI competitor, not one of the 12 largest distributors listed in the table. Nationwide for example does not sell MPPI stand-alone. These stand-alone distributors are not captured in the table.
- 50 The CC goes on to use a lack of evidence on switching of MPPI alone to support its contention that there is limited competition for MPPI products. However the CC fails to consider how many customers choose to cancel their MPPI policies in parallel with cancelling their mortgage which also creates competitive pressure on MPPI suppliers. There is significant remortgage activity, particularly in the intermediary market, which leads to large proportions of mortgages and MPPI policies being cancelled early and moved to a competitor. The price of the combined package of mortgage and MPPI will be a factor taken into account by the customer and their adviser when deciding when to remortgage.

### **Pricing**

- 51 Nationwide provided data to the CC following the Hearing on the impact on MPPI take-up following the introduction of first 12-month free MPPI cover, followed by 3-month free MPPI cover. It is clear from those charts that customers were very price sensitive – take-up rates in Nationwide branches rose from [X]% to [Y]% following the introduction of 12 month free MPPI cover.
- 52 In addition the evidence provided by Nationwide following the Hearing showing the cancellation rate of MPPI policies after the end of the three month free period shows significant price sensitivity. [Z]% of customers had cancelled their policy by the fourth month.
- 53 As stated above, Nationwide believes that comments in its management papers on price-sensitivity were taken out of context by the CC. It is to be expected that a small price increase that leaves Nationwide's PPI as one of the most competitive in the market should not have a significant effect on take-up rates. It cannot be inferred from this that customers would display insensitivity to price changes outside this range, for example if Nationwide moved from being first quartile to third quartile.
- 54 The CC requests evidence from the parties as to the reasons for the appearance of price variations between suppliers. A critical factor influencing the retail price of a stand alone MPPI policy is the fact that most stand alone providers do not have to support the cost of an extensive branch network and the associated costs of advisers in those branches – this is the single most significant factor affecting the retail price of MPPI cover.

- 55 There are relatively few price changes over time for MPPI products (although Nationwide considers the introduction of 12 month and 3 month free MPPI as price changes) because the costs of supply for MPPI do not change regularly. This is very different from the mortgage where the most significant cost, funding, changes on a daily basis as money market rates change.
- 56 The CC suggests (paragraph 165) that although competitors monitor others' prices and set their prices with a view to avoiding being out of line, they do not set their PPI prices with the objective to undercut competitors. Nationwide disagrees with this view since it explicitly sets its prices to be first quartile – that is to undercut the majority of its competitors. It also introduced free 12 month and 3 month MPPI cover with the explicit objective of creating differentiation from competitors.

### **Profitability of Distribution**

- 57 The CC is clearly at an early stage with its analysis of profitability. Nationwide would like to see the CC's analysis when it is further advanced including the evidence that the CC refers to in paragraph 193 before commenting in detail.
- 58 Irrespective of the CC's market definition, its analysis should consider the profitability of the combined MPPI plus mortgage business. This will ensure that CC takes account of the contribution of both MPPI and mortgages to the overall mortgage/MPPI business stream profits and avoids the need for arbitrary allocation of costs to specific components of the package.
- 59 Nationwide would like to point out, at this stage, that the analysis described in paragraph 192 is not robust. It cannot be concluded that the lower prices of stand-alone providers are indicative of prices being higher than competitive levels when PPI is sold alongside a credit product. This is because the main driver of the price of a stand-alone provider will be its much lower distribution costs than a branch based, or intermediary based supplier. In addition, the nature of the cover provided by the stand-alone provider is often inferior.

### **CCPPI**

- 60 Nationwide has similar concerns with the CC's emerging thinking for credit card PPI.
- 61 For credit cards in particular it is very difficult to separate the provision of credit cards from CCPPI due to the need to link the CCPPI premium to the balance on the card which changes regularly. The CC recognises this since it could only find one provider offering stand-alone CCPPI and there was virtually no stand alone provision of CCPPI during the period 2002 – 2006. This suggests there is no market for such a product.
- 62 In credit cards there is less point of sale advantage, since some customers take out CCPPI at the point of activation of their card rather than at the point of sale. Credit cards are also often purchased direct without a face-to-face interaction. In the OFT survey only 27% of customers purchased their credit card through face-to-face channels versus 83% for mortgages. Direct channels by their nature have a weaker point of sale advantage.
- 63 For CCPPI, the SSNIP test may be inappropriate as the cost of cover is only a relatively small proportion of the total monthly repayment on an average outstanding balance. For example the average balance at the end of October 2007 on a Nationwide credit card was £[<], the average repayment where the balance was not paid in full was £[<], and the average CCPPI premium was £[<].

64 For these reasons Nationwide believes that the CC's emerging thinking on CCPPI market definition is artificially narrow.

### **PLPPI**

65 A significant difference between the Personal Loan and PLPPI market relative to credit cards and mortgages is the single premium nature of the payment. This influences both the market definition and the competition analysis.

66 The single premium structure means that customers are provided with a quotation before they purchase the product showing the combined total and monthly cost of the personal loan and the PLPPI. Nationwide believes that customers make their purchase decision on the basis of this single combined price and will consider this as a single product. This means that it is illogical to expect customers to subsequently shop around for only one component of this price. If customers feel that the combined monthly cost is too high, the logical course of action is to shop around from other suppliers for the combined package not just one element of it.

67 The addition of the PLPPI premium to the loan, and the combined illustration, also mean that the sales process is not sequential, as assumed by the CC – it is part of one parallel decision-making process. Therefore it cannot be the case that the decision for PLPPI is taken after the decision has already been made on the personal loan.

68 Furthermore this structure means that customers are very clearly able to engage in whole-life-costing which is a core part of the test for system markets applied by the OFT, and for example in the US vs Kodak case, referred to by the CC. The whole life cost of the PLPPI is fixed and transparent at the point of sale. This is very different from the provision of service for photocopiers (in the Kodak case) where it was found that it would be very difficult for sufficient numbers of consumers to spend the time to work out the expected value of service costs over a copier's lifetime, and this would make it impractical for them to select the copier on the basis of the price of the combined package of copier plus service contract.

69 Personal loan customers will exhibit switching activity both through frequent early termination of the loan and the associated PLPPI, and by shopping around for their subsequent loan and PLPPI. [X] % of Nationwide's personal loan customers redeem the loan and PLPPI early. The CC should examine this behaviour as part of its competition analysis. By ignoring customers who also switch the personal loan, it is only examining [X] % of PLPPI customers.

### **CONCLUSIONS**

70 In summary, Nationwide has concerns with the CC's emerging thinking relating to both its market definition, and its analysis of competition. It believes that the CC should consider the evidence and develop its thinking for each type of PPI separately, so that its conclusions take account of the very different market structures, product offerings and customer behaviour in each area, and are proportionate to any competition concerns it finds in each market.

71 Nationwide believes that the CC's market definitions are too narrow and do not take account of customer and supplier behaviour which clearly demonstrates that they believe and behave as if PPI is inextricably linked and inseparable from the underlying credit product. Any conclusions that were based on the CC's existing narrow market definition would be unreliable, and for that reason any subsequent remedies proposed are likely to be ineffective.

- 72 Nationwide also believes that the use of the SSNIP test when applied to a secondary product in this way is inappropriate particularly given the relative cost of the PPI and the credit product, and the fact that not all credit customers take out PPI. Instead Nationwide believes there is potential for two-way, albeit asymmetric, complementarity.
- 73 The CC's competition analysis should take greater account of the impact of mortgage intermediaries on the mortgage / MPPI market and the effects of the interactions between the credit product and PPI in each market on customer search behaviour and switching. Nationwide believes that these factors demonstrate considerable competitive intensity in each market.