

Payment Protection Insurance (“PPI”) Market Investigation

The Royal Bank of Scotland Group PLC: Response to the CC's Emerging Thinking

This submission sets out The Royal Bank of Scotland Group PLC’s (“RBS”) initial views on the Emerging Thinking statement published by the Competition Commission (“CC”) on 6 November 2007. As a general point, RBS considers that the points made in our Initial Submission are still relevant to the investigation, and would ask the CC to consider all of RBS’ submissions together.

1 RBS agrees with the CC's conclusions on the underwriting market and the impact of vertical integration

RBS considers that there are no features which prevent, restrict or distort competition in the underwriting market and that vertical integration offers a number of important benefits for customers. As such, RBS welcomes the fact that the CC does not currently propose to pursue the inquiry in these areas.

2 RBS welcomes the CC's recognition that PPI is an important product providing valuable reassurance for consumers

- The CC’s qualitative consumer survey recognises the importance of PPI cover and the valuable reassurance this provides (eg Section 2.5.2 and paragraph 68).
- This is significant, given that low savings rates mean many people have insufficient funds to protect their outgoings in the event of accident, sickness or unemployment.
- Unemployment rates over the past few years have been at historic lows, so that memories of what a recession feels like have faded to distant memories. As such, any deterioration in economic conditions may be expected to lead to an increase in the level of unemployment. This makes it all the more important that those who wish to purchase PPI can have immediate peace of mind from the moment they purchase their credit product.

3 RBS offers high quality PPI products and a transparent sales process

- RBS’ PPI policies have generous exclusions policies and terms of coverage and the “claims paid” ratio is relatively high. For example, RBS believes that it is the only bank which provides personal loan payment protection where no claims will be rejected because of a customer’s medical history.
- This quality has also received external recognition. RBS Loanguard and the RBS, NatWest and MINT Payment Protection Plans have all been awarded five stars for quality of cover by Defaqto, an independent financial product research company. **[DELETED – BUSINESS SECRETS]** The Defaqto seal of approval is used in scripts and marketing literature (see example of a loan offer letter at Annex 1), reflecting how RBS competes on quality as well as price.
- RBS uses easy-to-understand terminology and has a transparent sales process. It provides customers with all the information they need to make a fully informed

decision. RBS' "Duty of Care Checklist" (DOCC) ensures that customers know precisely what they are purchasing.

- RBS sells its PPI products on a non-advised basis. It provides customers with a clear explanation of the product and its features, thereby enabling customers to decide whether it is appropriate for them and their circumstances or not.
- RBS takes great care to ensure that its employees are properly trained to offer PPI in full compliance with FSA rules and ICOB disclosure requirements.
- RBS considers that the single premium structure is an effective and popular way of providing customers with the peace of mind they seek. It offers a number of advantages to consumers, namely that it:
 - Minimises the risk of a lapse in cover at a critical time through missed PPI premium payments;
 - Avoids the risk of a price increase in times of recession; and
 - Offers a straightforward method of paying for protection via a single payment each month.
- RBS' consumer education website, MoneySense, gives objective information about PPI to help consumers decide what is right for them, outside of the sales environment.¹
- This approach reflects the fact that PPI is part of RBS' wider strategy, which is to offer high quality products to develop long-term relationships and increase the likelihood that customers recommend RBS to family and friends.

4 RBS agrees that the competitive analysis of the supply of PPI at the retail level is complex and that further work is required before the CC draws any conclusions

In this respect, RBS is pleased that the CC is mindful of the need to take into account the FSA's current work on PPI (paragraph 11) and would urge the CC to do the same with industry-level developments, such as ABI initiatives.

4.1 Market definition

RBS considers that the CC's preliminary finding of a series of brand-specific markets for PPI (paragraph 26) is overly narrow and fails to adequately reflect the complexities of the competitive environment. As already stated in its initial submission, RBS considers that the relevant product market for PPI is at least as wide as each of the four main PPI product categories (ie PPI on first charge mortgages, PPI on second charge mortgages and other secured loans, PPI on unsecured loans and PPI on credit card repayments) which in each case would include all providers' PPI. There are a number of reasons for this view, not least the fact that RBS believes that a significant number of consumers do consider the price of the credit product and PPI together when considering a purchase.

4.2 Competitive constraints

¹ For instance, on loans:

http://www.natwestf2f.com/natwest/adults/makingbankingsimple/loans_payment_protection_insurance.asp?page=MONEYSENSE/ADULTS/MAKING_BANKING_SIMPLE/LOANS

As the CC identifies throughout its Emerging Thinking, there are a large number of different potential competitive constraints on PPI providers. RBS agrees with this and urges the CC to assess these in the round.

4.2.1 Competition between suppliers

The Emerging Thinking overstates the competitive significance of any 'POS advantage' enjoyed by PPI distributors.

- RBS has also observed that customers are more likely to think about their protection needs when prompted to do so. As the CC's qualitative survey showed, this often coincides with taking on additional debt (paragraph 43), but can also be triggered by a change in circumstances (paragraph 44). While this could be interpreted as a 'POS advantage', it is important not to overstate the competitive significance of this situation.
- RBS believes that more and more customers are considering their protection needs at an early stage and are increasingly able to search and make an informed choice, as explained in more detail in Section 4.2.3 below.
- We accept, however, that more could still be done at an industry level eg by improving the level and quality of information available to all customers, encouraging the use of standard terminology and encouraging more consumers to think about their protection needs at an earlier stage. RBS would support such measures.

4.2.2 Alternatives to PPI

In addition, RBS feels that the Emerging Thinking fails to recognise the significance of recent developments in the PPI sector, including product innovation.

- The CC acknowledges that there has been a significant amount of product innovation and new product launches over the last 18-24 months, including the introduction of hybrid products such as the Post Office's Lifestyle Protection Product and the products launched by HBOS and HSBC, and of course RBS' own Churchill short term income protection product. RBS has also just enhanced its RBS, NatWest and Ulster loan PPI to make the product available to customers up to age 75 at the end of their loan. This means that customers working beyond 65 can now enjoy Accident & Sickness, Unemployment, Major Illness & Life cover and retired customers can enjoy protection in the form of Life & Hospitalisation cover.
- The CC accepts that it is too early to assess the impact of some of these developments. It suggests, however, that there is little evidence that competitive pressure has driven firms' decisions to innovate.
- RBS disagrees with the CC's analysis. RBS believes that these innovations reflect how PPI providers compete on non-price aspects of PPI, with customers balancing product characteristics and price. RBS believes that the wide choice of different levels of cover and price which have been developed over the past few years is healthy, provided that there is enough transparency to allow an informed choice.

- We believe these recent developments suggest that the PPI sector is in transition. The PPI sector is becoming more fragmented as new products and suppliers emerge. Customers can meet their protection needs in many ways, eg by buying cover which is not specifically product related, such as stand-alone PPI, income protection, critical illness cover and life assurance.

- **[DELETED – BUSINESS SECRETS]**

The CC hypothesises that standalone providers ought to face higher costs than those selling PPI alongside credit products, suggesting that this could mean the latter's prices are above competitive levels (paragraph 192). RBS would caution against drawing such inferences too readily:

- Standalone providers will not necessarily face higher costs than providers who offer PPI with their credit products. To take one example: given that most standalone providers distribute via the internet, one view would be that standalone providers would face lower distribution costs. However, this would be only one of the many different types of costs involved in selling PPI, and should not be viewed in isolation.
- As the CC recognises, as with all differentiated products, there will inevitably be differences in quality across the spectrum of protection products. RBS hopes that CC will not lose sight of these differences when considering prices, particularly in relation to standalone providers.

4.2.3 Customer searching

As already noted, RBS believes customers are already able to make meaningful comparisons of PPI prices and terms of cover.

- Websites such as www.moneysupermarket.com and comparison tables published in newspapers, as shown in our Initial Submission, usually show the cost of loans with and without PPI. Customers can also compare the whole cost of the package (ie credit product plus PPI) and select the supplier who offers the best overall value.
- We believe that our customers understand our PPI products and are capable of making informed choices. We give customers clear information on the key features of PPI (including price and exclusions) both at and before the application stage. We are also required under the Consumer Credit Act 1974 to provide information on the creditor agreement regarding the total price of the credit product and PPI.

However, we recognise that more can be done to facilitate customer searching.

- RBS notes that the evidence reviewed by the CC is mixed on the extent to which customers actually do search for PPI.
- The CC's qualitative consumer survey found that many customers had not thought about purchasing PPI when they decided to take out the primary credit product. However, there were a number of notable exceptions (paragraph 44). Similarly, the OFT's consumer survey found that over 60% of consumers thought about PPI before applying for the credit product.²

² Chart 5, Annexe B.

This suggests that many customers do consider - and therefore presumably search for - PPI at an early stage. We await the results of the CC's quantitative survey with interest.

We would stress that a number of important developments are currently taking place which can be expected to improve customers' ability to search:

- The FSA is developing a comparison website for PPI. We understand that this will allow customers to input their details and compare a range of PPI features such as: cover levels, cost (including single premium costs), exclusions, cover for pre-existing conditions, additional benefits and the basis of refund offered. RBS understands that the website will be run by the independent product research business Defaqto, and should be ready for use by March 2008. RBS' commercial strategy is to offer a high quality PPI product across all of its brands. As such, RBS welcomes any initiative, such as this website, which improves informed comparison by extending beyond price to encompass product design and features: important competitive parameters.
- The ABI consumer guide to PPI (attached as Annex 2) has now been finalised and published on the ABI and BBA websites, as well as those of a number of PPI providers.
- The FSA's current review of the ICOB rules (NEWICOB rules) could also have an impact on the degree of transparency and thus the ability to search. In summary, (if implemented), the draft new rules would require (for oral sales):
 - in a non-advised sale, taking reasonable steps to ensure the customer understands (s)he is responsible for deciding whether a policy meets his/her demands and needs;
 - oral disclosure of all of the main policy characteristics (such as significant benefits, exclusions, limitations and duration);
 - drawing the customer's attention orally to the importance of reading contract documentation before the end of the cancellation period to check the policy is suitable for the customer; and
 - enhanced oral pricing disclosure, given in such a way as to allow a customer to relate it to a regular (eg monthly) budget.
- Similarly, summary boxes such as those currently used in our literature (see eg pages 9 and 10 of the "Important Information" section of the NatWest brochure at Annex 3) could also be used to highlight key information.

What is clear from the CC's qualitative survey is that customers are keen to shop around for PPI, even though they may not be clear about how best to make use of the opportunities already available. This tends to suggest that more could be done to make customers aware that they can shop around for PPI.

As a responsible provider who offers a high quality product, RBS would support initiatives which increase meaningful disclosure and informed customer searching.

4.2.4 Customer switching

RBS considers that there are no significant barriers to switching. In our view, customers are able to cancel and are aware of their rights.

- All products can be cancelled without charge during the 30 day cooling off period (longer than the current ICOB minimum of 14 days).
- All of RBS' single and regular premium products can be cancelled at any time after the cooling off period. **[DELETED – BUSINESS SECRETS]**³
- We believe that the actuarial basis (Rule of 78) is a fair basis for calculating the refund for single premium policies, which reflects the front-loading of the insurer's risk across the life of the loan. We also believe that it is not a material barrier to switching.
- The ABI model wording on refunds has recently been agreed by the FSA and is being rolled out across the industry.
- Customers are aware of their right to cancel. The survey conducted by BMRB on behalf of the FSA found that 70% of respondents who purchased PPI 'know their rights and would definitely cancel if required'.

However, RBS agrees that more can be done to improve customer awareness.

- RBS ensures that customers are made aware of their rights to cancel during the sales process and in customer literature. We flag this prominently in our marketing materials in order to ensure that customers are fully aware of their rights. For example, RBS includes worked examples in the "Important Information about Personal Loan Protector" to show customers what refund to expect on single premium policies (see eg page 11 of Annex 3, "Important Information", for NatWest).
- Nevertheless, we agree with the CC that more can be done to ensure that this practice is adopted on an industry-wide basis.

4.3 The CC understates the cumulative effect of the competitive constraints which it has identified in its Emerging Thinking

In RBS' view, the CC needs to consider the cumulative impact of the many different competitive constraints it has identified, rather than focus on each in isolation.

Importantly, the CC should also take account of self-insurance, ie the decision not to purchase PPI at all. Many things could lie behind this decision: it could be because customers feel they can rely on other means of support (such as friends and family, or savings) in the event of accident, sickness or unemployment, or it could be because they already have other types of protection or employment benefits.

This has important implications for the CC's assessment of the barriers to competition.

As already noted, RBS would not agree with the CC's hypothetical market definition (ie narrow PPI markets, by brand). In any event, as the CC will be aware, market definition is a dynamic process and competitive constraints can come from an adjacent market, or from the decision not to purchase at all. RBS believes that the overall protection marketplace is

³ **[DELETED – BUSINESS SECRETS]**

already undergoing significant change and this trend can be expected to continue. The developments which are already underway, coupled with the introduction of the measures which RBS has suggested in this response, will further increase the scope for competition and encourage new entry.

5 Comments on the CC's intention to investigate profitability

Finally, RBS notes that the CC intends to investigate profitability in the distribution of PPI (paragraph 189) and the underlying credit products (paragraphs 194-195). We would make the following comments in this regard:

- There are many conceptual and practical difficulties in establishing an appropriate basis for allocating these shared costs to our PPI distribution activities. The CC accepted this in its NI PCA banking report, pointing out that any allocation of costs would be *"subjective and dependent on the assumptions made"*,⁴ going on to say that *"...given the interdependency of PCAs and other banking products, and the practical difficulties in identifying appropriate and accurate bases for cost and capital allocations, we are unable to measure profitability with a sufficient degree of accuracy ..."*.⁵
- As the CC will be aware from our previous submissions, RBS operates a contribution model and, other than at a very high level in its annual accounts, does not allocate shared costs or charge these out to individual businesses. It is therefore unable to estimate from its management accounts the profitability of individual products. This means that RBS measures the contribution made by individual products or product families toward the shared costs.

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⁴ At paragraph 4.314.

⁵ At paragraph 4.332.