

The Competition Commission's investigation into payment protection insurance and the remedies process

Peter Davis
Deputy Chairman and Inquiry Group Chairman, Competition Commission

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Introduction

Thank you for inviting me to come here today to talk about the Competition Commission's (CC) findings on PPI and the remedies we are going to implement.

I have only a short time today to speak about what was a two-year investigation and is an ongoing process of implementing remedies. I am going to use that time to touch, albeit briefly, upon four main areas.

- First I am going to briefly outline our findings on the state of competition between PPI providers, and in particular the problems we identified.
- Then I am going to outline the package of remedies we are introducing into the market.
- Thirdly I want to address some of the main arguments we considered when deciding whether this was the right remedies package.
- And finally I want to talk about where we go from here as we move forward to the Order and implementation of the remedies package.

The problems we found in the market

First, and very briefly, let me begin with the problems we found. In summary, we found that competition was not working well. More specifically, we found that distributors and intermediaries are not actively seeking to win customers by using either price or quality of their PPI policies as competitive variables. While we did see some price and quality changes aimed at attracting more of a distributor's credit customers, to be frank, there was very little evidence of firms following strategies like lowering price or raising quality to attract customers from rivals.

We analysed the causes of these competition problems. The first is that consumers who want to compare PPI policies are currently hindered in doing so—there are substantial barriers to effective search. These, in turn, are barriers to expansion by other PPI providers.

Second, we found that consumers who want to switch to alternative providers face some significant costs in doing so. This was particularly the case for consumers with single-premium policies.

Finally, we found that the sale of PPI at the point of sale of credit further restricts the extent to which other providers can compete effectively. Essentially the picture that emerges is one where the vast majority of consumers choose their credit provider on the basis of the credit product and are then offered PPI for the first time once they are in a conversation at the credit point of sale. We found that this structure results in a lack of competition, and—among other things—high prices for PPI.

Our remedies package

With that brief summary of the problems we found and its causes, let me turn to remedies. First, I want to note that, having found problems, the CC Inquiry Group is under a legal obligation to seek to achieve as comprehensive a solution as is reasonable and practicable. Fortunately, this legal duty requires us to do what is right—to find ways of ensuring that meaningful competition between providers will, in future, deliver the low prices and high-quality products that consumers deserve.

After a thorough consultation and publication of our provisional decision, we decided on a suitable package of remedies.

By now, most in this room will be aware that the package we decided upon includes a prohibition on selling PPI at the credit point of sale or within seven days of the conclusion of the credit sale. Doing so will open up the market, giving consumers time to search once they have secured their credit, and giving competing providers, who at the moment struggle to get a look in, the opportunity to offer their PPI products to consumers who currently only choose whether or not to buy their credit provider's PPI. Consumers who decide that they do want the PPI offered by their credit provider can contact that provider to purchase it after 24 hours.

Along with the point-of-sale prohibition we are acting to ensure that consumers are equipped with the information they need to take advantage of their opportunity to search the market. Such measures include the requirement that parties provide binding personal quotes, provide certain information in marketing materials and provide information for use in price comparison websites.

In addition we will also make it easier for consumers to switch their PPI policy at a later point if a better deal becomes available. We are prohibiting single-premium policies, which lock in customers to their current provider to a significant extent. Annual statements will also help remind consumers how much their policy is costing and of their ability to switch provider, while other elements of our remedies package will help them to find whether there are better-value policies available.

Arguments put to us about remedies

This package of measures represents a substantial change to the operation of the PPI market. In considering the package, one must resist the temptation to consider its elements in isolation. Each element of the package interacts and reinforces the others. For example, information remedies will increase the effectiveness of the point-of-sale prohibition relative to a prohibition alone. In the process of concluding that this was the right package of remedies, we considered a large number of arguments. Today I want to touch on four of the main lines of argument put to us.

Effectiveness

First, it was put to us that the remedies package, including the point-of-sale prohibition, would not be effective in addressing the adverse effect on competition. For some parties, the logical implication of that was that price caps were necessary. We considered that option carefully, but ultimately disagreed it was necessary to directly control prices in this market, although we did note that that is the route that has been followed by the US authorities. We decided we did not need to go down that route because we considered that by introducing measures that facilitate search and switching and, in addition, 'freeing up' the point of sale of credit directly we would generate conditions suitable for considerably more competition in this market.

Not all elements of the remedy package are necessary

In the other direction, towards less intervention, some argued that not all the elements of the remedy package were necessary; in particular, that the point-of-sale prohibition was not needed in the package.

In broad terms, we found that the point-of-sale advantage means that stand-alone providers have difficulty gaining access to credit customers. The result is that distributors have market power, and stand-alone PPI providers suffer from adverse selection, poor consumer awareness and high marketing costs. Such factors would not be addressed by a package of information remedies alone and so we concluded that we needed to increase the amount of information available *and* address the point-of-sale advantage directly.

Remedies will lead to higher credit prices

A third important argument was that distributors compete hard for loan business in substantial part because of the follow-on PPI sales with high margins. If so, it was put to us that effective remedies would get rid of the resulting cross-subsidy, leading to higher credit prices, and that consumers, as a whole, would be made worse off.

For credit cards we found that such effects are small and for mortgages that the effects are very small. However, we did find evidence of an appreciable impact on credit prices for personal loans.

Determining how large the credit price effects were likely to be in future was not easy. For example, the incentive to discount credit prices is due, in part, to the intensity of competition in the credit market and there is some uncertainty over that going forward. Recent events in the credit markets have involved consolidations while gross lending advances have contracted, with credit providers now more focused on their existing customer base and the quality of their lending book. Such uncertainties meant that we could not be confident that the scale of lower credit prices that we observed in the period up to December 2006 would persist at that level in the future.

In terms of the economics of secondary product markets, a distortion in credit prices is not intrinsically beneficial and so we considered carefully the effect of remedies on overall consumer well-being. Doing so involved a considerable amount of technical analysis. In a nutshell, we found that effective intervention in PPI markets would be greatly beneficial for consumers overall. Ultimately, if we had decided not to intervene, PPI consumers would have continued to face high PPI prices and our analysis found clearly that this negative element of the current structure overwhelmed the positive.

The economic downturn and the protection gap

A final argument I want to touch on today involved the economic downturn and what some parties have called the 'protection gap'. We were told that the point-of-sale prohibition would reduce the uptake of PPI and increase the protection gap during a period of substantial economic difficulty.

Let me deal with this important issue in two tranches. First, we acknowledged that the point-of-sale prohibition, if considered in isolation, would reduce the convenience of purchasing PPI at the credit point of sale. (And indeed we designed the detail of the point-of-sale prohibition to mitigate such concerns—in particular, allowing consumers to return on their own initiative after 24 hours should they wish to.) However, we did not agree that marketing away from the credit point of sale will not work in this industry—at least if prices were competitive. If consumers can search and switch and, as a result, can be targeted by multiple

distributors, then prices will come down. We noted the contrast between advertising budgets in insurance product categories such as travel or home insurance with those in PPI where we saw little active promotion. Lower prices will of course make the marketing message—that consumers are better off with protection—far more persuasive to consumers.

The second component of the argument around remedies and the protection gap involves the current economic downturn. We accept there may well be a greater need for consumers to obtain the cover that PPI—and other protection products—can provide. However, the fact is that consumers are currently—in these difficult times—getting a raw deal precisely because of the near monopoly that distributors currently enjoy over sales of PPI to their own credit customers. Monopolistic markets generate bad outcomes for consumers in both boom times and in more difficult economic times.

What happens next?

Let me turn to 'next steps'. While a significant milestone, the publication of our final report is a stage in the process of getting competition working in this market, not the end of it.

The next stage is to get the document which effectively implements our decision, the PPI Order, in place. A timetable for doing that was published on the CC website the day after we published our final report. It makes clear that our intention is to make the Order in September or early October of this year. The remedies will then come into force in two tranches. First, in April 2010:

- the measures relating to the provision of information in marketing materials;
- the requirements to provide information to the Financial Services Authority for publication in its price comparisons tables and to the Office of Fair Trading for monitoring purposes; and
- the obligation to provide claims ratios to any person on request

will come into force.

The rest of the remedies, including the point-of-sale and single-premium prohibitions and the requirement to provide consumers with annual statements will come into force in October 2010.

To that end, several pieces of work are already underway. First, we have commissioned a company called Insight Research to carry out consumer testing of the PPI Personal Quote and the Annual Statement. We will publish this research this April and we will also be ready to consult informally on a draft of the Order with the main parties and key third parties, including the BBA and other trade associations, between April and May. The aim of having an informal consultation is to identify and resolve most, if not all, the bigger picture issues before going out to a full public consultation.

Finally, I think it is fair to say that not all parts of the industry have accepted every aspect of our report or of the remedies that we are putting in place. It is not unusual for us to hear rumours of potential appeals and in this case we have heard such rumours already. Such judicial reviews are, of course, entirely within the rights of those subject to CC decisions, and form a right and proper part of the competition system.

I would like to take this opportunity to be clear, however, that we will be pushing forward with the process of consulting on the draft Order. If any appeal were successful, we might need to consult further, depending on the judgment. However, it would obviously be undesirable for the implementation of our remedies to be delayed by an unsuccessful appeal and we do

not intend to let that happen. An important consequence is that the coming consultation will provide the industry's opportunity to engage constructively and fully with the drafting of the Order. Doing so will help ensure that the practical aspects of implementation are dealt with in a way that minimizes the burden on business, and so I would like to take this opportunity to urge you to engage fully with that process.

With that, I should probably bring my remarks to a close. Thank you very much for your attention this morning.