Developments in PPI markets since the 2009 report

Changes at the business and product offering levels

1. In 2008 there was a severe financial crisis followed by a recession. This has had significant impacts on the entire economy. There has been a massive supply shock: banks' risk appetite has reduced which has decreased the quantum and volume of lending to consumers. In addition, some stand-alone providers have expressed concerns about, or experienced, increased levels of claims and adverse selection with respect to involuntary unemployment.

2. Since the second half of 2008 there have been some significant changes to the participants in PPI markets. In October 2008 Alliance & Leicester was taken over by Santander, which already owned Abbey. In January 2009 Lloyds TSB and HBOS merged to form LBG. Cattles, which was one of the largest suppliers of SMPPI, stopped selling PPI policies in February 2009 and is no longer providing credit. These changes did not result in an increase in competition in PPI markets. In addition, we noted that the creation of LBG was subject to concerns about whether it lessened competition in at least some markets, though the merger was cleared on public interest grounds.[1]

3. There have also been some significant changes at the individual product levels. We look first at LBG's July 2010 exit, and then set out other changes in paragraphs 6 to 17 for PLPPI, CCPPI, distributors generally, and stand-alone providers. We find that these changes occurred for a variety of reasons, but that none of the changes, at least among the large distributors, occurred because the suppliers in question had concluded that they could not continue in the market because of the possible impact of our remedies.

4. In July 2010 LBG informed the FSA and CC that it would stop selling PPI policies. For MPPI, all mortgage customers who bought PPI before 23 July would still be provided with PPI up to 20 November. For other PPI products it would stop offering PPI with effect from 23 July 2010 (with all sales to be completed by 31 July). This is discussed further in Appendix G.

5. Having considered all the evidence from LBG, we think that there are clear reasons for LBG's current withdrawal from the market. In our judgement, we believe that LBG is likely to re-enter the market once the remedy package is in place. This judgement is based on what LBG told us, the extensive work already done on looking at a replacement product and the continuing work on this, and the significant opportunities available to it to sell a product to its customers that it considers to be valuable to them.

6. With the withdrawal of single-premium PLPPI (see paragraph 4.2 of the 2009 report) some parties moved immediately or with some break to selling regular-premium PLPPI. However, as yet some have not replaced their single-premium product. Among the largest distributors of PLPPI:

[1]The OFT's report to the Secretary of State on this merger concluded that there was a realistic prospect of a substantial lessening of competition arising from the merger in three areas: personal current accounts, SME banking, and mortgages. See: www.oft.gov.uk/shared_oft/press_release_attachments/LLloydstsb.pdf.

- Barclays stopped selling all single-premium PLPPI in January 2009; regular-premium PLPPI, which was available only through telephone channels, was withdrawn on 28 July 2010. Barclays developed a replacement for its single-premium product and introduced a new product, Barclays Income Insurance, which is positioned within a suite of insurance protection products—ie alongside, for example, life and health insurance products. The BII product has not yet been launched in telephony, but is available via the branch network and online channels.

- As noted in the 2009 report, Nationwide did not sell PLPPI between August 2007 and August 2008. Nationwide reintroduced PLPPI in September 2008, but withdrew it again in March 2009. [✂]

- RBSG ceased selling single-premium PLPPI in December 2008, and has not, so far at least, introduced a replacement product. RBSG said that the decision to withdraw [✂].

- Abbey stopped selling PLPPI in branches in November 2008. It continued selling single-premium PLPPI through telephony channels and on the Internet until April 2009, and started selling regular-premium PLPPI through those two channels in May 2009. Santander said that the lack of a PLPPI product in branches after November 2008 was [✂].

7. The FLA told us about two FLA motor dealership members.[2] One member said that out of 350 car and motorcycle dealers which sold PPI three years ago, or had the ability to do so, it only had 14 left—and it said that those remaining were not very active. The other member listed brands which it dealt with and the number of motor dealers within each brand which had stopped selling PPI. It said that 109 groups out of 247 selling [✂] cars had stopped selling PPI—although some of these consumers might now be contacted directly rather than through the motor dealer. One of the members said it did not agree that its stopping selling PPI was unrelated to the possible impact of our remedies.

8. Regarding PLPPI distributors more generally, an internal LBG strategy document from October 2009 said that in June 2009 there were 37 businesses offering PLPPI, down from 46 in June 2008 and 58 in June 2007. It gave the following brands as examples of withdrawals: Northern Rock, Direct Line, Coventry Building Society, RAC, Barclaycard, Lombard Direct, Derbyshire Building Society and MBNA. It also said that, following the FSA action[3] on single-premium PLPPI, there were only seven banks offering PLPPI, three of which were part of LBG, and 23 stand-alone providers. Exits noted included those of Barclays, RBS and Egg.

9. There were also some withdrawals of CCPPI among the largest distributors:

- Barclays stopped selling CCPPI in the first half of 2009. A new protection product, Barclaycard LifestylePlan (LSP), was launched at the beginning of June 2010 on the Internet only to existing Barclaycard customers who were registered on Barclaycard's online account servicing facility. As of September 2010, LSP is available for all other customers on Barclaycard's website. Barclaycard is currently assessing how LSP can be rolled out across other channels, eg telephony and card sales/servicing.

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[2] In the 2009 report we concluded that motor finance PPI was a form of PLPPI.
[3] As noted in paragraph 4.7, on 24 February 2009 the FSA wrote to firms requesting them to stop selling single-premium PLPPI. This followed its welcome of moves by some firms, including LBG, to stop selling single-premium PLPPI.

- RBSG withdrew CCPPI from sale in branches in July 2009. The driver for withdrawal of branch sales of CCPPI was not the possible impact of the CC remedies package, but [✂]. In May 2010, RBSG withdrew CCPPI from sale through telephony and Internet channels.

- MBNA suspended selling CCPPI through telephone channels in November 2009. [✂]. Since this time, customers can choose to protect themselves by selecting LifestyleProtect on their credit card applications (direct mail and/or Internet applications); existing MBNA card customers can enrol in LifestyleProtect only through MBNA's Internet banking site.

- Santander withdrew CCPPI from branches in 2009. This was for the same reason as its withdrawal of PLPPI from branches.

10. Among smaller PPI distributors more generally there have also been withdrawals. The FLA told us that:

    - British Credit Trust (BCT) had now stopped selling loans and PPI;

    - The Funding Corporation left the market in 2009 and had no plans to return;

    - GE Home Money Lending had not been distributing or selling insurance products at the point of sale with loan or mortgages since early 2009; and

    - Advantage Finance Ltd left the PPI market in April 2009.

11. One of these parties said that the drivers for its withdrawal were FSA intervention and compliance uncertainty, but that the subsequent CC proposals 'sealed it'. Another said that major consideration for its exit from the market was the knowledge that de-linking the sale of PPI from the credit product together with an exclusion (no contact) period would kill the ability effectively to offer the product with a success rate that would make it worthwhile. A third said that one of its major considerations was the impact of the CC's remedies and having to comply with all its requirements which would be far more onerous. Its decision was also impacted by the poor decisions it was getting from the FOS.

12. There have also been changes among providers of stand-alone PPI and short-term income protection (short-term IP, which we concluded in the 2009 report was a form of PPI).

13. Two providers of stand-alone PPI, Post Office Financial Services (POFS) and RBSG (Churchill), withdrew from the market during 2009 and the product range of British Insurance was reduced to a single income protection product.

14. POFS saw a significant increase in sales volumes of its income protection product between September 2008 and January 2009 ([✂]). Following this, and linked to the deteriorating economic climate, its insurer experienced a significant increase in claims notification and subsequent claims costs. Prices were increased in April 2009 and although additional types of cover were introduced in April 2009 to reduce the impact of price increases, the higher prices, effects of negative publicity and reduced branch promotion resulted in a significant reduction in sales volumes. [✂].

15. POFS told us that other distributors of PPI had been able to absorb insurer premium increases by reducing their commission levels. As it had already reduced commission levels [✂].

16. RBSG withdrew its Churchill income protection product in May 2009 [✄].

17. The product range offered by British Insurance, which included MPPI, short-term IP and loan PPI, changed during 2009 partly as a result of a change in underwriters. It currently markets a general payment protection product via the Internet. It told us that consumers were cutting back during the recession and that, when applying for unemployment payment protection cover, an applicant would need to make a declaration about whether or not they felt they were aware of any potential redundancies. That may have been a harder question to answer for some individuals in 2009 than in previous years.

18. There have also been some new products launched. In early 2009 Columbus Direct introduced a new short-term IP product, and in May 2010 it introduced a new Lifestyle protection product. The iprotect brand was launched by Wessex Group in November 2007 offering short-term IP; this was followed by MPPI in October 2008. Millennium Insurance introduced a new stand-alone protection product in May 2010, and MMS launched its Keystone product in March 2009. In addition, Ant Insurance introduced new MPPI and short-term IP products in the first half of 2009 in order to offer more competitive products. These are being withdrawn and replaced with a short-term IP product.

19. It is therefore clear that there have been some significant withdrawals from PPI markets. However, certainly with regard to the largest suppliers of PPI, we saw no evidence that any withdrawals which have taken place have been because the suppliers in question concluded that they could not continue in the market because of the possible impact of our remedies.

Sales of PPI

20. Sales of PPI products and GWP fell in 2008 and 2009, a continuation of the decline which we saw starting as far back as 2003. Table 1 shows, for the 12 largest distributors of PPI (and the two largest providers of retail PPI), the number of policies sold in the years 2003 to 2009.

TABLE 1 **Number of policies sold by the largest parties, 2003 to 2009**

	2003	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Unsecured personal loan	3,573,732	3,250,244	2,517,679	2,066,493	1,667,123	1,191,413	377,800
First-charge mortgage	410,992	319,110	209,077	183,411	427,354	144,059	116,911
Credit card	3,202,891	2,564,381	1,661,996	1,332,476	1,293,514	1,042,053	709,653
Second-charge mortgage	153,461	140,905	109,373	106,957	78,524	38,664	2,314
Retail credit	945,532	863,709	436,877	405,623	337,048	301,817	195,170
Total	8,286,608	7,138,349	4,935,002	4,094,960	3,803,563	2,718,006	1,401,848

Source: CC from data provided by the parties.

21. Compared with 2008, there were fewer new policies sold in 2009 across all types of PPI. The number of new PLPPI policies sold by the largest distributors was about one-fifth of the policies sold in 2006; the number of new SMPPI policies sold was 98 per cent lower than in 2006; the number of new CCPPI and MPPI policies sold was about 45 per cent lower than in 2006, and the number of retail PPI policies sold was about half the number sold in 2006.[4]

[4]The data for 2009 is for 11 months only (to end November 2009).

22. Table 2 shows, for the 12 largest distributors of PPI[5] (and the two largest distributors of retail PPI), the GWP received in the years 2003 to 2009 for the main types of PPI policy. GWP is the amount of money (less insurance premium tax) paid by customers for their PPI policy, either payable up front at the start of a policy (in the case of a single-premium policy) or in monthly instalments over the life of the policy (in the case of a regular-premium policy). If a customer cancelled a single-premium policy early, they would be entitled to a rebate of part of the premium paid, which would result in negative GWP. We discuss this result and explain the negative GWP for PLPPI in 2009 in more detail below.

TABLE 2 **GWP for the five main product types**

£ million

	2003	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Unsecured personal loan PPI	2,515	2,398	2,176	1,786	1,602	1,224	−123
First-charge mortgage PPI	311	348	354	348	294	287	277
Credit card PPI	721	851	898	811	750	622	532
Second-charge mortgage PPI	269	331	386	464	363	169	5
Retail credit PPI	72	71	69	90	78	59	43
Total	3,887	3,998	3,883	3,499	3,088	2,360	735

Source: CC from data provided by the parties.

23. As with the number of new policies sold, the GWP received on each type of PPI declined in 2009, particularly steeply for PLPPI and SMPPI. We look here at the reasons for the declines in PLPPI and SMPPI, and then the reasons for the overall drop in the number of policies sold, and GWP received.

24. Overall PLPPI GWP in 2009 was negative. In 2009, five distributors ([✂]) reported negative GWP.[6] We were told that the sharp decline in PLPPI GWP was due to a number of factors:

- The launch of regular-premium policies to replace single-premium products. As explained in paragraph 22, GWP for single-premium policies was received up front at the start of the policy whereas GWP for regular-premium policies is received over the life of the policy. This means that there was a one-off drop in GWP received in 2008 or 2009 (depending on when each distributor stopped selling single-premium PPI), which would be followed by a recovery to a comparable steady state, which would take the number of years over which the average loan lasted.

- Rebates on cancelled single-premium policies outweighing the sum of GWP received on existing and new (regular-premium) policies. When an existing single-premium PLPPI and SMPPI product is cancelled, a rebate is due to the customer based on the original term of the policy. As regular-premium PLPPI is accounted for on an 'as-received' basis, if new and existing business is smaller than the rebates paid out on cancelled policies, the result is negative GWP. As new business fell away, the back book of cancellation refunds started to exceed the

[5]There have been consolidations in the industry (Lloyds TSB/HBOS; Santander/Abbey/Alliance & Leicester); however, the newly enlarged banks have provided data separately for the different parts of their business. For years up to and including 2007, the data was provided by the 12 largest distributors of PPI (Abbey, Alliance & Leicester, Barclays, Capital One, Cattles, HBOS, HSBC, Lloyds TSB, MBNA, Nationwide, Northern Rock, and RBSG) and the four largest providers of retail PPI (Express Gifts, JD Williams, Otto, and SDGFS). For 2008 and 2009, the data was provided by the 12 largest distributors (or in the case of Santander and LBG, business units thereof) of PPI (Abbey, Alliance & Leicester, Barclays, Capital One, Cattles, HBOS, HSBC, Lloyds TSB, MBNA, CYB, Nationwide, and RBSG) and the two largest distributors of retail PPI (JD Williams and SDGFS). Thus there are four differences in the sample pre- and post-2007: we collected data from one additional distributor after 2007 (CYB), and we stopped collecting data from Northern Rock, Otto and Express Gifts.

[6][✂] and [✂] also reported negative GWP for PLPPI to us for 2008. [✂]

premiums written for new business. We note that cancellation of PPI policies could result from (1) the PPI policy being cancelled (either by the customer or the distributor) due to mis-selling (if the bank or the FOS decides that the policy has been mis-sold, a refund covering the full cost of the PPI policy, including any interest paid on the premium, is likely to be made); (2) a customer terminating the policy early due to early settlement of the loan, and (3) a customer cancelling the policy but keeping the loan in place. We found that rebates totalling over £177 million were paid in 2009, though not all of those rebates were in relation to single-premium policies.

- Distributors ceasing selling PLPPI policies altogether (see paragraphs 6 to 8).

- Lower take-up of PLPPI policies.

25. Because of the level of rebates paid in 2009, we found the GWP levels reported for PLPPI in 2009 to be uninformative of the state of PLPPI markets in 2009; it under-reports very significantly the amount of money actually paid by consumers to distributors for PLPPI in 2009. Moreover, the change from single-premium policies means that, for those distributors which did sell regular-premium policies in 2009, the amount of money paid by consumers under-represents the number of policies sold by distributors compared with previous years—as for single-premium policies the entire cost of the policy was paid on Day 1 and reported in Year 1, whereas for regular-premium policies only the monthly premiums paid in that year are reported. Finally, the fact that several providers did not replace their single-premium policies but, given the evidence on parties' plans set out in Appendix G, we expect those exits to be temporary, we believe that these figures significantly underestimate the number of policies that would be sold in a typical year.

26. SMPPI GWP also dropped sharply, with Barclays stopping offering SMPPI policies in 2008 and Cattles in 2009. Of the largest distributors, only LBG offered second-charge mortgages and SMPPI in 2010, but LBG stopped offering SMPPI on 23 July 2010.

27. The reduction in the number of policies sold across all types of PPI products, and the resulting reduction in GWP received on policies, had two main causes.

28. The first was a reduction in credit volumes. Table 3 shows the total number of new loans sold by the largest 12 distributors in the years 2003 to 2009, by type of loan. It can be seen that there has been a general decline in the number of new credit agreements since 2003, but also a significant decline in 2008 and 2009 on the previous years' sales.

TABLE 3 **New loans sold, 2002 to 2009, by type of loan**

million

	2003	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Personal loans	4.4	4.4	4.0	4.3	3.9	3.2	2.0
Mortgages	2.2	2.0	1.7	1.8	1.7	1.4	0.9
Credit cards	10.6	9.5	7.3	6.6	6.7	5.9	4.7
Second-charge mortgages	0.2	0.2	0.2	0.2	0.1	0.1	0.0
Retail credit	3.3	3.2	3.7	3.7	3.7	3.0	2.7
Total	17.4	16.1	13.1	12.8	12.4	10.6	7.6

Source: CC from data provided by the parties.

29. This data on new loans sold is consistent with data on monthly mortgage approvals compiled by the Bank of England. Figure 1 shows the number of monthly mortgage

approvals dropping from approximately 300,000 in July 2007 to approximately 100,000 in July 2008. The number of monthly approvals between July 2008 and December 2009 has remained at this level.

FIGURE 1

Monthly mortgage approvals by volume

Source: CC based on data provided by the Bank of England.

30. The second effect contributing to a lower take-up of PPI policies, at least in some products, was a continuation of the longer-term reduction in PPI penetration rates. These are shown in Table 4. For 2008 and 2009, these are calculated as total number of PPI policies sold divided by the total number of loans sold only by distributors still selling PPI throughout most of the year (aggregate PLPPI penetration rates across all distributors would be much lower, because, as noted in paragraph 6, some distributors stopped offering PLPPI).

TABLE 4 **PPI penetration rates, 2003 to 2009, by type of loan**

	2003	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Personal loans	58	51	48	44	40	34	30
First-charge mortgages	20	17	14	12	10	11	14
Credit cards	39	31	26	22	21	21	20
Second-charge mortgages	83	80	74	70	56	45	36

Source: Table 2.5 of the 2009 report for 2002 to 2007; CC based on data provided by the parties for 2008 and 2009.

31. Penetration rates on all PPI products have been decreasing since at least 2004, with the exception of MPPI which increased in 2009. CCPPI penetration rates have stabilized since 2006, and SMPPI penetration rates dropped sharply in 2007, 2008 and 2009; SMPPI penetration has halved since 2006.[7] As noted in paragraph 2.25 of the 2009 report, reasons put to us for the decline in penetration rates included the shift by some PPI providers to selling PPI on a non-advised basis when the FSA took over regulation of PPI in 2005; regulatory scrutiny; and negative publicity in the media.

[7]SMPPI penetration rates are calculated on very low sales of secured mortgages in 2008 and 2009, due to the withdrawals from the market.

Shares of supply and sales by stand-alone providers

32. Tables 5 and 6 show the shares of supply for the largest distributors of PPI (and the two largest distributors of retail PPI) and underwriters respectively. We have not shown shares of supply for 2009 for distributors and underwriters due to negative GWP shown by some of the parties (see paragraph 24). Table 5 shows that over the period 2006 to 2008 Lloyds TSB saw the largest growth in share of supply, whilst Barclays and HSBC saw the largest reductions in their shares of supply. With the Lloyds/HBOS merger LBG has achieved a significantly larger share than the next largest distributor.

TABLE 5 **Shares of supply for the largest distributors**

	GWP 2006		*GWP 2007*		*GWP 2008*	
	£m	*%*	*£m*	*%*	*£m*	*%*
Abbey	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Alliance & Leicester	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Barclays	[✂]	*[15–20*	[✂]	*[10–15]*	[✂]	*[10–15]*
Capital One	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Cattles	[✂]	*[0–5]*	[✂]	*[5–10]*	[✂]	*[5–10]*
CYB	N/A	*N/A*	N/A	*N/A*	[✂]	*[0–5]*
HBOS	[✂]	*[10–15]*	[✂]	*[10–15]*	[✂]	*[10–15]*
HSBC	[✂]	*[5–10]*	[✂]	*[5–10]*	[✂]	*[0–5]*
JD Williams	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Lloyds TSB	[✂]	*[20–25]*	[✂]	*[25–30]*	[✂]	*[30–35]*
MBNA	[✂]	*[5–10]*	[✂]	*[5–10]*	[✂]	*[5–10]*
Nationwide	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Northern Rock	[✂]	*[0–5]*	[✂]	*[0–5]*	N/A	*N/A*
RBSG	[✂]	*[10–15]*	[✂]	*[10–15]*	[✂]	*[10–15]*
SDGFS	[✂]	*[0–5]*	[✂]	*[0–5]*	[✂]	*[0–5]*
Total	3,564.6	*100*	3,128.1	*100*	2,359.9	*100*

Source: CC based on data provided by the parties.

Note: N/A = not available.

TABLE 6 **Shares of supply for the largest underwriters**

per cent

	2006	*2007*	*2008*
Aviva	[25–30]	[25–30]	[25–30]
AXA	[5–10]	[5–10]	[0–5]
Cardif Pinnacle	[5–10]	[0–5]	[0–5]
Genworth	[0–5]	[0–5]	[0–5]
London General Insurance	[0–5]	[0–5]	[0–5]
Prudential	15–20]	[0–5]	[0–5]
Barclays	[10–15]	[10–15]	[10–15]
HBOS	[15–20]	[15–20]	[20–25]
Lloyds	[0–5]	[20–25]	[20–25]
RBS	[10–15]	[10–15]	[10–15]
HSBC	[0–5]	[0–5]	[0–5]
Total	100	100	100

Source: CC based on data provided by the parties.

33. Table 7, on stand-alone provision, shows that sales of all types of stand-alone PPI and short-term IP policies fell from around 116,500 in 2008 to around 61,000 up to November 2009. This was mainly due to a reduction in the sales of stand-alone MPPI policies. One provider ([✂]) stopped selling stand-alone MPPI as a separate product and another ([✂]) saw a very significant reduction in sales.

TABLE 7 **Provision of stand-alone PPI and short-term IP policies**

Credit product	*Company*	*Name of policy*	*Sales*			
			2006	*2007*	*2008*	*11 months to November 2009*
Credit cards	Barclays	Barclaycard Plan B for multiple cards	[✂]	[✂]	[✂]	[✂]
Credit cards	Paymentcare	Credit Card Payment Protection Insurance	[✂]	[✂]	[✂]	[✂]
Personal loans	British Insurance	Loan Payment Protection Insurance	[✂]	[✂]	[✂]	[✂]
Personal loans	Paymentcare	Loan Payment Protection Insurance	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	Abbey	Paymentcare Mortgage Payment Protection	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	Alliance & Leicester	Bill Protector (until May 2007)	[✂]	[✂]	[✂]	[✂]
		Mortgage Payment Protection Insurance (from February 2008)				
First-charge mortgages	Barclays	Openplan protect and mortgage care		[✂]		
First-charge mortgages	British Insurance	Mortgage Payment Protection Insurance	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	Cardif Pinnacle	Helpucover	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	HBOS*	Total Mortgage Protection Plan	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	HSBC‡	Mortgage Repayment Protector	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	Paymentcare	Mortgage Payment Protection Insurance	[✂]	[✂]	[✂]	[✂]
First-charge mortgages	Paymentshield	Mortgage Payment Protection Insurance (includes BestQuote, FreeFirst, FreeStart, MortgageShield, MortgageProtector & MortgageProtectorSoloSales)	[✂]	[✂]	[✂]	[✂]
Second-charge mortgages	British Insurance		[✂]	[✂]	[✂]	[✂]
Short-term IP	Barclays	Lifestyle Protector ([✂])	[✂]	[✂]	[✂]	[✂]
	Barclays	Income Insurance	[✂]	[✂]	[✂]	[✂]
IP	British Insurance	First Assist Income	[✂]	[✂]	[✂]	[✂]
Short-term IP	HBOS	Bill Protector	[✂]	[✂]	[✂]	[✂]
	HBOS	Life Style/Life Stage	[✂]	[✂]	[✂]	[✂]
Short-term IP	HSBC‡	LifeChoices (launched June 2007)	[✂]	[✂]	[✂]	[✂]
Short-term IP	MBNA	Extra Cash (pilot)	[✂]	[✂]	[✂]	[✂]
Short-term IP	NHI Services Ltd	Payprotect	[✂]	[✂]	[✂]	[✂]

Credit product	Company	Name of policy	Sales 2006	 2007	 2008	 11 months to November 2009
Short-term IP	POFS	Lifestyle	[✄]	[✄]	[✄]	[✄]
Short-term IP	RBSG	Churchill Income Protection	[✄]	[✄]	[✄]	[✄]

Source: CC based on information from the parties.

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*The 2009 figures do not represent a full year of active sales as not all the products were on sale for the whole year.
†Following the submission of the 2007/08 data to the CC in September 2008, HBOS discovered that most of the mortgage PPI sales reported to be stand-alone were in fact sales to remortgage customers. HBOS reported this to the CC and said that the number of actual stand-alone sales was in reality extremely small, estimating that around [✄] per cent of the sales which it reported as being stand-alone were true stand-alone sales. The figures included in this submission have therefore been calculated on this basis.
‡HSBC told us that it was not currently selling PPI through any of its brands. HSBC currently offers to customers to whom it previously offered PLPPI and CCPPI the chance to discuss their broader protection needs with one possible outcome being to take LifeChoices (if it is the most suitable product), a short-term IP product. Customers who were previously offered MPPI are offered LifeChoices subject to suitability. The sales figure quoted here is derived by analysing the number of LifeChoices sales with an Accident, Sickness or Unemployment component where no credit sale had been made in the previous 120 days and as such has been defined as 'stand-alone'. In Jan–Nov 2008, [✄] per cent of LifeChoices sales were stand-alone; in Jan–Nov 2009 it was [✄] per cent.
§MBNA has made no stand-alone sales since ceasing to offer Extra cash product in July 2007.

Notes:
1. N/A = not applicable.
2. N/P = not provided.

Distributor income

34. Distributors generate income in the form of commission and profit share, as a proportion of GWP. The amount of income as a percentage of GWP is set out in the contract between distributor and underwriter. Commission is normally a percentage of GWP, and profit share is a percentage of profits once claims and underwriter expenses have been taken into account. The income figures we set out below are a combination of commission and profit share. We set out in Figure 4.1 of the 2009 report how GWP is split between distributor and underwriter. Overall, the income received by distributors in the years 2003 to 2005 remained at approximately £2.6 billion per year, although by 2006 and 2007 it had dropped to £2.2 billion per year.

35. In 2008 the income dropped further, to £1.8 billion, and to £517 million in 2009. The reduced income was partly due to lower GWP (see paragraph 24); we were told that it was also due to increased claims which reduced the profit available to be shared between the underwriter and distributor (paragraph 52 sets out evidence on the relative importance of profit share to distributors' income).

36. In 2009 five distributors reported negative PLPPI income ([✂]):

- [✂] told us that single-premium GWP and income were negative as they were shown net of refund premiums paid back to customers due to terminations. As new business had fallen away, the cancellation refunds on the back book had started to exceed the premiums written for new business.

- [✂] told us that the PLPPI income figure for 2009 was negative because (1) it withdrew from the sale of single-premium PLPPI in [✂] and thus no new business income was received for single-premium PLPPI after that and (2) a provision was made for its share of future claims on policies which remained in place.

- [✂] and [✂] told us that the negative income was a result of commission being clawed back on refunds of single-premium policies, which outweighed the income from new regular-premium policies.

37. In terms of MPPI:

- [✂] told us that MPPI income was lower in 2009 than in previous years because (1) there was no profit share between [✂] due to the high level of claims on policies and (2) the underwriter increased the cost of providing the cover to reflect the deterioration in the economic environment: RBSG chose not to pass the increased cost on to the customer which effectively reduced the commission rate.

- [✂] also told us why its commission and profit share income as a percentage of GWP on first-charge mortgages was very low (13 per cent): increased claims rates resulted in a negative profit share, which was netted against commissions paid.

38. Table 8 shows the distributor income between 2005 and 2009.

TABLE 8 **Distributor income, 2005 to 2009, by PPI product**

£ million

	2005	*2006*	*2007*	*2008*	*2009*
PLPPI	1,523	1,179	1,202	1,023	59
MPPI	173	181	185	148	84
CCPPI	710	625	608	501	339
SMPPI	154	195	156	99	9
RPPI	47	63	55	38	28
Total	2,608	2,242	2,205	1,810	519

Source: CC based on data provided by the parties.

39. In the years 2003 to 2006 distributor income (in the form of commission and profit share) was approximately 66 to 68 per cent of the total GWP received on policies. Overall, distributor income was 77 per cent and 71 per cent of GWP in 2008 and 2009, although these figures must be interpreted with caution as the GWP for PLPPI in 2009 and some parties' reported income was negative (see paragraph 24) which skews the overall result. Looking at regular-premium policies only, distributor income was 72 per cent and 53 per cent of GWP in 2008 and 2009 across all products. This suggested that the proportion of income paid out in the form of profit share from the underwriter had only decreased significantly in 2009 but not 2008.

40. Most large distributors told us that during 2007 to 2009 they did not make significant changes to the prices of any of their PPI or short-term IP products (where significant meant a change which resulted in an increase or decrease of the price charged to the customer of 5 per cent or more). We set out below the price changes made by RBSG, HSBC and LBG, and price decreases seen in 2009.

41. RBSG told us that in December 2007, in relation to PLPPI, it increased the price of its single-premium product by 5 per cent; and in September 2007, it changed the way in which the CCPPI premium was calculated for the NatWest, RBS and MINT brands—from £0.79 per £100 based on the customer's balance at statement date to £0.79 per £100, or part thereof, based on the customer's highest balance in that month rather than at statement date. In May 2008, Ulster Bank changed to the same calculation model.

42. HSBC told us that, in relation to LifeChoices, in August 2008 and again in July 2009 price increases were implemented due to high claim rates under the unemployment and sickness components. Unemployment cover was priced at £2.40 per £100 of cover at launch in July 2007. In August 2008, the price was increased to new customers to £2.75 per £100 and in July 2009 the price for new customers was increased again to £3.25 per £100. (These price changes were implemented only in respect of new business.)

43. LBG told us of price rises in the Lloyds TSB and HBOS businesses:

- For PLPPI HBOS's risk-based pricing matrix changed twice in 2007 and once in 2008, with some risk categories experiencing price increases and others price decreases each time. In 2009 it replaced its existing product with a new product; and in December 2009 it implemented a change in pricing, with the changes varying between a price decrease of 9 per cent (for £100 insured—the only pricing point to see a price decrease) and a price rise of 34.8 per cent (for £1,500 insured). For Lloyds TSB PLPPI there was a 7 per cent price increase for new business applied in January 2007, and a further 6 per cent price increase for new business applied in December 2007, although this was reduced by 4.7 per cent in March 2008. For Lloyds TSB's Asset Finance Division in May 2007 Professional

Financial Services PPI Broker offerings increased by 7.5 per cent, and a further 7 per cent increase in October 2007. In November 2007 all offerings were capped at 60 per cent of the loan repayment, which constituted a price decrease for some consumers; the change was instigated when it was realized that some customers' monthly repayment amount exceeded the month loan repayment amount. In July 2008 the offers were capped at 40 per cent of the loan repayment, which again constituted a price decrease for some customers.

- For CCPPI in February 2008, HBOS's premium calculation was changed so that it was based on the highest balance during the previous statement month. In April 2009 a similar change was made for AA, Sainsbury's and Britannia CCPPI products.

- For MPPI, in 2008 HBOS unbundled its MPPI product, offering single-peril products at lower prices to its former ASU-only policy. In December 2009 it increased its MPPI prices for new business by between 14 per cent (AS cover) and 35 per cent (U-only cover).

44. The only price decreases we saw in 2009 were directed by the FSA, ie reversals of price increases made to MPPI policies. Santander told us that Abbey Paymentcare (MPPI) and Alliance & Leicester Mortgage PaymentCover (MPPI) rates increased in March 2009 as a result of the expected increase in underwriting claims cost due to the worsening economic conditions, but as a result of an agreement between the industry and the FSA, all affected customers would be reimbursed for this rate increase.

Claims

45. In paragraph 10.112 of the 2009 report we noted evidence received from parties that the number of claims had increased significantly between autumn 2007 and autumn 2008. During the remittal we received evidence that claims had continued to rise in 2009, especially for MPPI. Some parties said to us that claims had increased significantly during the recession and this had had an impact on profit margins. We looked at the evidence on claims, and their impact.

46. We looked at the claims frequency (which we defined as the number of claims accepted in a year as a proportion of the average number of active policies in a year) between 2002 and 2009.

47. We found that, overall, and for PLPPI, claims frequency was fewer than three in 100 policies in 2009, slightly higher than two in 100 policies in 2002. Claims frequency for MPPI had increased between 2002 and 2009, with just over five claims per 100 policies in 2009 compared with just under four claims per 100 policies in 2002. Claims on credit card and second-charge mortgage had actually fallen between 2002 and 2009, with just over one claim per 100 policies for credit cards, and just under three claims per 100 policies for second-charge mortgages, in 2009. This is shown in Table 9.

TABLE 9 **Claims frequency, 2002, 2006 and 2009**

per cent

	PPI on personal loans	*PPI on first-charge mortgages*	*PPI on credit cards*	*PPI on second-charge mortgages*	*Total all PPI*
2002	2.39	3.65	1.99	2.97	2.03
2006	1.70	2.77	0.88	1.14	1.25
2009	2.94	5.23	1.08	2.95	2.27

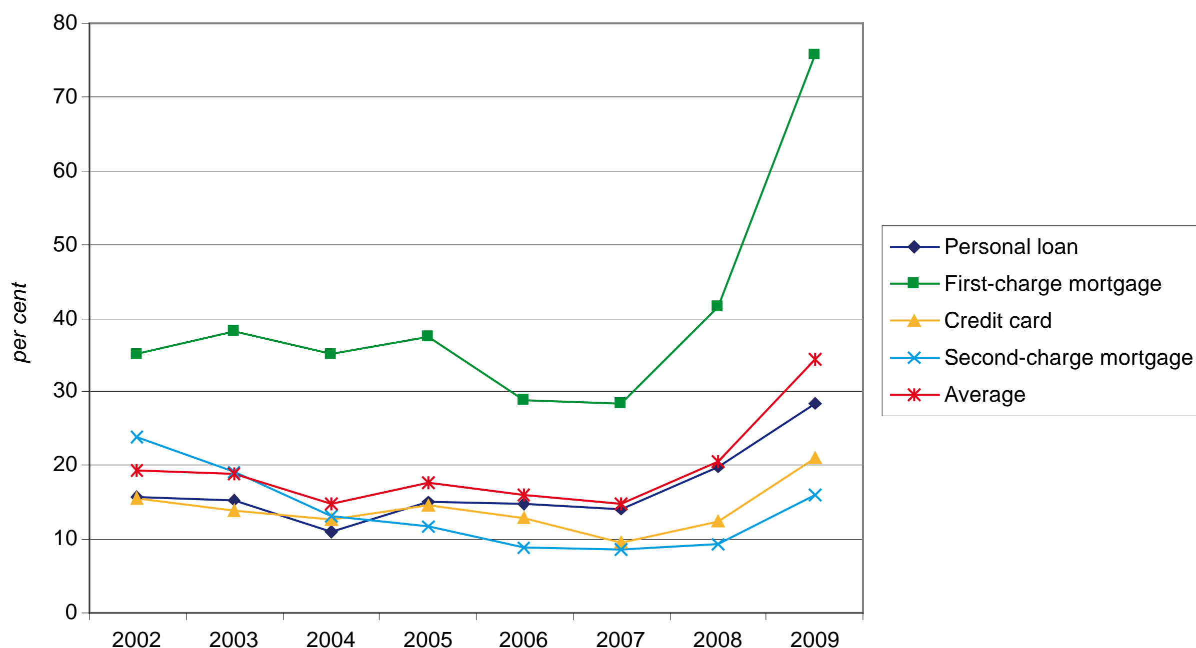
Source: CC based on data provided by the parties.

48. We also looked at the claims ratio. The claims ratio is calculated as claims paid as a percentage of net premiums earned,[8] and depends both on the amount of premiums earned and on the claims experience. During 2009, looking at PPI as a whole, the value of claims paid has increased as the frequency of claims has risen (particularly in relation to MPPI and unemployment claims) while at the same time the amount of premiums earned has reduced due to the various factors outlined in paragraphs to 18. As a result of these developments, claims ratios have risen since 2007, with a particularly large rise in relation to MPPI.

49. Figure 2 shows the claims ratios for different types of PPI policies over the period 2002 to 2009. Between 2002 and 2007 they declined slightly for all types of PPI. In 2008 the average increased slightly, and doubled in 2009 from its 2008 level (to 34 per cent).

FIGURE 2

Claims ratios, 2002 to 2009



Source: CC, based on data provided by the parties.

50. The largest increases in claims ratio were in 2009 for MPPI (to 76 per cent) and an increase to 28 per cent for PLPPI. By contrast, claims ratios for SMPPI and CCPPI

[8]Net premiums earned are calculated as GWP, net of reinsurance and any change in provision for unearned premiums. Claims are calculated net of reinsurance and any change in provision for claims.

increased but were still only around or below 20 per cent (and in 2009 the claims ratio for SMPPI was below levels experienced in 2002 and 2003).

51. The high claims ratio for MPPI was experienced by all but one of the underwriters from which we collected data. The claims ratios for PLPPI, SMPPI and CCPPI were constant across the underwriters.

52. Distributors receive income from PPI as a mixture of up-front commission and profit share. The latter is paid from the money left after all claims are paid out. Most of the income received by a distributor on a PPI policy is as commission; the profit-share element of its income is a small proportion of its overall income on a PPI policy.[9] For example, [✂] contracts with [✂] for MPPI and PLPPI include up-front commission payments of [✂] and [✂] per cent respectively, and [✂] per cent (less than many other contracts we have seen) of the scheme underwriting profit is returned to [✂]. In the years 2004 to 2008 profit share accounted for 15 per cent (£[✂] million of the £[✂] million) of the income [✂] received from the contracts. This example shows how distributors receive most of their income as commission, with only a relatively small proportion as profit share; as such an increase in claims generally has more of an impact, in the short term, for underwriters than for distributors—unless the increase in claims is so extreme as to lead to changes to the contractual relationship between distributor and underwriter.

53. Contracts between distributors and underwriters recognize that claims experience can vary over time. As noted in paragraph 71 of Appendix 7.1 of the 2009 report, the underwriter often has the contractual right to adjust the existing terms of the agreement with the distributor, for example by increasing rates (ie prices) on monthly-paid policies, reducing commission rates or changing the terms and conditions of the policy (for example, by widening exclusions), with an appropriate notice period. Such changes could be invoked if the underwriter was faced with a shortfall, or possible shortfall, of premiums from which to pay claims on policies.

54. We asked the main parties for evidence on any changes made to the contractual arrangements between underwriters and distributors.

55. The only adjustments to contracts we were made aware of related to negotiations prompted by increases in MPPI claims, and expected significant further increases in MPPI claims. In these cases the proportion of GWP paid to the underwriter to meet the underwriter's costs was increased, to enable it to meet claims on MPPI policies. For example, in light of an expected 300 per cent increase in claims ratio for its MPPI contract with [✂], [✂] negotiated a 37 per cent increase in net premium for 2009 (having sought an increase of 48.5 per cent). In doing so, to show its commitment that the required net premium rating action was to do no more than guard against an underwriting loss in 2009, it agreed to return 100 per cent of any underwriting profit to [✂] (the profit-share arrangement was previously 85/15 in [✂] favour). Moreover, [✂] passed the increase through to consumers so it made the same absolute level of return.

56. We received no evidence of changes to contracts between underwriters and distributors made for any other PPI product.[10]

---

[9]In paragraph 2.62 of the 2009 report we found that typical commission rates were 50 to 80 per cent for PLPPI and CCPPI and 40 to 65 per cent for MPPI. Table 2 of Appendix 4.4 of the 2009 report set out the aggregate income (commission and profit share) for each product type in 2006. For PLPPI it was 66 per cent; for CCPPI it was 77 per cent; for MPPI it was 52 per cent; and for SMPPI it was 42 per cent.

[10]Negotiations for an increase in net premium for [✂] on its CCPPI contract with [✂] were conducted, but the increase was not made.

57. The claims experience for MPPI did lead to some contract adjustments, but distributors still maintained a significant share of GWP as commission under these re-negotiated contracts, and if less money was required to pay for claims than set aside then distributors would still receive most or all of this through the profit-sharing arrangements. This indicated to us that the risk was still borne by the underwriter, most notably because it would suffer any losses resulting from claims exceeding expectations.

58. Some parties reacted to the upturn in claims by removing some policies from sale, to minimize future risk. For example, some companies withdrew unemployment-only insurance policies from sale: the Cheshire Building Society removed the unemployment-only option cover from MPPI policies for new business at the same time as implementing a rate increase in May 2009.

Profitability

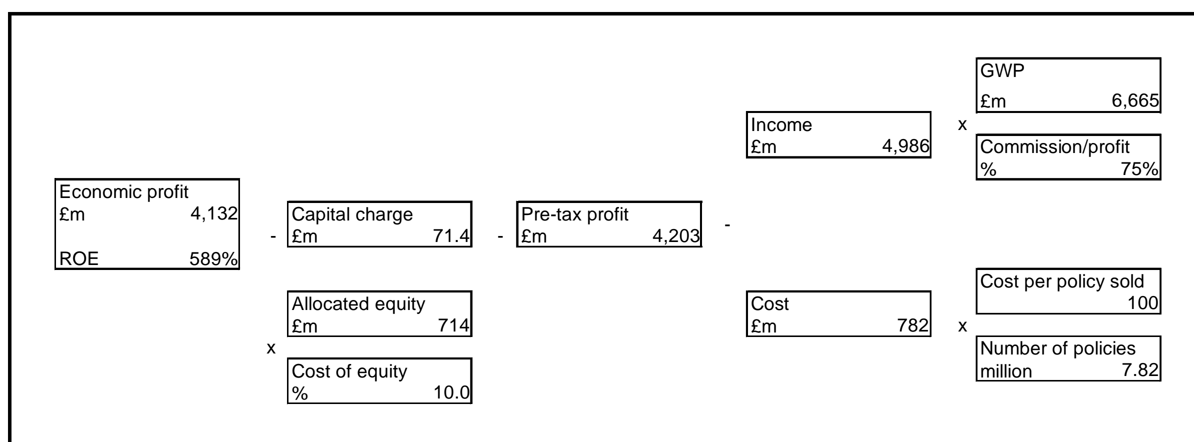
59. This section sets out the results of the profitability analysis we carried out to determine the size of the consumer detriment for each type of PPI product. The consumer detriment figures were used in the modelling of static consumer benefits from the package of remedies.

60. We originally calculated the economic profits (the post-tax profits less a charge to reflect the cost of capital required to support the distribution of PPI) earned by the 12 largest distributors of PPI and set the results out in Section 4 and Appendix 4.4 of the 2009 report. We updated these calculations to take account of 2008 and 2009.

61. We estimated the consumer detriment for each PPI product for the five years 2005 to 2009 by calculating the total pre-tax economic profits earned by distributors over this five-year period. Figures 3 to 7 show the total consumer detriment and return on equity for each PPI product.

FIGURE 3

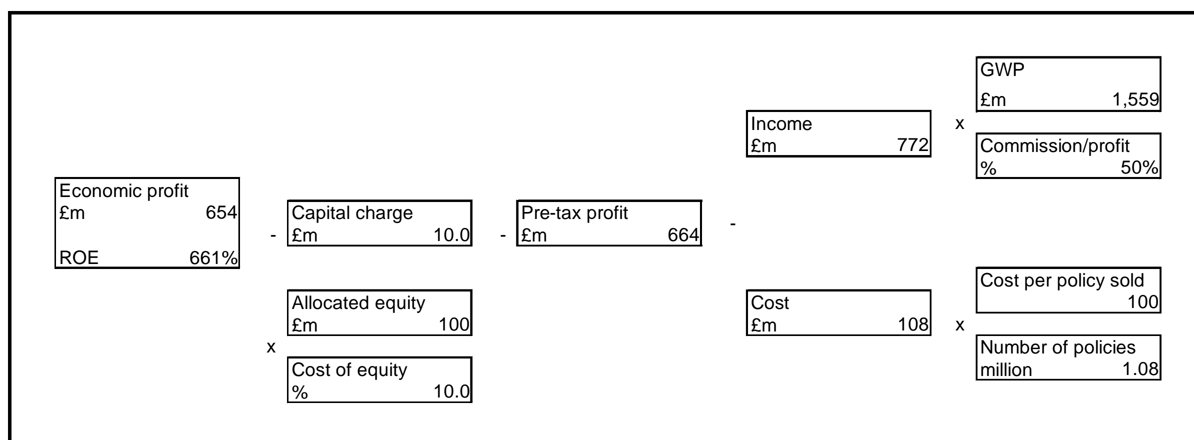
PLPPI pre-tax economic profits, 2005 to 2009



Source: CC based on data provided by the parties.

FIGURE 4

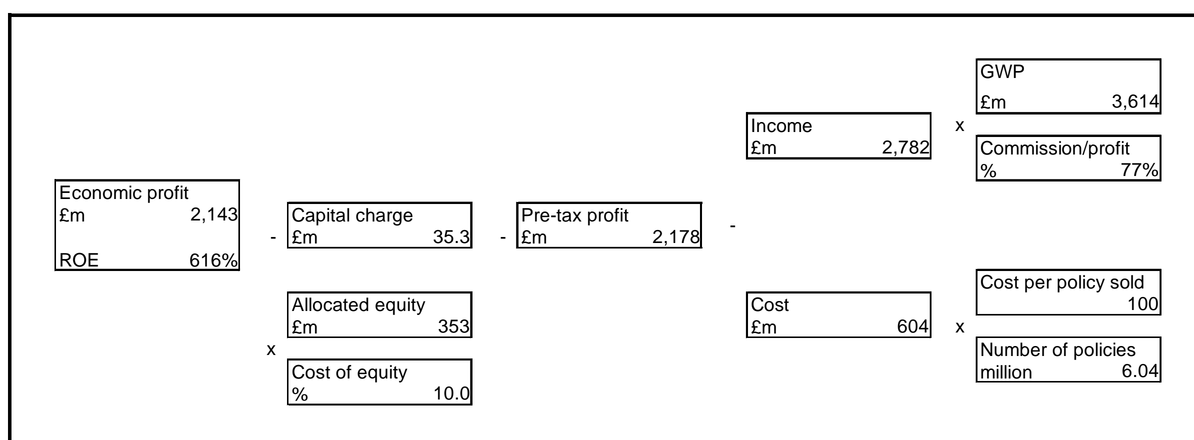
MPPI pre-tax economic profits, 2005 to 2009



Source: CC based on data provided by the parties.

FIGURE 5

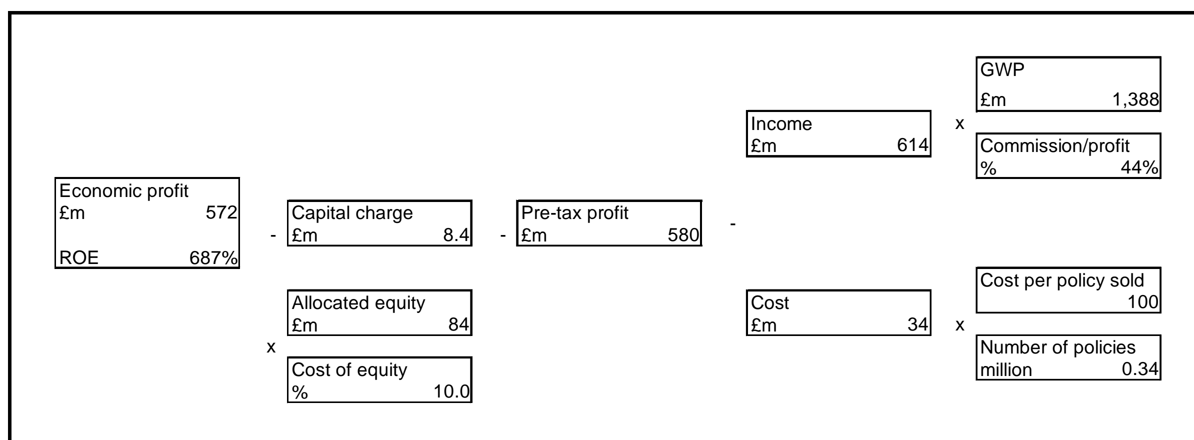
CCPPI pre-tax economic profits, 2005 to 2009



Source: CC based on data provided by the parties.

FIGURE 6

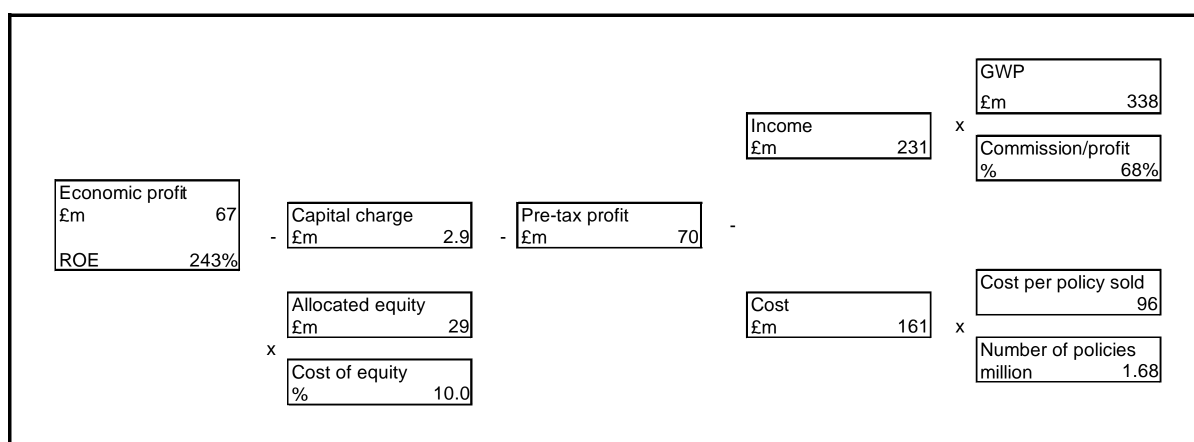
SMPPI pre-tax economic profits, 2005 to 2009



Source: CC based on data provided by the parties.

FIGURE 7

Retail PPI pre-tax economic profits, 2005 to 2009



Source: CC based on data provided by the parties.

62. Table 10 summarizes the average annual pre-tax economic profits for each PPI product for the five-year period 2005 to 2009. We took these figures as the consumer detriment and included them in the modelling of static consumer benefits from the package of remedies.

TABLE 10 **Average annual pre-tax economic profits by PPI product, 2005 to 2009**

	Average annual pre-tax economic profits £m
PLPPI	826.4
MPPI	130.8
CCPPI	428.6
SMPPI	114.3
RPPI	13.5

Source: CC based on data provided by the parties.

Sales quality issues and customer complaints

Introduction

1. This appendix summarizes the history of action taken by the FSA in relation to sales quality issues[1] in the selling of PPI and information about consumer complaints provided by the parties and by the FOS (in relation to complaints referred to it).

Parties' comments on the relevance of complaints and sales quality

[✂]

2. [✂] told us that PPI mis-selling was not unique to point-of-credit-sale transactions. Any adjustment to the size of the PPI market due to mis-selling complaints should be made to all distribution channels, point of credit or stand-alone. [✂] also told us that the FSA had repeatedly stated that there was a significantly lower risk of mis-selling with MPPI and therefore any amendment for this product should be minimal.

[✂]

3. [✂] said that our proposal to use information on complaints and alleged mis-selling was unclear and raised serious concerns. [✂] view was that no allegations of wide-spread mis-selling of PPI had been substantiated by the CC and that any attempt to use such evidence to support the POSP might mean that the CC was taking into account irrelevant considerations. It said that the inclusion of an analysis of alleged mis-selling as part of the proportionality assessment lacked clarity and raised a number of serious concerns: *(a)* the CC would need to link alleged mis-selling to AEC or resulting consumer detriment; *(b)* there was no reference in the CC's analysis to date to any link between alleged mis-selling and the point-of-sale advantage and as a result alleged mis-selling had never been analysed as a feature of the market that might give rise to an AEC nor as part of the detrimental effects on consumers resulting from the features of the market identified; and *(c)* [✂] was not clear what potential benefits the CC was referring to when it suggested that there could be a reduced incentive and ability to mis-sell as a result of the POSP. Neither had the CC analysed whether a reduction in alleged mis-selling might be expected (only) to arise as a result of an increase in competition in the sale of PPI resulting from the POSP. It said that the CC had never suggested that the package of remedies was aimed at ensuring more compliant sales processes nor had it assessed the extent to which the package of remedies may be effective in achieving this.

4. [✂] therefore submitted that the CC risked taking into account an irrelevant consideration by considering a reduction in alleged mis-selling as a benefit of the POSP. [✂] said:

   (a) no convincing evidence of any mis-selling had been provided by the CC;

[1]We use the term 'sales quality issues' to refer to non-compliant sales processes and other possible failings at the PPI point of sale (see for an example of possible non-compliant sales process the FSA update on its review of the sale of PPI, FSA/PN/112/2008). Sales quality issues may include cases in which PPI has been mis-sold (see Annex A for a summary of a note by the FSA on what it regards as mis-selling) as well as cases where PPI has not been sold according to the FSA's Principles of Business (see Annex B).

(b) it was not clear to [✄] why any supposed mis-selling of PPI might change because of an increase in competition in the market;

(c) it was very likely that any benefit would also arise from alternative remedy packages;

(d) mis-selling had not formed a material part of the investigation;

(e) the FSA had in the past been active in regulating sales of PPI. Any consumer detriment that was identified should and would be addressed through FSA regulation. It would not be appropriate for the CC to include any benefits arising from lower mis-selling in its consideration of benefits arising from the remedy package, since on a counterfactual analysis such concerns would be dealt with by the FSA; and

(f) the public perception of PPI had been negatively affected by the coverage of the investigation itself. This would have introduced bias into the number of customer complaints.

[✄]

5. [✄] told us that it was not clear whether the CC thought its remedies would reduce mis-selling simply by reducing the volume of sales of PPI or whether the CC considered that sales processes would become better as a result of the remedies, leading to less mis-selling. It suggested that non-advised sales made after the credit point of sale were likely to be of lower quality, even if not entailing mis-selling.

6. [✄] took issue with any assumption that there had been significant mis-selling in the past, and would be in the future. It referred to the extensive debate with the FSA and said that the industry had serious concerns with the position taken by the FSA. It believed there had been an incorrect (and often retrospective) interpretation of sales standards by the FSA and observed that in its thematic work the FSA generally felt that sales standards were improving. [✄] said that it would be inappropriate for the CC to consider mis-selling when there was an ongoing debate between the industry and the FSA.

7. [✄] gave further information on the actions of the FSA across the market. It said that the FSA had undertaken three thematic reviews into PPI, revisions to the ICOB section of its Handbook and the issuance of more than 20 Enforcement Notices. [✄] also referred to the consultation documents recently published by the FSA, which asserted widespread mis-selling of PPI.[2] [✄] said that there was extensive debate between the industry and the FSA about the consultations. The industry believed that the FSA and the FOS had wrongly based their views that PPI had been widely mis-sold on a mistaken interpretation of the sales standards applying to PPI sales and a mystery shopping exercise undertaken was flawed. [✄] said that it would not be appropriate to make any assumptions about the extent of any PPI mis-selling until the standards had been clarified and the other issues being consulted on had been resolved.

8. [✄] said that PPI mis-selling was a regulatory issue to be determined by the FSA. If the CC wished to rely on the views of the FSA, it should wait until those views had been settled.

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[2]CP09/23 and CP10/6, consultation papers proposing new DISP rules and guidance as to how firms should handle existing and future complaints about PPI.

9. [✄]

10. In terms of complaints, [✄] noted that the FSA had stated that the level of complaints was an indicator of the extent of mis-selling. [✄] said that its complaint rates were low [✄],[3] and this was further evidence that there had not been widespread mis-selling.

11. Finally [✄] said that the FSA had relied in CP09/23 and CP10/6 on the increasing number of complaints upheld by the FOS (some 90 per cent of all PPI complaints). [✄] said that the FOS had been inconsistent and, in particular, its uphold rate in relation to [✄] single-premium unsecured loan PPI had increased from [0–10] per cent in 2006 to [90–100] per cent in 2009. It suggested that the FOS was applying new sales standards to the determination of complaints and [✄]. In addition, [✄] said that the FOS applied the criterion of 'fairness' in reaching its decisions, which was a wider and more flexible standard than the FSA rules to which [✄] adhered.

12. [✄] concluded that it would be incorrect to assume that there had been and was widespread mis-selling in the industry. It said that there might have been problems at some firms historically but there were no widespread mis-selling practices today. It said that the FSA now found that over 90 per cent of the firms visited were now making it clear to customers that PPI was optional. [✄] also said that as a result of FSA involvement, all firms included clear breakdowns of price in customer agreements so customers could not be materially misled on the price of PPI.

FSA initiatives on PPI mis-selling and complaints

13. The FSA took over responsibility for General Insurance regulation from the General Insurance Standards Council in 2005. The key PPI activities undertaken by the FSA since 2005 are listed below, with further details provided in Annex C.

Thematic reviews

14. The FSA has conducted three thematic reviews of PPI, which involved mystery shopping exercises. In 2005, as a result of the first review the FSA issued a 'Dear CEO' letter that instructed firms to improve sales standards and the disclosure of: the optionality of PPI; its price; whether it was regular or single premium; refund terms; and the limitations and exclusions. It also suggested that there were wider competition issues in the PPI market and said that it was liaising with the OFT.

15. In October 2006, the FSA published the second thematic review and noted that limited progress had been made by firms. In particular, many firms were still not giving customers clear information during the sales process. It was not being made clear that PPI is optional and customers were not getting full information about cost; customers were still not being made fully aware that they might not be able to claim under some aspects of the policy. Firms were still failing to establish that the PPI policies they recommended were suitable because they were not collecting sufficient information from the customer; and where customers were sold single-premium policies, this was not always done with the best interests of the customer in mind—for example, the sales conversation might be biased towards a single-premium policy when this was not the most suitable option.

[3] [✄]

16. In March 2007, agreement was reached to phase out nil-refund terms. Previously many customers who terminated a single-premium policy before term (eg because they paid off the loan early) received none of their single-premium payment back.

17. In September 2007, the third thematic review showed improvements in some areas, but the FSA said that many firms were still failing to treat their customers fairly. The FSA noted that it had, on a number of occasions, set out clearly its requirements for the sale of PPI. It said that it was extremely disappointed that some firms had still made little progress in improving sales practices and that too many firms were not meeting the FSA requirements.

18. The FSA found that improvements had been made in some areas: the majority of firms were making it clear to customers that PPI was optional; and firms were offering cancellation refunds on virtually all single-premium PPI policies. However, the FSA found that many firms were still not giving customers clear information about the product and its cost; the extent they were eligible for cover; what they were covered for; and why the recommended PPI policy met their demands and needs.

19. In February 2009, the FSA wrote another 'Dear CEO' letter to firms, requesting them to stop offering single-premium PPI with unsecured personal loans.[4]

FSA enforcement actions

20. The FSA took 23 enforcement actions over the period from September 2006 to October 2009, largely as a result of its thematic reviews. The largest fine was £7 million in October 2008, when Alliance & Leicester was fined for serious failings in its telephone sales of PPI. In total, fines have amounted to £12.6 million. The Alliance & Leicester fine and other significant fines (over £500,000) are listed in Table 1. Further details are provided in Annex C. The FSA considered that in each case several of its principles for business (see Annex B) had been breached.

TABLE 1 **FSA PPI enforcement actions**

Company	*Date*	*Fine*	*Reason*
Alliance & Leicester	Oct 08	£7 million	Failure to disclose price details, selling without establishing demands and needs, failing to disclose that PPI was optional, and pressure selling.
HFC bank	Jan 08	£1.1 million	Inadequate assessment of customer needs.
Liverpool Victoria	Jul 08	£840,000	Optionality of PPI, explanation of mechanism of single premium, explanation of exclusions and limitations, failure to be clear and not misleading.
Swinton Insurance	Oct 09	£770,000	Built PPI into quote automatically.
Egg Banking	Dec 08	£721,000	Over-emphasized the benefits of PPI, used objection handling techniques, applied PPI to credit card sales anyway.
GE Capital	Jan 07	£610,000	Inadequate information, staff training, monitoring, compliance.

Source: CC from information provided by the FSA.

21. It is clear from Table 1 and the further detail in Annex C that the concerns of the FSA that have led to enforcement actions so far have concerned sales practices and have involved firms which sell PPI at the credit point of sale.

[4]This followed the withdrawal of a number of parties from the sale of single-premium policies—see paragraph 10.247 of the 2009 report.

FOS raising PPI complaints as a wider implications issue

22. In July 2008, the FOS wrote to the FSA raising the issue of PPI complaints as a wider implications issue (wider implications issues are those issues which may affect a large number of consumers or firms. It requires the FSA to consider whether a regulatory solution may be more appropriate than the FOS deciding individual cases). The FOS asked the FSA to consider appropriate regulatory action to ensure that firms took appropriate and proportional action to remediate customers. This was one of the reasons behind the FSA's consultation exercise on the assessment and redress of payment protection insurance complaints (see paragraphs 23 to 26) below.

Consultation paper concerning complaints

23. After significant pre-consultation with industry, in September 2009 the FSA published consultation paper CP 09/23, *The assessment and redress of payment protection insurance complaints*. The proposals stem from the FSA's 'serious concerns about the fairness with which firms have assessed consumer complaints about past PPI sales, which have significantly increased in recent times'.

24. The FSA considered that firms' unfair assessments of PPI complaints reflected:

    (a) deficiencies in the general assessment of PPI complaints, including not investigating them properly and giving too little weight to the particular events and circumstances of the specific sale;

    (b) specific deficiencies in assessing PPI complaints arising from firms' failure to consider appropriately PPI sales standards (including FSA principles); and

    (c) deficiencies in assessing fair redress where a complaint was upheld.

25. CP09/23 set out guidance on:

    (a) the fair assessment of a complaint, intended to ensure that firms give a balanced consideration to evidence about PPI complaints and consider the complaints fully and in the round;

    (b) standards for calculating redress where the complaint is upheld; particular detail is provided on the redress of complaints about single-premium policies; and

    (c) a review rule requiring firms to reassess against the guidance PPI complaints previously rejected.

26. A further consultation, CP10/6, was published on 9 March. The further consultation on CP 10/6 closed on 22 April 2010. The FSA published its final policy statement on 10 August 2010 (see paragraph 4.20).

Information provided by the parties

Information on complaints

27. We requested information on complaints from the larger parties. The parties[5] each provided information on complaints made over the last three years covering:

- total complaints (from all sources) made to the party;
- the number upheld by the party;
- the redress paid to the customer;
- the number of complaints referred to FOS;
- the number of complaints upheld by the FOS; and
- the compensation paid for complaints upheld by the FOS.

28. We compared the parties' responses with information on complaints published by the FOS. We also received information direct from the FOS. The results are reported below.

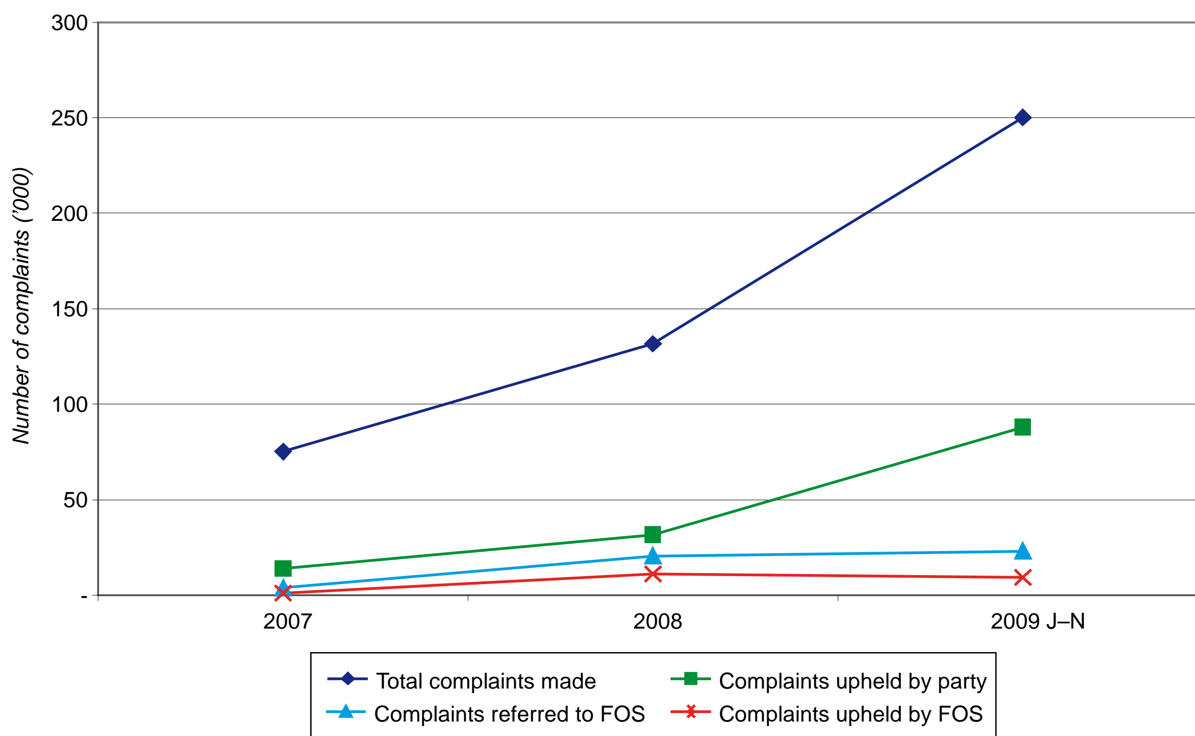
Total volume of complaints and amount of redress paid to customers

29. Figure 1 shows trends in the information reported by the parties listed in the footnote to paragraph 27 for all types of PPI and all parties. The figures show a sharp increase in the number of claims made to the companies, rising from 74,000 in 2007 to 247,000 in January–November 2009. The number of complaints upheld by the parties has increased from 13,000 in 2007 to 87,000 in January–November 2009, resulting in a large increase in overall payout (ie for cases agreed by the company itself and the complaints that were upheld by the FOS) from £14 million in 2007 to £177 million in January–November 2009. To place these figures into context, the total payout of £246 million from January 2007 to November 2009 may be compared with total sales of PPI across the same period, which amounted to £6,361 million.[6] This indicates that claims payouts represent around 1 per cent of total sales by value over the same period. By volume, the claims represented 6 per cent of all policies sold between January 2007 and November 2009.

[5]The parties that submitted a spreadsheet reporting complaints were Aviva, Barclays, Capital One, Cardif Pinnacle, CYB, HSBC, Genworth, JD Williams, LGI, LBG, MBNA, Nationwide, RBS, Santander and SDGFS.
[6]While this helps place the payouts into context, this is not a perfect comparison because claims made or in a particular year do not always relate to the PPI policies sold in that year.

FIGURE 1

Total complaints received by the main parties*



*Represents figures from the parties that submitted a spreadsheet reporting complaints (see footnote to paragraph 27).
Source: CC analysis of parties' submissions.

30. The FOS reported that it had received 31,000 cases in 2008/09 and in 89 per cent of cases the complaint was changed in favour of the customer (2007/08: 45 per cent of cases). By comparison, the figures from the parties showed 21,000 cases in 2008 and 24,000 in January–November 2009. There appear to be two reasons for the difference—the first is that the figures reported to us are only from the companies listed in the footnote to paragraph 27, and the figures analysed from the FOS (see paragraphs 51 to 53) show that there are a large number of smaller parties that have also had cases submitted to the FOS. There are also timing differences, because the FOS reports the number of cases received in the year received and the number of decisions either changed or not changed after the case has been referred to it, in the year the change occurred. Thus a claim could be submitted in one year and a change made or not made in another year. The FOS at any one time has a significant number of cases unresolved, which have not been reported by the parties.

31. There is some evidence that parties have been adapting their claims handling procedures to reduce the number reported to the FOS. For example, [✂] internal papers state:

> We have lost 92% of all cases at the FOS … Concerns were raised, and agreed by all that we are not able to demonstrate that we are learning from the FOS decisions and evolving our policies accordingly … We are aware that most of the other leading players are avoiding cases going to the FOS by simply not defending them in the first instance.

[✂] said:

Complaints are still being upheld by the Ombudsman, however due to the long pipe line at the FOS these cases were submitted prior to the decision being made to not attempt to defend certain types of complaints. [✂] about the basis on which we are appealing the decisions. … [✂] is confident that our complaints handling process is compliant and we are still winning a high number of CCPPI and MPPI cases at the FOS. However, we have seen a loss rate of over 90% on single premium cases in the last 7 months. [✂] paper recommends that the 270 single premium cases currently with the FOS are ring-fenced and Stage 1 and 2 processes are reviewed so that no new cases are sent to FOS unnecessarily.

Breakdown of complaints by PPI product type

32. The figures we received from the main parties are broken down by product type in Table 2. In each year around two-thirds of the complaints are about PLPPI (this is in line with comments made to us by the FOS that approximately 60 per cent of complaints are about single-premium PPI products, which are predominantly PLPPI). 91 per cent of complaints received by the companies in January–November 2009 were about PLPPI and CCPPI.

TABLE 2 **PPI complaints by product type***

	CCPPI	*MPPI*	*PLPPI*	*Retail PPI*	*SMPPI*	*Total*
2007						
Customer complaints made to firm	20,423	7,347	39,671	3,423	2,858	73,722
Complaints upheld by firm	2,403	1,405	8,285	844	334	13,271
Total redress paid by firm (£'000)	1,076	244	10,427	67	1,092	12,906
Complaints referred to FOS	1,002	407	2,052	44	394	3,899
Complaints upheld by FOS	247	42	822	11	30	1,152
Total redress paid for complaints referred to FOS (£'000)	394	19	476	2	347	1,238
2008						
Customer complaints made to firm	31,818	7,905	81,975	3,908	4,242	129,848
Complaints upheld by firm	7,774	1,397	21,310	601	396	31,478
Total redress paid by firm (£'000)	7,096	709	31,187	155	5,164	44,312
Complaints referred to FOS	6,089	784	13,027	152	534	20,586
Complaints upheld by FOS	1,488	149	9,499	10	124	11,270
Total redress paid for complaints referred to FOS (£'000)	2,349	399	6,603	4	1,364	10,719
2009 Jan–Nov						
Customer complaints made to firm	63,217	10,235	161,374	4,101	8,210	247,137
Complaints upheld by firm	18,649	1,637	65,738	438	781	87,243
Total redress paid by firm (£'000)	27,166	638	105,491	160	19,183	152,638
Complaints referred to FOS	7,024	878	14,360	162	731	23,155
Complaints upheld by FOS	3,368	76	5,122	5	872	9,443
Total redress paid for complaints referred to FOS (£'000)	3,935	116	9,375	3	10,981	24,409

Source: CC analysis of parties' submissions.

*Represents figures from the parties that submitted a spreadsheet reporting complaints (see footnote to paragraph 27). The figures do not show unresolved complaints.

Breakdown of complaints by provider

33. Figure 2 shows the amount of redress paid by provider in January–November 2009 where the company settled a complaint itself. [✂] paid out the largest amount (£[✂] million out of a total of £153 million); Figure 2 is broadly in line with the market shares of the parties. Further detail on the complaints by provider is shown in Annex D.

FIGURE 2

Total complaints by company

[✄]

Source: CC analysis of parties' submissions.

Type of complaints

34. We also asked providers to provide details of the nature of the complaints received by them. It was not always possible directly to compare the reasons, since terms used for the nature of the complaint varied by company. However, we are satisfied that a large majority were related to the sales process, and not to other issues such as claims handling.

35. To illustrate this, the proportion of complaints that we assessed were related to the sales process for six of the larger distributors are shown in Figure 3. Our assessment indicated that, with the exception of [✄], over 90 per cent of each of the distributors' claims were sales related. [✄] appeared to have a higher proportion of complaints related to the management of disputes.

FIGURE 3

Complaints split for six larger parties showing split between sales-process related and other complaints

[✄]

Source: CC analysis of parties' submissions.

36. The FOS explained to us that since 2005 the nature of the complaint had changed. The majority of complaints in 2005 were related to the settlement of a claim. More recently, however, the complaints were predominantly about the sale. It explained that this had been raised in relation to the FSA consultation about PPI complaints (see paragraphs 23 to 26). Barclays suggested that the FOS had changed the standards it used to decide complaints; however, the FOS believed that the change in the volume and number of cases where the FOS recorded a change was because of the nature of the complaints it had more recently received.

Actions taken by providers over complaints

37. The parties monitor complaints closely and are taking steps to reduce costs to their business of regulatory intervention and consumer redress. Some relevant activities are summarized below.

38. *Barclays.* [✄]

39. Barclays was concerned about the impact on PPI and the potential for wider effects on other products. It said that its concerns included its view that retrospective standards had been applied to sales; the FOS was not applying the Code to its adjudications; and limitations in the FSA's mystery shopping exercises.

40. In addition, Barclays has worked on remediation—[✄]. Some examples of the work Barclays did are: [✄].

41. [✂]

FIGURE 4

[✂]

Source: [✂].

42. *LBG.* [✂]

43. *HSBC.* [✂]

44. In addition, HSBC noted in December 2009 that complainants were now using the Internet for template letters and advice on how to conduct the complaint. [✂]

45. [✂]

46. *RBSG.* [✂]

47. RBSG withdrew CCPPI from sale in branches in July 2009, [✂]. The driver for withdrawal was not the possible impact of the CC remedy package, but [✂].

48. The largest FSA fine was suffered by Alliance & Leicester (£7 million) before it was acquired by *Santander*. [✂]

49. [✂]

50. *Nationwide.* [✂]

Material provided by the FOS on complaints

51. The FOS provided information on the complaints it has received by company between 2005 and 2010 year to date (to 12 March 2010). The information showed the number of complaints received by year, the number where the initial decision of the company was changed by year, the number that were not changed, and the number that were unresolved at 12 March 2010. The information covered more companies than we had received information about (there were details of 984 companies). However, the data did not have details of the type of policy that was being complained about and gave no information about whether the company was a subsidiary of a larger group. However, we were able to identify companies that were a subsidiary of one of the larger PPI parties, and we were often able to identify the product that was being sold from the type of company. However, we were unable to identify the product being sold in many cases and we were also unable to distinguish the products sold where the company was a larger company that sold a variety of PPI products. Given this we were able to report:

    (a) overall trends in complaints received by the FOS;

    (b) trends in the percentages where an initial decision of the company was changed; and

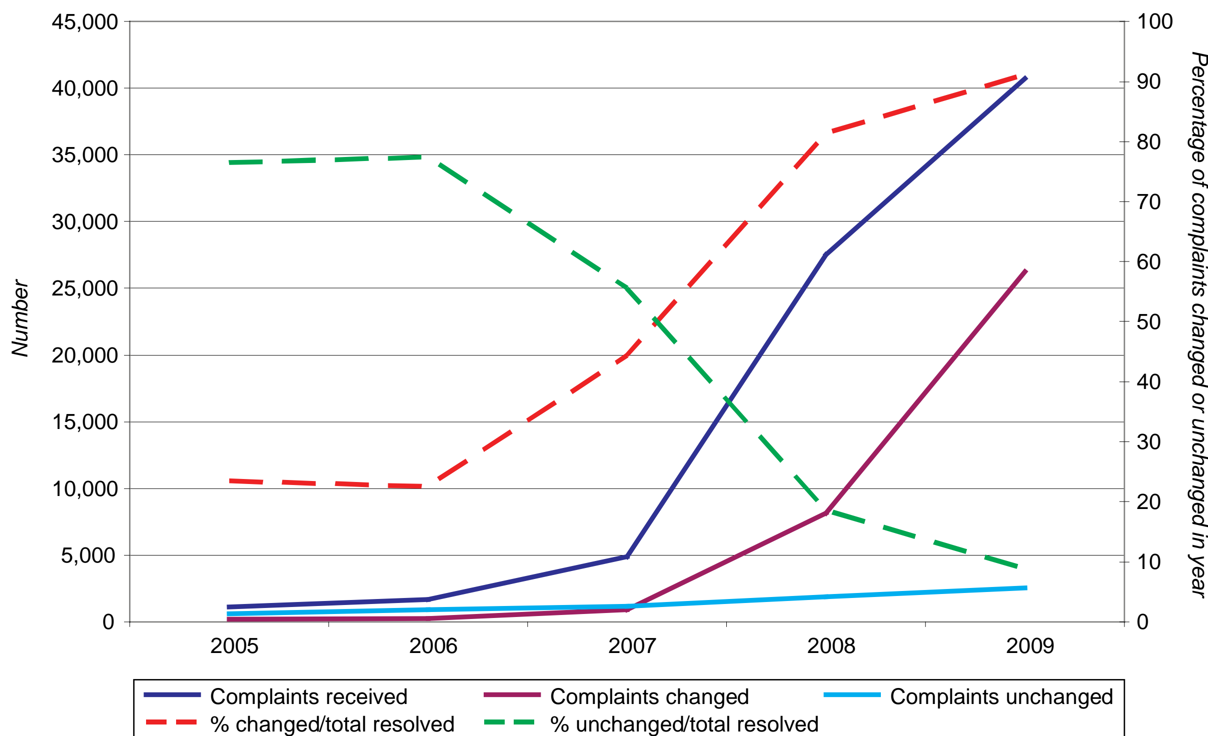
    (c) any differences between large and small companies in the percentages where an initial decision of the company was changed.

52. Overall trends in the number of complaints received by the FOS and the number of changes by the FOS from the initial decision of the company are shown in Figure 5.

The number of complaints received is increasing substantially, from 1,100 in 2005 to 41,000 in 2009. The proportion that are changed by the FOS in the year as a percentage of the total decided in the year (ie the total number of complaints where the decision of the company is either changed by the FOS or upheld by the FOS) has also increased substantially, from 24 per cent in 2005 to 91 per cent in 2009. Note that a complaint recorded by the FOS as changed or unchanged in a year was not necessarily received in the same year. In March 2010, there were 33,000 cases that were unresolved at that time.

FIGURE 5

Chart showing trends in FOS complaints

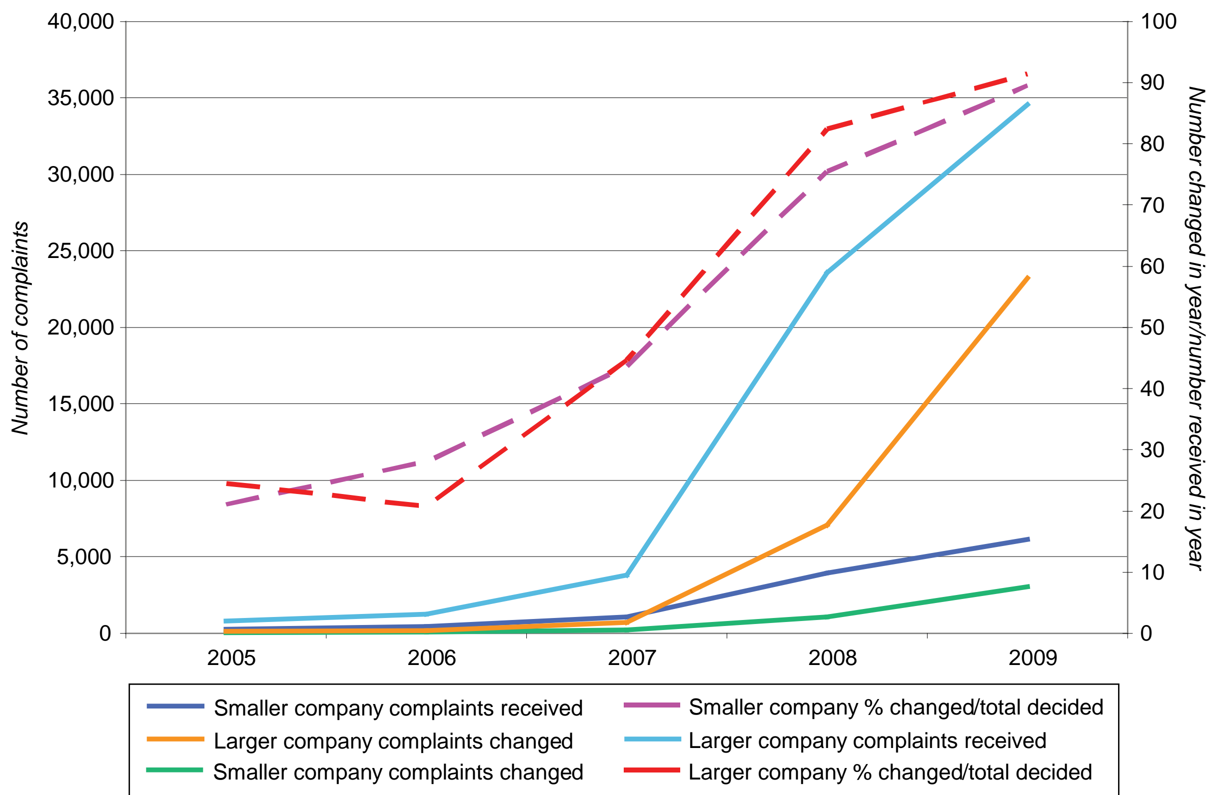


Source: CC analysis of information provided by the FOS.

53. Figure 6 compares the outcome for large and smaller companies. The proportion of complaints changed by the FOS in the year as a percentage of the total decided in the year is similar between the two.

FIGURE 6

Comparison between outcomes for large and smaller companies



Source: CC analysis of information provided by the FOS.

FSA note on concept of mis-selling

1. In April 2003 the FSA issued a note[1] to clarify what it regarded as mis-selling. The note was prepared in the light of industry concerns about the need for greater clarity. The note explained that mis-selling is commonly used to refer to an advised sale which does not meet the Handbook requirements for suitability, or the know your customer obligations, and that historically, poor selling which has not met these requirements has been a major source of consumer detriment. The FSA pointed to five of its standards for business[2] as particularly relevant:

   (a) No 1: A firm must conduct its business with integrity.

   (b) No 2: A firm must conduct its business with due skill, care and diligence.

   (c) No 6: A firm must pay due regard to the interests of its customers and treat them fairly.

   (d) No 7: A firm must pay due regard to the information needs of its customers, and communicate information to them in a way which is clear, fair and not misleading.

   (e) No 9: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

2. These are supplemented by the Conduct of Business Sourcebook which is specific for particular types of business. The FSA points out that consumers expect those who advise and sell financial services products to behave with honesty and integrity and to apply their skills, experience and judgement to give them appropriate advice and sell them a suitable product (a fair deal). FSA rules and guidance, including the Principles, make it clear to firms that this is what is expected.

3. The FSA said that it would not be practicable or ultimately desirable for it to provide an exhaustive set of specifications by way of safe harbour and it was the responsibility of firms' senior management to run their business in a way that met the FSA requirements. If firms meet the FSA requirements as set out in the Handbook, as it stands when they give advice, the regulator will not be pursuing them after the event for mis-selling and retrospective redefinition of regulatory requirements is 'out of the question'.

[1] FSA/PN/052/2003—this was a general note and did not specifically apply to PPI.
[2] Annex B lists all the FSA standards for business.

FSA Principles of Business

1. **Integrity**—A firm must conduct its business with integrity.

2. **Skill, care and diligence**—A firm must conduct its business with due skill, care and diligence.

3. **Management and control**—A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

4. **Financial prudence**—A firm must maintain adequate financial resources.

5. **Market conduct**—A firm must observe proper standards of market conduct.

6. **Customers' interests**—A firm must pay due regard to the interests of its customers and treat them fairly.

7. **Communications with clients**—A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.

8. **Conflicts of interest**—A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

9. **Customers: relationships of trust**—A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

10. **Clients' assets**—A firm must arrange adequate protection for clients' assets when it is responsible for them.

11. **Relations with regulators**—A firm must deal with its regulators in an open and co-operative way and must disclose to the FSA anything relating to the firm of which the FSA would reasonably expect notice.

Past PPI enforcement cases

To date the FSA has taken enforcement action against 23 firms, and two CEOs. The fines and the Principles for Business[1] on which the firm was found to have failed are shown in the table below.

Number	Firm	Sanction	Principles for Business Breached	Date of Final Notice	Link to Final Notice
23	Swinton Insurance	Fined £770,000	**3,6,7,9**	28/10/2009	www.fsa.gov.uk/pubs/final/swinton.pdf
22	Egg	Fined £721,00	**3,6**	10/12/2008	Final Notice: Egg Banking plc
21	Alliance & Leicester	Fined £7million	**3,6,7,9**	7/10/2008	Final Notice—Alliance & Leicester
20	Park's of Hamilton	Fined £61,600	**9,6**	21/8/2008	Final Notice: Park's of Hamilton (Holdings) Limited
18 and 19	Ringways Garage (Leeds) Ringways Garage (Doncaster)	Fined £35,000	**9**	21/8/2008	Final Notice: Ringways Garages (Leeds) Limited & Ringways Garages (Doncaster) Limited
17	GK Group	Fined £51,100	**9**	21/8/2008	Final Notice: GK Group Limited
16	George White Motors	Fined £28,000	**9**	21/8/2008	Final Notice: George White Motors Limited
15	Liverpool Victoria	Fined £840,000	**3,6,7**	30/7/2008	Final notice—Liverpool Victoria

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[1]A complete list of the Principles for Business can be found in section 2.1 of the Full Handbook: http://fsahandbook.info/FSA/html/handbook/PRIN/2/1.

14	Land of Leather	Fined £210,000 (firm) and £14,000 (CEO)	**3**	9/5/2008	Final Notice—Land of Leather Final Notice—Paul Simon Briant
13	HFC Bank	Fined £1,085,000	**3, 9**	16/01/2008	Final Notice—HFC Bank Limited
12	Homebuyer Securities Ltd	Permission cancelled	**7,9**	16/11/2007	Final notice: Homebuyer Securities Limited
11	Hadenglen	Fined £133,000 (firm) and £49,000 (CEO)	**3, 9**	6/9/2007	Final Notice—Hadenglen Home Finance Plc
10	Chapel Finance Ltd	Director banned from regulatory activity	**2,6,7**	11/4/2007	Final Notice—Chapel Finance Ltd
9	Cathedral	Public Censure	**3, 7**	26/2/2007	Final Notice—Cathedral Motor Company Limited
8	Capital One	Fined £175,000	**3, 6**	15/2/2007	Final Notice—Capital One Bank (Europe) Limited
7	GE Capital Bank	Fines £610,000	**2, 3, 6**	30/1/2007	Final Notice—GE Capital Bank Limited
6	Redcats	Fined £270,000	**2, 3, 6**	20/12/2006	Final Notice—Redcats Brands Limited
5	EW Motor Group	Public Censure	**2, 3, 7**	19/12/2006	Final Notice—Eastern Western Motor Group Limited
4	Home & Country Mortgages	Fine of £52,500 included PPI failures	**2, 3**	6/12/2006	Final Notice—Home and Country Mortgages Limited
3	Capital Mortgage Connections	Fine of £17,500 included PPI failures	**3, 6, 7**	20/11/2006	Final Notice—Capital Mortgage Connections Limited
2	Loans.co.uk	Fined £455,000	**2, 3, 6**	25/10/2006	Final Notice—Loans.co.uk Limited
1	Regency	Fined £56,000	**2, 3, 6**	4/09/2006	Final Notice—Regency Mortgage Corporation Limited

Key Enforcement action failings summary

23. Swinton Insurance. Telephone sale. Failed on assumptiveness (built PPI into quote automatically) optionality, effective SODAN, price disclosure, fees for administering the cover (Swinton fees were over 90% of the insurance premium).

During sales discussion, Swinton did not ensure that customers were properly informed at the point of sale as to the main characteristics (including significant features, benefits, limitations, exclusions, cost and term) of the PPI policy being sold.

Telephone Sales:

(a) failing to ask the minimum scripted questions necessary to establish the customer's eligibility for PPI;

(b) failing to disclose significant features in accordance with the script;

(c) failing to obtain customer consent to proceed with the sale on the basis of limited information; and

(d) failing to inform the customers about their PPI cancellation rights (or lack thereof).

22. Egg. Used objection handling and pressure selling. Over-emphasised the positive features of the PPI, or told the customer they could take the PPI for a free period and cancel it later if they did not want it. Even where customer did not consent, PPI was sometimes applied to their credit card anyway. Failed to obtain clear consent from customers to receive only limited information in the post.

Key (oral) telesales failings

(a) failing to obtain clear consent to the purchase of the policy;

(b) failing to obtain clear and explicit consent from the customer to proceed with the sale on the basis of limited information only;

(c) inappropriate handling of customers' objections to purchasing PPI, over-emphasising customers' ability to cancel the policy in the initial free period, and in some cases putting undue pressure on customers to purchase PPI; and

(d) failing to give adequate responses to customers' queries on the price of, or exclusions applicable to, PPI policies, and in some cases providing information that was inaccurate;

21. Alliance and Leicester. Recommended sale. Failed to disclose price details. Sold without establishing demands and needs. Failed to disclose optionality. Put pressure on customers.

In some calls the adviser failed to draw the attention of the customer orally to the importance of reading the policy summary, and in particular the section of the policy summary on significant or unusual exclusions or limitations in accordance with the FSA's requirements. In some calls inaccurate information was provided about the consequences of not having the policy or extent of the cover (such as by referring to a dependant's liability for the loan in the event of the customer's death). There were also some occasions where the adviser misled the customer about the amount of refund payable in the event of cancellation, in some circumstances wrongly indicating that they would receive a pro rata refund.

Moreover, whilst A&L required advisers to make customers aware of the exclusion relating to pre-existing medical conditions (which was often represented orally as being the only exclusion), advisers did not have to explain the meaning of that exclusion.

16-20. Various Motor Dealers. Failed to gather enough information about each customer (including pre-existing medical conditions, existing insurance cover and benefits received from employers), failed to monitor quality of advice, failed to ensure that proper sales processes were followed. One firm failed to establish eligibility, and another one failed to assess complaints properly.

15. Liverpool Victoria. Failed on optionality, pressure sales, explaining single premium payment mechanism and implications, inadequate information about features exclusions and limitation, and other information provided failed to be clear, fair and not misleading. Of 97 sales calls reviewed, the FSA found over 60% to be non-compliant.

When customers rang LVBS to apply for a personal loan, LVBS added the cost of single premium PPI plus interest to the quotation without the customer asking for it. LVBS did not tell customers on the telephone that PPI was optional, that there was an additional cost for PPI, that it was single premium, that the premium was added to the loan and that it

attracted additional interest on top of the interest charged for the loan. The subsequent paperwork provided to customers also failed to make it sufficiently clear that this was an optional product which the customer could choose not to buy.

LVBS provided customers with inadequate information about the benefits, exclusions, limitations and cost of PPI on the telephone

14. Land of Leather. Failed to train staff on PPI sales for 7 months. Once staff trained, failed to provide effective monitoring. Placed customers at unacceptable risk of buying unsuitable PPI. Failed to keep adequate systems and controls.

13. HFC Bank Limited. UPL PPI. Advised. Failed to gather sufficient information to ensure recommendations suitable for, and adequately explained to, customers - including explaining what needs had not been met. Poor records keeping. Ineffective training and monitoring processes. MI insufficient to identify problems to senior management. Less than pro rata refund post 30 days. More than pro rata amount of interest paid on SP if settled early.

HFC failed to ensure that advisers properly took into account any existing means the customer may have had to protect some or all of the loan.

HFC's sales procedures did not provide guidance to advisers as to the factors (such as individual circumstances and cost) to be taken into account in assessing whether to recommend life cover on its own, accident, sickness and involuntary unemployment cover on its own or both together

Whilst HFC required advisers to make customers aware of the exclusion relating to pre-existing medical conditions, it did not require advisers to explain the meaning of the exclusion.

11. Hadenglen. Failed to properly establish or take into account customers demands, needs and eligibility for PPI before making a recommendation. Failed to provide adequate or accurate SODANs. Failed to gather adequate MI to monitor the risks to customers arising from its processes.

The failings in the fact finding process arose from an assumption that its customers would not have any existing insurance cover or other resources from which mortgage repayments could be made. The design of the SODAN simply required the sales adviser to identify whether a number of generic statements were applicable to that client's circumstances but did not require the sales adviser to explain the reasons for personally recommending the contract. The advisers also did not make an assessment of the affordability of the PPI contract that they did not consider whether funding the PPI contract through single or regular premiums was more suitable.

9. Cathedral Motor Company Limited. Inadequate risk management systems: no written compliance manual; poor regulatory knowledge and compliance 'ownership' amongst senior management; poor record-keeping, training and monitoring. Customers not provided with initial disclosure, SODAN or statement of total price before conclusion.

Cathedral's failure to provide customers with a copy of the initial disclosure document, a statement of demands and needs and a statement of the total price before conclusion of the PPI sale created a risk of consumer detriment. The timely provision of this information is important to enable a customer to make an informed decision as to whether to take out the PPI policy.

As part of the advised sale process described in paragraph 3.4 above, Cathedral used a series of questions generated by its point of sale insurance software, which the business manager then discussed with the customer, to establish demands and needs. Each question required a "yes" or "no" or "not applicable" answer. A significant failing in the process was the absence of questions to enable the business manager to obtain sufficient information on the customer's personal circumstances prior to making a recommendation.

8. Capital One Bank (Europe) Plc. Significant failures in systems and controls: 98,000 customers not sent policy document; 2 of four telephone sales scripts did not ask customer for explicit consent to receive only limited information; inadequate disclosure of policy features, benefits, exclusions and limitations over the telephone; failure to provide non-telephone customers with policy document prior to contract conclusion; and ineffective compliance monitoring. Insufficient oral consent for limited distance marketing documents.

7. GE Capital Bank Limited. Sales process did not ensure customer received adequate information before making a purchase decision. Failed to improve training despite evidence that staff not complying with procedures. Inadequate monitoring procedures and inadequate response to identified non-compliant sales. Inadequate compliance function.

The sales process did not require staff to describe all the elements of Account Cover. The printed application form for the store card contained a section where the customer could opt for insurance. The policy summary containing a written explanation of the key features of the insurance was contained on the customer copy of the application form, on the reverse of the third page of the application pack used by the retail assistants. To comply with FSA requirements, staff were obliged to draw the attention of the customer to the importance of reading the policy summary and particularly the section of the policy summary which contained details of the important exclusions or limitations.

The firm's own mystery shopping from February to December 2005 indicated that between 57% and 76% of the 2,500 retail assistants sampled were not drawing the attention of the customer to the importance of reading the written policy summary. In the absence of this, the customer had no adequate explanation of the main features, benefits, exclusions and limitations of the insurance product being sold until after the transaction had been completed.

In the course of the investigation the firm provided the FSA with recordings of 196 sales calls made by the firm between April and November 2005, including 57 calls which had been monitored by the firm. The FSA found all 196 calls to be deficient, most on the basis of multiple compliance breaches, for example telesales staff:

(a) deviated from the script by omitting or changing the firm's mandatory wording intended to obtain explicit consent from the customer to proceed with a telephone sale based on limited information about the insurance being offered; and

(b) provided the customer with inaccurate or misleading information. For example, asserting that there were "*only four exclusions*" when the policy terms and conditions for that type of cover contained 12 exclusions or omitting scripted exclusions or limitations.

These operational failings were widespread in the sample analysed, in that they were not limited to particular months, specific products, scripts, policies, or particular telesales staff.

6. Redcats (Brands) Limited. Failed to disclose all exclusions and limitations and did not tailor SODANs to customers' needs. Did not obtain sufficient information to assess suitability before recommendation. Did not adhere to requirements for advised sales. Issues with sales processes, training and competence and compliance systems.

The wording of the telephone sales script was inadequate as it did not cover all of the regulatory requirements for advised sales. The most serious failing in the sales script was the absence of sufficient information about the limitations and exclusions of the policy. The scripts also failed to ensure that advisers conducted an adequate eligibility check. In respect of written and internet applications, Redcats provided inadequate information to allow the customer to make an informed decision about the policy.

The telephone sales channels did not provide for the collection of information of the customer's demands, needs and objectives, the provision of a personal recommendation or the justification of that personal recommendation.

5. Eastern Western Motor Group Limited. Did not sufficiently apportion compliance responsibilities amongst senior management, and to act in a timely and effective manner on compliance failings. Inadequate records of sales. Did not provide clear, fair statement of price in a durable medium. Did not ensure appropriate training and monitoring.

The failure to provide each customer with a document clearly stating the total price of the PPI policy created a risk of consumer detriment. A clear statement of price is essential in order for a customer to be able to determine whether the PPI policy is suitable for them. A clear statement of price is essential in order for a customer to be able to determine whether the PPI policy is suitable for them.

4. Home & Country Mortgages Limited. Failures of care in relation to PPI - specifically failure to discuss and disclose total cost including interest payable. Failure to ensure compliance with documented sales processes including retention of income verification documentation and monitoring of data entry staff processes. Failure to prevent an advisor placing customers at risk and evidence of two sales of mortgages with an unauthorised lender. Complaints handling procedures not consistently adhered to.

Since 14 January 2005, HCML sold approximately 500 ASU policies, of which approximately 300 were single premium policies. According to HCML, the majority of these policies were sold at the time of the purchase of the properties by the customers from the council and provided cover for three or five years corresponding with the discount repayment period. HCML’s advisers would receive a completion fee of £100 for the sale of single premium ASU policies compared to £10 for the sale of a regular premium ASU policy. HCML

failed to ensure that its advisers discussed with customers and disclosed to them the total cost of the payment protection insurance policies, including interest payable on the premium (as appropriate).

3. Capital Mortgage Connections Ltd. Unable to demonstrate suitability of advice, particularly in relation to affordability and suitability of single premium sale to the customer's future intentions. Lack of evidence that appropriate factors considered when customer consolidating debt. Combined Initial Disclosure Documents deficient.

In the relevant period CMC sold 220 ASU insurance policies of which 214 were on a single premium basis rather than the potentially cheaper option of a regular premium. CMC was unable to demonstrate that it discussed regular premium ASU with these customers or that, in cases where the premium was added to the mortgage (as frequently occurred), the customers were made aware of the interest that would be charged on the single premium (as is required by ICOB 5.3.1R and 5.5.14R). This created a significant risk that a large number of CMC's customers bought single premium ASU without being advised of potentially cheaper options. As a result CMC failed to treat its customers fairly (Principle 6) and failed to pay due regard to the information needs of its clients (Principle 7);

2. Loans.co.uk.

The script failed to include oral disclosure of the term of the contract until revisions were made in August 2005. In the majority of cases the term of the PPI was shorter than the term of the loan. The script made no provision for the oral disclosure of the cost of PPI and the interest payable as a result of the further borrowing to fund PPI. In the sample of sales reviewed by the FSA the customer's total debt in respect of the loan was increased by between 19% and 28% through the addition of the PPI premium and associated interest. The information provided to the customer on the telephone was inadequate to enable the customer to make an informed decision about the purchase of PPI and to understand fully any terms and exclusions which might apply. The sales scripts in use from January 2005 until March 2006 failed fully to comply with ICOB. The most serious failing was the absence of questions to obtain sufficient information on the customer's personal circumstances prior to making the recommendation.

1. Regency Mortgage Corporation. Inadequate oral disclosure at the point of sale of policy exclusions, price, refunds policy and cancellation rights; practices that suggested that Regency was not treating its customers fairly, for example, failing to consider affordability when making a MPPI recommendation, which was likely to be a relevant factor for most of the firm's customers, given its customer base; the lack of available management information to enable Regency adequately to assess risks of regulatory concern; and inadequate resources in the compliance department.

Complaints data for large companies

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Experiments

Introduction

1. This appendix sets out the experiments referred to in paragraphs 10.47 and 10.48*(b)* of the 2009 report, and those put to us during the remittal.

2. The appendix looks at what happened in the experiments, and what can be concluded from those experiments. In doing so, it looks at the evidence from two perspectives. First, it considers what the evidence tells us about the impact of implementing a POSP (on its own) on take-up rates. Secondly, it considers what the evidence tells us about the implementation of the whole remedy package on take-up rates. Regarding the second of these, all the experiments did not look at the dynamic ways in which the market might develop with a POSP in place—for example, distributors offering better-value products, a larger and more dynamic stand-alone market developing to attract business lost by distributors, or the impact of consumers having more information about PPI policies—or inform us of what the impact of those dynamic effects might be. Partial exceptions are the HBOS pilot in paragraph 8, where the trial involved PPI being offered at two different prices, and the LBG pilot in paragraph 28*(c)*, where customers were asked if they would have taken out PPI had the price been lower. In response to the provisional decision, HSBC noted that the CC's own modelling did not take dynamic benefits into account, suggesting that it was unable to do so, and said that it was therefore no reason not to use the evidence from its experiment on loss of convenience in the CC's modelling. We noted this comment. The Accent survey attempts to isolate the impact of convenience by evaluating the cost of the loss of convenience, rather than to look at what consumers will actually do with a POSP in place—which will depend on many factors including the dynamic benefits.

3. In addition, the evidence does not generally inform us on the cause of the reduced PPI penetration. Understanding the cause would enable us to distinguish a fall in take-up resulting from a loss of convenience from, for example, a fall in take-up due to consumers having more time to assess whether they want or need PPI. The LBG pilot in paragraph 28 is a partial exception, in so far as LBG sought some feedback about the process from its sales staff and those customers who had not taken out PPI, which gives some indication of customer perceptions of the split sales process. In response to the provisional decision, HSBC said that, in the CC's modelling, the assumption was that there were not significant volumes of policies being sold which would not have been sold if consumers had had more time and space to consider their needs. It said that there was therefore no reason not to use the HSBC experiment evidence on loss of convenience. In our judgement this is not a strong argument. This was an assumption made for the base case in our modelling, and we conducted sensitivity tests to consider the impact of there being significant volumes of 'unwanted' sales. We discuss what we can learn from HSBC's pilot in paragraphs 75 to 86.

4. The evidence that we review in this appendix therefore told us about the impact of the loss of convenience resulting from the introduction of a delay into the sales process, in the absence of the benefits of the remedy package—in effect, in the hypothetical situation that the remedy package is wholly ineffective and does not introduce competition into the market. This does not invalidate such evidence, but in reaching our overall view on proportionality we will need to take account of the beneficial effects that we expect to result from introducing the remedy package.

Evidence from parties

Nationwide

5. Nationwide said that only 3 per cent of its unsecured personal loan and credit card consumers had bought PPI or altered an existing PPI policy to cover a new credit agreement after it temporarily withdrew its PPI product in August 2007.[1] Nationwide told us that this indicated that only a small number of people would buy PPI if it was not sold at the point of sale.

6. We thought that this was not a good experiment for evaluating the loss of convenience associated with (or even the overall impact of) the POSP or with the whole remedy package. The estimates in the fall in penetration were based on a situation where stand-alone PPI products were not widely promoted, at a time before the FSA comparison website was available and when Nationwide was not selling PLPPI or CCPPI at all (it was selling MPPI), and so no personal quotes were provided to help consumers start comparing policies. We did not therefore attach weight to this evidence in our assessment of the likely impact of our remedy package.

Capital One

7. Capital One told us of evidence of a month in October 2007 when it did not offer PPI to Internet channel sales customers when the customer signed to accept the credit card terms and conditions ([✂]). It said that it saw only a small uplift in take-up at the activation stage, 'demonstrating that even just a few days following the point of credit application, consumer engagement is significantly reduced'.

8. Some information about PPI was available to customers online at the credit application stage. When the card terms and conditions were sent, a PPI policy document was sent with it, whereas the obligation to provide a personal PPI quote before a PPI sale can be concluded is a key feature of our remedy package. We expect that a personal quote will increase customer engagement and awareness of PPI following the credit application significantly more than copy of the policy document.

9. We also noted that during the experiment customers would typically wait 26 to 32 days between being encouraged to look at information on PPI (by being sent a policy document along with the credit card terms and conditions) and being invited to purchase PPI at the card activation stage. Given the significant time lag during the experiment, we did not take much useful information from this evidence.

HBOS

10. HBOS carried out a six-week pilot involving [✂] branches and a Retail Contact Centre (RCC) team with [✂] staff where consumers at the loan point of sale were handed a telephone to discuss PPI with a specialized insurance team (located in Shannon). The pilot also explored the sensitivity of sales to the price at which the Lifestages policy was offered—this offered more limited cover and was significantly cheaper than HBOS's single-premium product. A price increase of [50–60] per cent (bringing the overall price more in line with HBOS's single-premium product) was

[1]On 16 August 2007 Nationwide temporarily stopped selling CCPPI and PLPPI. The revised sales process included a discussion on PPI and a suggestion of useful sources for information regarding PPI. In January to April 2008 Nationwide contacted 946 of its consumers and found that 5 per cent of them had gone on to get a PPI quote and 1 per cent had gone on to purchase a new PPI policy, while 2 per cent altered an existing policy to get the additional cover to protect the new credit.

implemented in the fifth week of the pilot to test the impact of the higher price point. The results are shown in Table 1.

TABLE 1 **Results of HBOS pilot**

		At original price					*At higher price*	
		Wk1	*Wk2*	*Wk 3*	*Wk4*	*Wk 5**	*Wk 5**	*Wk 6**
Lifestages sales	Branch	[0–10]	[10–20]	[10–20]	[20–30]	[0–10]	N/P	N/P
	RCC	[0–10]	[10–20]	[10–20]	[20–30]	[0–10]	N/P	N/P
	Total	[10–20]	[30–40]	[20–30]	[40–50]	[10–20]	N/P	N/P
Lifestages sales as % of completed loans	Branch	[10–20]%	[20–30]%	[10–20]%	[40–50]%	[30–40]%	[10–20]%	[20–30]%
	RCC	[10–20]%	[10–20]%	[20–30]%	[20–30]%	[20–30]%	[10–20]%	[20–30]%
	Total	[10–20]%	[20–30]%	[10–20]%	[20–30]%	[30–40]%	[10–20]%	[20–30]%

Source: CC based on data provided by HBOS.

*Part of week only.
Note: N/P = not provided.

11. The overall penetration rate achieved with the original pilot price was [20–30] per cent for in-branch sales and [10–20] per cent for telephone sales. By comparison, penetration rates of HBOS's PLPPI product in the month to 20 November 2008 were [30–40] per cent ([30–40] per cent in branch, [40–50] per cent by telephone). HBOS said the pilot resulted in a halving of take-up rates.

12. In December 2008, HBOS decided to stop selling single-premium PPI and to roll out the sale of Lifestages through Shannon—as in the pilot—to cover all personal loan sales through HBOS branches and the RCC. This process was adopted across the branch network in January 2009. This process was only expected to be a temporary measure pending development of a new product. However, given delays to the project to develop a medium-term replacement, a decision was made to assess and amend this process which remained the process by which PLPPI sales were made in relation to HBOS personal loans until LBG announced its decision to suspend sales of PPI in July 2010.

13. Overall, we did not think that HBOS's experience was a particularly reliable indicator of the likely impact of putting in place either a POSP or the whole remedy package. In terms of the impact of the POSP in isolation on take-up rates, we had concerns about the design and scale of the experiment. We noted that there was no break in time between the sale of credit and the sale of PPI involved in HBOS's pilot and subsequent way of selling PPI—there was a change in the person conducting the two sales. Moreover, the pilot was of small scale—on average, branches achieved [✄] of Lifestages per week, such that small changes in the number of policies sold had a large impact on the take-up rate achieved.

14. In terms of the impact of take-up rates on the whole remedy package, we noted that the pilot did not highlight where alternative providers of PPI could be found, or provide customers with an opportunity to try and find alternative providers. Neither did it involve the provision of a personal quote to help consumers start comparing different policies. We were not, therefore, able to learn much from this experience about the scale of any loss of convenience associated with either the POSP on its own or the full remedy package. However, we thought that it did offer evidence that there could be a reduced take-up of PPI if the sales process between credit and PPI was in some way split, with everything else held equal, and we had regard to it in that respect.

LBG 2009 pilot

15. In April 2009 LBG conducted a two-week pilot in eight Lloyds TSB branches to simulate the post-CC remedies sales environment. The goal of the pilot was to get a directional sense of what take-up-rates would be achievable in a post-CC world. LBG said that the customer journey and sales process was designed to reflect (at least partly) that expected if the 2009 report remedies were in place. The customer needs were explored as normal and PPI was explained and fully sold at the credit point of sale. The customer had to telephone back or return to branch after 24 hours to confirm that they wanted the product otherwise it was cancelled after 14 days. All customers were written to ten days after the original sale, unless they had already responded. For just under half the sample (28 of the 58 customers in the pilot), there was no attempt to outbound call and for the remaining 30 customers, LBG attempted to outbound call them if they had not already made an inbound call (either unprompted or on the back of the reminder letter). The outbound calling attempts started at day 8 after the original sale and continued every few days until either *(a)* a successful contact was made, *(b)* three attempts had been made, or *(c)* the end of the pilot period was reached.

16. Of the 58 customers who completed the purchase of loan and PPI during this period in branch and were told to call back to confirm they wanted the product to avoid it being cancelled, 21 responded without chasing, and a further 12 confirmed after follow-up contacts either by telephone or letter. LBG successfully contacted by telephone six customers who had not proactively contacted LBG to confirm the policy, and were unsuccessful with a further eight customers.

17. LBG considered these results to be 'encouraging' and interpreted them as suggesting that 50 to 70 per cent of today's sales volume could be achieved. It was also noted that more could have been done to follow up and drive extra sales, although the cost and benefit of this activity had not been assessed.

18. While recognizing that a significant proportion of the customers in the pilot did contact (or were contacted by) LBG in order to confirm purchase of the product, we also noted some limitations in terms of the ability of the pilot to replicate the impact of introducing the POSP on take-up of PPI. The pilot involved PPI being sold at the credit point of sale and customers being asked to confirm later on that they still wanted it, which we considered to be a fundamentally different process to not buying PPI at the credit point of sale but having the opportunity to shop around and consider one's needs before making a decision in relation to PPI.[2] However, by requiring the customers to telephone to confirm that they want the PPI policy, this experiment does attempt to replicate the part of the POSP sales process where consumers can call back to instigate a sale. We also noted that the pilot was conducted using a small sample—58 customers—which we felt was too small a sample to offer robust quantitative results. We did not think the experiment told us very much about the impact of the whole remedy package on take-up rates—in addition to the limitations already noted, the experiment did not involve customers receiving personal quotes and there was a reduced incentive to consider the need for PPI given that PPI had already been purchased, and we know that once the product has been purchased many consumers do not give much further thought to it. Whilst LBG considered the results encouraging with respect to its ability to sell PPI with a POSP in place, which we noted, we considered that the pilot was likely to underestimate likely take-up rates if a POSP was in place.

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[2]In this respect LBG said to us that 'the proportion of sales vs attempted customer contacts (29 per cent [in the 2009 pilot] vs 17.4 per cent in the 2010 pilot) may well be reflective of the fact that customers had progressed as far as purchasing their PPI, and simply needed to call to confirm, therefore had higher levels of engagement with the product/process'

LBG 2010 pilot

The objectives of the pilot

19. LBG ran a further pilot in January and February 2010. In internal documentation from November 2009 LBG said that the overriding objective was to demonstrate that:

    (a) the loss of convenience caused by the POSP was such that its introduction would cause a significant reduction in penetration of PPI;

    (b) a large proportion of customers would be left uncovered as the loss of convenience had influenced their behaviour; and

    (c) even if all of the CC's other remedies increased customer searching and switching in the market, this would not be sufficient to counteract the negative impact of introducing a POSP.

20. In informing us in December 2009 of its intention to run a pilot and in its report to us of the pilot, it said that the objectives of the pilot were:

    (a) to understand the impact on customers' purchasing behaviour of any loss of convenience associated with the sale and purchase of PPI at the credit point of sale;

    (b) in particular, to understand the impact of the POSP on PPI penetration rates; and

    (c) to provide an input into economic/financial modelling to inform LBG's future participation strategy.

The sales process

21. LBG carried out the pilot in 42 Lloyds TSB branches in the Eastern Region, and at a telephone banking call centre with a ring-fenced team of 20 staff. During the pilot 1,336 loans were sold in those branches and the telephone sales team sold 357 loans.

22. The sales process involved the sale of the personal loan, and the consumer being made aware of the existence of Lloyds TSB's PLPPI product and other PPI products available via the FSA website. Where a customer expressed interest in the PLPPI product, the sales person collected relevant information and provided a personal PPI quote.

23. In branches customers were taken through the usual process of establishing eligibility and suitability for PPI, before the seller provided a recommendation. If the customer agreed to a loan illustration with PPI, this was provided on screen, and then a personal quote template was manually completed on paper. The customer was then credit scored for the loan only, and if this was successful, the loan was set up on the relevant system. Customers were then provided with documentation to take away: customers were only classified as receiving a quote when they took away the quote.

24. Over the telephone, customers were taken through the same process of establishing eligibility/suitability for PPI, and were then provided with an initial recommendation. For those interested in receiving a loan illustration with insurance, this was provided orally (repayments per month, and in total, including PPI). Agents asked customers whether they wanted to receive a PPI quote—for those who agreed to this the agents then explained to customers that their PPI quote would be posted to them. Customers not wishing to receive a quote were not sent one in the post. In terms of

statistics for quote take-up, customers were only classified as receiving a quote if a quote was posted out to them.

25. LBG said that customers who said that they did not wish to receive information (and a quote) about PPI during the loan sale were not followed up during the pilot, for a number of reasons:

- LBG accepted customers' decision that they did not wish to receive information; and

- difficulty in contacting customers after credit purchase made it less cost effective, bearing in mind that customers had already made a decision not to take information about PPI.

26. Customers could telephone back after 24 hours and go through the sales process to purchase PPI. If they did not do so, attempts were made to contact those customers who received quotes after seven days. For customers who had purchased their loan over the telephone, all first follow-up attempts (up to three telephone calls) were by telephone. For customers who purchased loans in branches, half were contacted by telephone, and half were sent a letter. For all customers who did not respond to these contacts, a follow-up letter was sent after 14 days.

The results of the pilot

27. The results of the LBG pilot are set out in Table 2. By way of comparison, LBG told us that the penetration rate in the rest of the branch network in January 2010 was [40–50] per cent, and in the rest of Telephony in January 2010 was [40–50] per cent.

TABLE 2 **Results of LBG 2010 pilot—penetration rates**

	Loans sold	*Personal quote provided*	*% quoted*	*PPI sale*	*Ratio of PPI sales to loans sold %*	*Ratio of PPI sales to personal quotes issued %*
Branch	[1,000–1,500]	[✂]	13.4	[70–80]	[0–10]	[40–50]
Telephony	[300–400]	[✂]	40.6	[20–30]	[0–10]	[10–20]
Total	[1,500–2,000]	[✂]	19.1	[100–110]	[0–10]	[30–40]

Source: LBG.

28. In terms of when sales were made in the process, the results were as set out in Table 3.

TABLE 3 **Results of LBG 2010 pilot: sales by channel**

	Total PPI policies sold	*PPI sold when customer calls back %*	*PPI sold when customer called after 7 days %*	*PPI sold after customer receives 7-day letter %*	*PPI sold after customer receives 14-day letter %*
Branch	[70–80]	[40–50]	[20–30]	[20–30]	[0–10]
Telephony	[20–30]	[30–40]	[50–60]	[0–10]	[0–10]
Total	[100–110]	[40–50]	[30–40]	[10–20]	[0–10]

Source: LBG.

29. LBG said that it was difficult to contact customers once they had left the credit point of sale. It said that it made 372 calls (including first, second and third attempts) to 201 customers but only managed to reach the right contact in 29.8 per cent of calls. This equated to being able to contact 111 out of 201 customers—55 per cent of the customers.

30. LBG carried out customer and staff feedback exercises, the results of which we studied carefully. Some of the points of note coming out included:

(a) Staff said that some branch customers were frustrated at having to provide the same information (in terms of suitability) twice—we noted that our remedy allows firms to collect this information during the credit sale as well as during the subsequent PPI sale, though neither our remedy nor ICOBS requires firms to do this—and some reacted negatively to the idea of the prohibition, both in terms of not being able to buy PPI when they wanted, and in being forced to undertake more work in order to make the purchase.

(b) Staff said that some telephony customers were happy with the POSP process and the opportunity to shop around, whilst others were unhappy they could not buy PPI for at least 24 hours.

(c) Customer follow-up interviews were conducted with 98 customers who received quotes but did not make a purchase. 18 per cent of those customers said that they searched for and compared products elsewhere (many of these searched using the Internet, others visited an LBG branch), and nine customers made a purchase elsewhere: eight of these were products from other parts of LBG (five bought Scottish Widows products and three bought Lloyds TSB or Halifax products); one bought a First Assist product. The customers were asked if they would have purchased the product if it had been 30 per cent cheaper—11 per cent said yes, 34 per cent said possibly or probably, 16 per cent said no or doubtful, 24 per cent said they did not need or want the product and 15 per cent made other responses.[3]

Our analysis of the LBG 2010 pilot

31. We thought that LBG's pilot was an interesting attempt to understand what might happen if a POSP were put in place. We considered what lessons we could learn from it.

Differences between the pilot and the post-remedies world

32. We noted first that the pilot was necessarily conducted without the remedy package in place, so customers did not have the new market environment in which to search for the best policy for them. Indeed the pilot took place in a world where most publicity about PPI is negative and focused on mis-selling. As part of this new market environment, we expect the remedy package to lead to reduced PPI prices and in commenting upon LBG's proposal for this pilot we noted that we would expect the pilot to be of less value if the PLPPI policies sold during the pilot were the same price as currently. LBG conducted the pilot with PLPPI policies at the same price as those sold in the rest of the network. We thought that a pilot that did not reduce prices relative to today's prices would be likely to overestimate any reduction in take-up of PPI in the presence of a remedy package including the POSP, as we expect that our remedy package would lead to reduced PPI prices. In that respect we did not find the evidence in paragraph 28*(c)*, on whether non-purchasers would have bought PPI if it were cheaper, surprising and felt able to attach some weight to it, despite LBG's suggestion that it should be treated with caution. These issues impacted on the usefulness of the experiment for telling us about the impact of the whole remedy package on take-up rates.

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[3]LBG said that these results should be treated with caution, as customer responses might have been influenced by a natural inclination to agree that they would probably purchase a product at a cheaper rate.

33. We also noted that customers were not able to return to buy PPI over the Internet during the pilot. [✄] We thought that some distributors might make use of the Internet as a channel for concluding PPI sales, and that this way of purchasing PPI was likely to appeal to some customers. We thought that this reduced the usefulness of the experiment for telling us about the impact of the POSP on its own, as well as the impact of the whole remedy package.

Take-up of personal quotes

34. We were surprised at the small proportions of customers receiving personal PPI quotes, both through the telephone channel and (especially) in branches. In both cases, the proportion of customers receiving a personal PPI quote was lower (for branch sales, substantially lower) than the normal penetration rate for PPI sales through this channel. We did not need to reach a conclusion on why this low take-up occurred—there was a low take-up and this impacted on the usefulness of the pilot to us. But we did consider why it might be.

35. LBG said that the reason why the proportion of quotes provided to consumers in branches was so low was a combination of factors:

(a) when customers learned that they could not fulfil their purchase the same day, some were dissuaded from continuing;

(b) customers were taken through the key pieces of information from the quote, and found some confusing. For example:

- the combined APR was not well understood—customers found it difficult to understand how the figure was made up, and how it was calculated;
- sellers felt uncomfortable trying to explain this concept (despite their training) and therefore found it more difficult to answer questions;
- monthly cost for every £100 monthly benefit was also not well understood. Partly because this is a relatively new concept and customers were not familiar with this method of calculation. They found it difficult to reconcile the cost per £100 with the actual price they paid each month;

(c) sellers were guaranteed that their bonuses would not be negatively affected by participating in this pilot, so LBG could not discount the possibility that some staff decided to spend only cursory time offering the product, because the sale could not be completed; and

(d) the low proportion of customers actually taking a quote in-branch suggested to LBG that the only ones taking a quote were those who intended to fulfil, rather than customers taking a quote ambivalently. However, between quote and fulfilment, almost 60 per cent of customers dropped out of the process.

36. In contrast, it said that the proportion of customers taking a quote by telephone was nearly the same as the penetration rate for PPI generally by telephone. It suggested that there were a number of arguments as to why this was the case:

(a) In the telephone process the seller is absent, so customers may have felt more comfortable committing to a quote without obligation.

(b) With the telephone process, customers are already used to being told that 'information will be sent to them in the post' and were therefore comfortable with this.

(c) Customers on the telephone were not taken through all sections on the CC quote pro forma, because the manual nature of aspects of this test meant that two variables—combined APR and cost per £100 of monthly benefits—could not be included within the initial sales process. This therefore meant that information which confused/put off customers in the branch channel was not available in telephony, meaning that customers were happier to receive the quote by post.

(d) There is a natural consumer tendency—when faced with either a new process or new information—to wish to read and understand implications before committing themselves.

37. We accepted that some people might be dissuaded from asking for a quote if faced with not buying PPI the same day (paragraph 33*(a)*), although LBG was unable to quantify this effect and nothing was put to us that suggested to us that it was a significant effect. LBG's reasoning in paragraph 33*(b)* was that consumers were talked through PPI details before being asked whether they wanted to take the quote away. We agreed that some consumers who decide quickly that PPI is not for them might not then take a personal quote. However, we did not see how this could be a significant factor given normal take-up rates of around 40 per cent. We were not convinced by LBG's suggestion in paragraph 33*(d)* that only customers who intended to take out PPI accepted a quote.

38. Rather more importantly, we thought that there were questions around staff incentives and motivation—referred to in paragraph 33*(c)*. The fact that the proportion of loan customers taking a quote for PLPPI was around one-third of the penetration rate of PLPPI generally in branches suggested to us either that sales staff did not put anything like the same effort into trying to sell PLPPI to their consumers in the pilot, or that a significant proportion of LBG's normal PLPPI purchasers are taking out PPI policies that if they had time in which to reflect, they would not take out. We would expect more—possibly significantly more—people to accept quotes (both in branches and over the telephone) than would take out PPI normally, if sales staff were putting in a similar degree of effort to achieve sales. Moreover, if LBG were trying to maximize sales, we thought that LBG would work rather harder to maximize the number of quotes issued; providing a quote only when a customer expressed interest struck us as more reactive than a distributor would be if it were trying to maximize uptake.

39. LBG staff normally receive a bonus for the sale of a PPI policy (as they do for sales of other insurance policies, banking products and services). LBG told us that the bonus scheme was amended for sellers in the telephone channel to protect the bonus reward irrespective of performance. The telephony team were located in one location, allowing performance to be monitored and managed daily.

40. LBG told us that staff bonuses were also amended in the branch channel so that staff did not suffer as a result of taking part in the trial. LBG said that for sellers in branches:

> to ensure seller behaviours and effort to sell PPI remained unchanged, additional performance management processes and reporting were put in place. A bandwidth report was produced and circulated twice a week: the report covered all the branch locations participating in the pilot and detailed the sales being achieved at each branch. This report provided visibility about branch performance to branch managers. It was used as a basis for discussion in the weekly branch performance meeting that takes place between a branch manager and the relevant Area Director. Branch managers were asked to manage the performance of their staff using the data from this report in order to ensure that staff used as

much effort as they normally would to sell PPI. We did not want to affect the operation of the pilot through sellers losing their bonus reward as a result of the point of sale prohibition leading to an anticipated drop off in sales. But equally we were also concerned to ensure that sellers used the same amount of effort to sell PPI as before, and we actively managed that through the performance management discussions that took place as a result of the data in the bandwidth report.

41. We noted the reporting LBG put in place. However, the evidence on the low take-up rates for quotes in both channels, but in particular in the branch channel, led us to believe that there was something in the sales process during the pilot that artificially kept down the proportion of customers receiving a quote compared with what might be expected if LBG and its staff were trying to maximize sales.

42. We thought that one cause of this was that temporary changes to the bonus structure, reducing the incentive on sales staff to push PPI and to maximize the number of quotes, and sales made, (for example, the extent to which they accepted an initial lack of interest—see paragraph 23).

43. Another possible cause for the reduction in take-up might be that staff felt that the pilot needed to achieve a low take-up of PPI. We noted LBG's original objective (see paragraph 17). LBG told us that staff were never told that this was the objective of the pilot, and were told that they should make as much effort with consumers to promote PPI as normal. LBG sent us documents relevant to the pilot that were seen by staff, and we saw nothing that explicitly encouraged staff to underperform. However, in Team Leader Guidance Notes, which included the training script for sales advisers, we noted that the section on why the pilot was happening said:

> Lloyds Banking Group is currently supporting a Barclays Bank Plc appeal against some aspects of the Competition Commission's proposed rulings, Point of Sale Prohibition (POSP) being a key one.
>
> To support this appeal a significant amount of data is required to demonstrate how our customers react to not being able to arrange their Loan Protection at the point of sale.

44. We thought that this gave the team leader and sales staff a clear steer that LBG was opposed to the POSP and was gathering evidence to support a case that it should not be imposed. We thought it was therefore possible that team leaders and sales staff concluded that the pilot needed to achieve low take-up rates in order to support the business's case against the POSP.

45. In our judgement the very low take-up of personal quotes meant that we could not attach significant weight to the proportion of personal loan customers choosing to take out quotes, or to penetration rates for PPI calculated on the basis of the total number of loan customers. It therefore impacted significantly on the usefulness of the experiment for telling us what would happen to take-up rates if a POSP were imposed on its own. We did not need to reach a conclusion on why there was a low take-up. However, we identified two possible contributory factors. First, we thought it most likely that the way sales staff bonuses had been guaranteed had a negative effect on the effort made to encourage customers to take a personal quote. Second, team leaders and sales staff had understood from the training documentation that they received that the pilot was to provide evidence to support LBG's case against imposing a POSP, and concluded from this that the pilot needed to achieve low take-up rates in order to support the business's case against the POSP.

Purchasers of PLPPI in the pilot

46. We thought it more instructive to focus on the proportion of customers who received a written personal quote who then purchased PLPPI (the last column in Table 2).

47. We noted that the conversion rate was very different in the two channels, but averaged 32 per cent. As noted in paragraph 30, we expected the pilot to underestimate significantly the take-up of PLPPI if the remedy package were put in place because, among other things, the policy was being sold at the same price as currently. We noted the evidence in paragraph 28*(c)* on whether non-purchasers would have bought PLPPI if it had been 30 per cent cheaper, which indicated that potentially many more consumers would have bought PPI if the policy had been 30 per cent cheaper. This trend is in line with what we would expect.

Conclusions to be drawn from the pilot

48. LBG said that the penetration rate achieved during the pilot was significantly lower than it expected and below levels used in its financial planning. It said that it thought the pilot was a serious indicator of the potential impact of the POSP at a 'raw' level, and were of such a level that LBG would be prudent in considering whether the return on investment would make it economically viable to continue participating in the market if a POSP were imposed.

49. We noted LBG's conclusions. In our judgement, there were problems with the design of the experiment (paragraph 31), and in particular implementation of the experiment (paragraph 43), which meant that the results were not a good indicator of the impact on take-up rates of the introduction of a POSP. Further, the timing of the experiment and the price at which PPI was offered (paragraph 30) reduced the usefulness of the experiment for telling us about the impact of the whole remedy package on take-up rates. But we did think we could draw some useful conclusions from the research:

    (a) Using a standard three callbacks and a follow-up letter (to half of the branch sample), Lloyds TSB was able to contact just over half of the customers who had received a written personal quote but had not proactively contacted Lloyds TSB to buy PPI. We thought this indicated that some potential PPI purchasers might not purchase PPI with a POSP in place because the outbound calls fail to reach them. We did not think that the research allowed us to quantify this effect.

    (b) If a POSP were imposed and all else held equal—for example, parties did not reduce PLPPI prices—distributors would face a reduction in PLPPI sales, although we did not think that this research enabled us to quantify this effect. Nor did we think that, from this research alone, we could assume this would be the case for other PPI products, although we recognized that it might be, because of the different sales processes associated with different types of PPI—for example, mortgage and credit card sales processes both have multiple points of contact between customer and distributor meaning that a second conversation in which the sale of PPI is concluded may be able to take place during a scheduled interaction, such as a credit card activation call.

    (c) The research indicated that of those customers who took a personal quote, 32 per cent bought PPI from LBG and a further 10 per cent bought PPI elsewhere. If the price had been 30 per cent lower the research indicated that the proportion who bought PPI was likely to increase, potentially significantly. This suggested to us that take-up might be expected to increase if price decreased, in line with standard economic theory.

(d) The detail of how distributors choose to set up their sales processes—including motivation of sales staff—can have a material impact on the penetration rates that can be achieved. We expected that there would be an iterative process within distributors, as they optimize their sales processes subject to the POSP and learn from pilot exercises such as this one.

50. Barclays also said that we had dismissed the evidence from LBG and HSBC (see paragraphs 52 to 83) on the grounds that either sales staff put less effort into the sale, or purchasers were taking out PPI policies which they would not have taken out had they had the time to reflect, but that neither conclusion was supported by evidence. We did not accept Barclays' analysis. Our judgement on sales staff motivation (which was one possible factor for the low take-up rates in at least the LBG pilot) was informed by evidence from staff surveys conducted (see paragraphs 28 and 67) as well as evidence on the rewards structure for staff.

51. In response to the provisional decision RBSG said that it was not clear why the evidence from the LBG pilot was not used. It said that many of the issues raised by LBG's pilot might apply to real-life selling and therefore the pilot provided a helpful example of the POSP at work.

52. We were not persuaded by RBSG's submission. The issues we raised were:

- the cost being the same in the pilot as currently (paragraph 30)—we expect prices to decrease with the remedies in place as customers increasingly search around and competition develops between providers, leading to a greater variety of products on offer and decreased prices as providers seek to win customers;

- customers not being able to return and buy over the Internet (paragraph 31)—we expect that other distributors would allow this as this is permitted by the remedy; it would be a convenient way for some consumers to complete a purchase, and we would expect distributors to react to customer preferences by making it as easy as possible to complete a transaction; and

- the low take-up of quotes (paragraphs 33 to 39). We accepted that some consumers might be put off by not being able to buy on the same day, or upon being talked through the quote would quickly decide that PPI was not for them and not take a quote, but our view was that there was something in the pilot's implementation that discouraged staff from making maximum effort to make sales—we did not need to decide what—and we would not expect such incentives to prevail in a real-world situation where distributors would have a keen interest in ensuring that staff were fully incentivized to maximize take-up of the product.

53. In addition, RBSG said that the LBG pilot provided other evidence relevant to the analysis and should be taken into account when assessing the likely reduction in the penetration rate following the implementation of the remedies:

- Take-up of quotes via telephone was higher (40.6 per cent) than in branches and similar to the corresponding penetration rate. RBSG assumed that the incentive structure for telephone staff was similar to that for staff in branches, and that it was not therefore apparent that the incentive structure applicable to staff sales, and hence the process of sales, was the reason for the low take-up of quotes in-branch. We noted that the bonus schemes were both amended, but monitoring of performance was very different and it is possible that the ability to monitor all calls on the telephone did more to keep penetration rates up than regular post-dated management reports on sales achieved in branches but no actual listening in on interviews.

- Of the customers who received quotes but did not purchase PPI, 11 per cent said they would have purchased the product if the price was 30 per cent lower. If this were taken into account, the penetration rate would be around 20 per cent, which RBSG said was still much lower than the penetration rate in branches without the POSP (and constituted a drop of around 60 per cent). We noted this, but as we had concluded that either sales staff did not put anything like the same effort into trying to sell PLPPI to their customers in the pilot, or a significant proportion of LBG's normal PLPPI purchasers are taking out PPI policies that if they had time to reflect, they would not take out, we could not attach much weight to the actual percentages of purchasers in the survey.

- It said that the LBG pilot provided useful evidence on the extent to which customers would be 'lost' due to difficulties in contacting them after the credit point of sale. The LBG pilot showed that only 55 per cent of customers could be contacted via outbound calls to sell PPI after the initial sale and hence some potential PPI purchasers might not purchase PPI at all. RBSG's own experience indicated that a decision maker contact rate of around [✂] per cent is common in telemarketing. We agreed in part with RBSG's analysis. We concluded in paragraph 47*(a)* that some potential PPI purchasers might not purchase PPI with a POSP in place because the outbound calls fail to reach them, but we did not think the research allowed us to quantify this effect. We were not convinced that outbound telemarketing gave an accurate prediction of the percentage of customers who would be contacted if a distributor was trying to complete a sale—though we fully accepted that some customers would fail to be contacted.

HSBC

54. We considered two pieces of evidence from HSBC—the introduction of LifeChoices, and a pilot conducted between September 2009 and February 2010.

The introduction of LifeChoices

55. In June 2007 HSBC withdrew its MPPI policy and introduced LifeChoices as one of the products offered to those consumers. In December 2007, HSBC withdrew advised sales in branches of PLPPI and CCPPI and offered consumers a meeting with a financial planning manager (FPM), with LifeChoices one of the products on offer. Figure 1 of Appendix 2.3 of the 2009 report showed that sales of LifeChoices effectively replaced sales of its previous MPPI policy, with similar numbers of policies sold. Figure 2 of Appendix 2.3 of the 2009 report showed that there was a decline in PLPPI sales for which the increased sales of LifeChoices did not fully compensate, and we considered that this could be explained by the delay in the time from when the consumer bought the credit product to the time they spoke to the FPM to discuss their protection needs, and because the sales process for LifeChoices might not be attractive to consumers who have taken on a debt which is small in comparison to a mortgage. Sales of LifeChoices to credit card customers have been extremely small.

56. We considered whether this experience was to some extent useful as an experiment.

57. For PLPPI and CCPPI we were not convinced that the introduction of LifeChoices was a good experiment. LifeChoices was not designed for sale with PLPPI or CCPPI and was introduced at short notice. We noted in particular that it was a poor fit for CCPPI, with LifeChoices over five times more expensive than HSBC's previous CCPPI policy for the same level of cover (see paragraph 57*(c)* of Appendix 2.3 of the 2009 report), and we were not convinced that arranging meetings with FPMs to discuss a customer's wider protection needs was necessarily an efficient way of selling

PLPPI, such that a comparison of take-up rates would be informative. For MPPI the introduction of LifeChoices did not result in any material changes to the sales process.

58. However, we did think that we could infer from this evidence that a break in the sales process can, all else held equal, lead to a reduction in take-up of PPI.

The 2009–2010 pilot

The pilot

59. HSBC conducted a pilot on sales of LifeChoices alongside personal loans and credit cards between September 2009 and February 2010. HSBC focused on developing a pilot that used the existing LifeChoices product but was compliant with the remedy package set out in the 2009 report, and went further than the existing sales process by offering branch customers a direct sales approach by telephone (as opposed to customers having to meet with FPMs). The pilot therefore focused on developing a sales process to establish a workable product that could be sold directly. The purpose of the pilot was to test the likely impact of the proposals to ban the immediate sale of protection alongside a credit product and how this would work in relation to HSBC's current product offering and sales process.

60. Customers were sold credit and then provided with a quote for LifeChoices. These customers were offered an appointment with an FPM. Those who declined an appointment were invited to call back after 24 hours to buy LifeChoices. If the customer did not call back within seven days then outbound calls were made to try and make a sale.

61. The success criteria that were set for this pilot included that LifeChoices penetration rates by channel and product meet or exceed certain assumptions:

- An increase from [✂] to [✂] per cent of loan customers who make an appointment with an FPM, following receipt of a quote at the credit point of sale.[4]
- [✂] per cent of all quotes (excluding those customers who made an appointment with an FPM) to result in an inbound telephone sale during the prohibition period —ie 24 hours to seven days after the credit sale. This was referred to as the 'Prohibition Penetration Rate'.
- For those customers who had received a quote at the credit point of sale but not made an FPM appointment or an inbound telephone call during the prohibition period, following the expiry of that period, to contact [✂] per cent of those customers (and seek to sell LifeChoices to [✂] per cent of those customers contacted).

62. The pilot was conducted in [✂] selected branches and at a telephone call centre.

[4]Pre-pilot, telephony channel customers were offered the opportunity to be transferred to a separate LifeChoices team (to speak on a non-advised basis) as a continuation of the sales call; branch customers would see an FPM immediately if one was available or make an appointment. HSBC believed that the majority of these customers would make an appointment. During the pilot FPM appointments were not available immediately in branch; customers had to wait at least seven days for an appointment. In the telephone channel customers were not offered the opportunity to be transferred to the LifeChoices team as a continuation of the call.

Results of the pilot

63. HSBC told us the results of the branch pilot. It only provided the results of sales of credit in branches with subsequent LifeChoices sales in any channel, as it said that there were data recording problems for the sales of credit through the telephony channel (which accounted for around three-quarters of all credit sales during the pilot) and subsequent sales of LifeChoices to those customers. The results for the branch pilot are set out in Table 4.

TABLE 4 **Results of HSBC 2010 pilot—penetration rates**

	Credit products sold	*Personal quote provided*	*% quoted*	*LifeChoices sale*	*Ratio of LifeChoices sales to loans sold %*	*Ratio of LifeChoices sales to personal quotes issued* %*
Personal loans	[✂]	[✂]	[60–70]	[✂]	[5–10]	[5–10]
Credit cards	[✂]	[✂]	[20–30]	[✂]	[0–5]	[5–10]
Total	[✂]	[✂]	[40–50]	[✂]	[0–5]	[5–10]

Source: CC based on data provided by HSBC.

*HSBC told us that in its view these figures would be meaningless, as some branch staff had not offered personal quotes but had offered FPM meetings at which LifeChoices had been sold, and because HSBC was not confident about the accuracy of the number of quotes issued in branch.

64. The take-up rate during the pilot varied by month quite considerably. Table 5 shows the take-up as a proportion of all credit sales in the pilot branches in the nine months prior to the pilot (the pilot started in the first pilot branch on 23 September 2009 and was rolled out to other participating branches on a phased basis) and in each month of the pilot.

TABLE 5 **Results of HSBC 2010 pilot—take-up in pilot branches by month**

per cent

	Personal loans	*Credit cards*
January 2009	[✂]	[✂]
February 2009	[✂]	[✂]
March 2009	[✂]	[✂]
April 2009	[✂]	[✂]
May 2009	[✂]	[✂]
June 2009	[✂]	[✂]
July 2009	[✂]	[✂]
August 2009	[✂]	[✂]
September 2009	[✂]	[✂]
October 2009	[✂]	[✂]
November 2009	[✂]	[✂]
December 2009	[✂]	[✂]
January 2010	[✂]	[✂]
February 2010	[✂]	[✂]

Source: CC based on data provided by HSBC.

65. By way of comparison, HSBC provided us with a chart which showed that during the pilot its non-pilot branches achieved LifeChoices take-up following the sale of a personal loan of between [0 and 10] per cent, whilst the pilot branches achieved slightly higher take-ups in each month. However, in the nine months before the pilot, the pilot branches achieved higher take-ups than the average. Non-pilot branches achieved a take-up in the nine months prior to the pilot of between [0–10] and [0–10] per cent, on a fairly consistent downward trend. Pilot branches achieved take-ups varying between [0–10] and [10–20] per cent per month; whilst the largest take-up was in the first recorded month, there was not a consistent downward trend, with two of the three last pre-pilot months achieving the second and third highest take-up

rates. HSBC told us that the pilot branches were chosen at random and the higher than average take-up in the pilot branches had not been expected prior to the pilot (but upon reflection it could think of reasons why they might have higher take-up). Pilot branches (and non-pilot branches) saw a decrease in take-up rates during the pilot, although the decline for non-pilot branches was less marked than for pilot branches. We calculated a LifeChoices penetration rate for sales made alongside personal loans, using data on all LifeChoices sales and HSBC credit sales for the period January to November 2009. We found that the penetration rates were [0–10] per cent for PLPPI and [0–10] per cent for CCPPI, which were in line with HSBC's estimates for the individual products.

66. These results showed that in the pilot branches the average take-up of LifeChoices alongside personal loans reduced during the pilot compared with the months prior to the pilot. The average take-up alongside credit cards increased during the pilot compared with the nine months prior to the pilot, but the take-up decreased during the pilot if only the three months before the pilot were looked at. For LifeChoices sold alongside both personal loans and credit cards the take-up was still higher than the average take-up rates in non-pilot branches during the same period.

67. We looked at the sales of LifeChoices as a proportion of personal quotes issued. We noted the limitations HSBC said there were on the data on quotes issued in branch (set out in the footnote to Table 4), and on the telephony channel pilot data, which in our view were severe limitations given that HSBC did not send us the data on the telephone pilot. HSBC said that reasons for the low take-up of personal quotes included that not all customers were eligible for LifeChoices, and that some refused to take quotes. In addition, in some cases the salesperson did not offer a quote but did offer a meeting with an FPM.

Results of a survey into the pilot

68. In a research study conducted by GfK between October 2009 and February 2010 to test and learn the impacts of a POSP on the two-stage sales process as one of its objectives, telephone interviews were conducted with 23 PPI customers (2 purchasers and 21 decliners) and face-to-face depth interviews with 14 HSBC staff involved in providing quotes.

69. GfK interviewed customers to evaluate the pilot's sales process. HSBC summarized the results of the GfK findings as follows. LifeChoices was a difficult product to explain but well-matched to customer needs. It also suggested that the approach and timing of the sales process undermined the proposition—approaching protection during the credit sale made the offer feel like PPI and sales-based rather than needs-based; the customer's main focus was on the credit application and they did not seem to take in the product information, especially when the credit was linked to debt consolidation. Therefore GfK concluded that the value of LifeChoices is lost in the presentation, customers needed assistance to recognize the need for protection and staff providing quotes [✂] and were cautious not to go too far for fear of giving advice or misleading information.

70. [✂][5] The GfK survey[6] suggested that the pilot processes were failing effectively to promote the benefits of LifeChoices to customers. It said that the cause of this was multi-factored, including inherent reluctance on the part of many people to value

[5] [✂]
[6] [✂] was originally established by HSBC to consider the protection proposition offered to HSBC's customers following its withdrawal of PPI products in December 2007. [✂]

discretionary insurance, exacerbated by the current reluctance to increase financial commitments; [✂]; but critically the position of the pilot quote within a credit application. It said that in this interaction the pilot quote was often at a significant disadvantage from the start—as many customers applying for credit were either distracted (attention on the purpose of the credit) or were in 'distress' (consolidating debts in 'crisis' mode) and therefore resistant to taking any further commitments.

71. The results of the research indicated that customers thought it helpful to have time to think about purchasing the product but staff felt it made it much harder to engage the customer. The research found that among both staff and customers there was a strong sense that they should have the choice to take out the product immediately if they wished to do so.

72. [✂], and noted that staff only provided customers with a quote in [50–60] per cent of loan sales and [20–30] per cent of credit card sales (compared with targets of 100 per cent).

73. HSBC noted that the findings and recommendations were based on a small sample of responses and interviews. Furthermore, the results and recommendations were currently subject to ongoing consideration by HSBC.

What can be learnt from the pilot

74. HSBC told us that the pilot showed a significant reduction in PPI penetration rates—around 25 per cent—when a POSP was implemented, that customers became confused by the 'broken journey' and staff concerned about how best to help and guide, and that consequently many consumers who needed protection could end up with inadequate or no cover. HSBC told us that its pilot raised serious concerns about the proposed POSP remedy. In particular, it said, the loss of convenience to customers would be significant, evidenced by the significantly lower LifeChoices penetration rates observed at pilot branches. It said that the loss of convenience could imply a significant reduction in consumer welfare, as some consumers would no longer be willing to purchase protection because of the loss of convenience, and all consumers who still purchased protection would suffer a loss of convenience. HSBC said that its evidence should carry significantly more weight than 'the hypothetical, counter-intuitive and unreliable results produced by the Accent survey', and that to use the Accent survey in preference to its experiment would be 'irrational'. It said that the reasons we gave for not taking its results at face value were flawed. We address two of its comments in paragraphs 2 and 3. HSBC also said that its experiment and others showed that some current PPI purchasers would not be contacted (and so would not be reminded about PPI) by the credit provider, which it said reinforced the fact that a POSP would lead to many existing PPI consumers not obtaining cover in future.

75. We considered what we could learn from the experiment about the reduction in take-up due to the introduction of a POSP. We looked first at the limitations of the experiment, and then what we could nevertheless draw from it.

76. We looked first at issues arising from the design of the pilot. We noted that the average take-up for LifeChoices sold during the pilot was lower than the average take-up in the nine months prior to the pilot for sales with personal loans (though it was higher for sales with credit cards). We noted that within this there was significant variability by month—perhaps inevitably given the small numbers of LifeChoices sales per month in the sample. For sales to personal loan customers we noted that the take-up rate in November 2009 was higher than in one of the non-pilot months for which we received data (April 2009), and only 0.1 per cent lower than the take-up

rate in another non-pilot month (August 2009). On the other hand, take-up rates in three of the five months of the pilot were under half the take-up rates in six of the nine months prior to the pilot. For sales to credit card customers there was also variability, with take-up rates in two of the pilot months greater than the take-up rates in any of the nine months preceding the pilot; on the other hand, two months during the pilot had take-up rates of less than 1 per cent, with no sales at all in one month.

77. We also noted that the pilot branches achieved significantly higher penetration rates than the non-pilot branches (more than 50 per cent higher than the average in five of the nine months preceding the pilot) and that, during the pilot, the pilot branches achieved higher average take-up rates than the non-pilot branches. HSBC's conclusion on a loss of convenience was therefore based primarily on a comparison of the pilot branches' performance before and during the pilot, though HSBC said that it was also based on a comparison with the trend in penetration rates in non-pilot branches. We noted that an alternative hypothesis could be constructed—that the decline during the pilot period was at least in part due to a reversion to the mean level of branch sales following a period of abnormally high sales in the pilot branches.

78. Further, we noted that HSBC's [✂]. We were told that this was a reservation about the extent to which LifeChoices met a PPI need where the customer was, for example seeking only to protect a loan and cover the exact term and amount of that borrowing. We thought this meant that, notwithstanding LifeChoices being HSBC's product of choice, there were doubts as to how good a product LifeChoices was for consumers who were interested in taking out insurance to cover only their ability to meet repayments on a personal loan.[7] HSBC noted that any such doubts would already have had an impact on penetration rates when it was introduced, and the results of the pilot would not be affected by these factors. We agreed that product quality was the same before and during the pilot, though we could not be sure that take-up rates during the pilot would not be adversely affected. This is because the personal quote provides information on the product and the POSP gives the customer time and space to consider the product. If consumers use the personal quote, then we would expect them to be able to take a more considered view on how good the product is for them.

79. Next we considered issues around how the experiment was implemented. We noted that HSBC had aimed to provide personal quotes to all its personal loan and credit card customers, but in fact only [40–50] per cent of customers received a quote. We also noted the problems with data recording which led to us not receiving evidence from the telephony channel element of the pilot, the finding in the staff survey of [✂] and the fact that some sales staff had not offered personal quotes but had nevertheless arranged interviews at which LifeChoices could be sold. We were therefore concerned that the performance of sales staff during the pilot did not match HSBC's expectations or was as good as we thought it would be if staff were fully incentivized to maximize take-up using this sales process, and that sales could expect to have been lost for these reasons. This suggested to us that the pilot was not a good indicator of what would happen if a well-motivated sales team were trying to sell PPI.

80. We also noted the concerns [✂] about this product's suitability for use in a pilot testing a sales process for personal loan customers. In that respect, we also noted that when sold alongside credit cards, LifeChoices offers cover which, at least for small sums outstanding, is significantly more expensive than the CCPPI policy it replaced

[7] As was noted in the 2009 report, HSBC does not consider LifeChoices to be a PPI product, but we are content that it is.

in 2007 (see paragraph 55), and that LifeChoices sold alongside credit cards has a very small penetration rate (see paragraph 69).

81. We then looked at issues regarding the timing and scale of the experiment. We looked at whether the experiment's results were statistically significant. We normally consider that results are robust if they are statistically significant at the 95 per cent confidence level. Because of the low penetration rates of LifeChoices sales for personal loans, we found that the results for sales of LifeChoices alongside personal loans were not statistically significant at the 95 per cent confidence level. The results were statistically significant at the 90 per cent confidence level. These results are dependent on the assumptions that underlay the significance calculations (a normal distribution, independence of results and a random sample). HSBC told us the branches were chosen at random, and whilst we had no reasons to doubt this we noted that the selection of branches did turn out to be atypical of the average, with far higher, and far more variable over time, penetration rates in pilot branches than non-pilot branches.

82. There were significantly fewer sales of LifeChoices alongside credit cards. We found that the resulting penetration rates were variable and erratic, such that it was not possible to say whether there had been an increase or a decrease in PPI take-up as a result of the pilot.

83. Despite these concerns, we thought that we could draw some useful lessons from the pilot. We thought that, whilst on an individual month level the trends were not entirely clear, the pilot in aggregate did suggest that a break in the sales process could lead to a reduction in take-up rates of PLPPI. We also thought that [✀] sales staff [✀] some sales staff [✀] offering sales interviews without quotes, showed that the detail of how a distributor chooses to set up its sales processes—including the motivation of sales staff—can have a material impact on the penetration rates that can be achieved.

84. In terms of the scale of reduction that might be expected with a POSP in place, the pilot suggested that a 25 per cent reduction in sales was possible, though we had concerns over the statistical significance of the result. The concerns we had about how the pilot was run and the product in question (the performance of sales staff—see paragraph 77; and the impact of product of quality on the pilot—see paragraphs 78 and 80) suggested to us that the pilot overestimated the reduction in take-up. The survey did not reach any statistically significant conclusions regarding CCPPI.

85. We noted HSBC's views about attaching more weight to its evidence than to the Accent survey. We have attached weight to the HSBC evidence that imposing a POSP could result in a reduction in take-up all else held equal, and that the reduction might be of the order of 25 per cent. However, given the issues identified about the design, implementation and timing and scale of the experiment, we thought that this was likely to be an overestimate of the true figure of reduced take-up with a POSP in place for PLPPI policies.

Barclays

86. In preparation for the roll-out of its regular-premium PLPPI product in the branch network (a roll-out which was subsequently put on hold), Barclays conducted four pilots for PPI sales processes. Two involved both credit and PPI sales being completed in the branch. One involved the PPI sale being conducted over the telephone whilst the customer was still in the branch. The fourth pilot involved customers who expressed an interest in a quote for PPI being telephoned back at a later date. The fourth pilot, which was conducted between 18 August and 2 September 2009, might

therefore offer some insight into PPI take-up with a POSP in place, though Barclays did not direct us to this research as evidence of the impact of the POSP.

87. The results of the pilots, reported internally in September 2009, showed that take-up rates for PPI varied considerably across the pilots. For the fourth pilot there was a very low percentage of quotes provided for loan sales ([<1] per cent of loan sales customers were given a quote—compared with between [0 and 70] per cent for the other pilots). However, [70–80] per cent of quotes resulted in sales (the next highest conversion rate was [40–50] per cent, for one of the pilots where both products were sold in the branch). The overall penetration rate for the fourth pilot was [<1] per cent—for the other pilots the penetration rates varied from [0–30] per cent.

88. The fourth pilot relied on leads generated during the loans sale. However, a quote for PPI was not provided during the loan sale—customers who expressed an interest were subsequently telephoned and at that stage offered a quote for PPI. The proportion of people who received a quote therefore depended in part on the number of people who were successfully contacted. Of the [5,000–6,000] loan sales leads, calls were successfully made to only [50–60] customers (1 per cent), leading to [10–20] quotes and [10–20] sales. On the basis of the number of customers who were actually contacted, just over one-quarter of customers contacted agreed to receive a quote, and three-quarters of customers who received a quote (around one-fifth of all customers contacted) bought PPI.

89. Because so few customers were successfully called back in the fourth pilot we cannot assume that the results are statistically significant. But taken on face value, just over one-quarter of customers who expressed interest in PPI being prepared to take a quote seems a low figure. This may have been due to the non-provision of a quote at the credit point of sale. Instead customers received a one-page letter inviting them to consider purchasing any of four different protection products, one of which was PPI.[8] The pilot therefore encouraged customers to think of products other than PPI as well as PPI, which we thought would naturally lead to lower take-up of PPI than if customers were encouraged to consider PPI only. Moreover, the lack of a personal quote did not allow consumers to consider the value of the product either in isolation or relative to other protection products.

90. We thought that this pilot substantially underestimated the likely take-up of PPI with a remedy package including a POSP in place, because of the low contact rate, the lack of a personal quote at the point of sale (in effect, making this a three-stage sales process) and the active encouragement to consider alternative products alongside PPI.

RBSG and GMAC

91. In response to footnote 10 of our overall consultation, which set out that a number of distributors withdrew from the market in 2009, RBSG suggested that we should consider the events of 2009 as a form of 'natural experiment' in response to our original decision to impose a POSP (for example, withdrawal from the market by a number of providers following the original decision). GMAC made a similar argument about the relevance of what happened in 2009. It said that customers in this recession have had no access to motor PPI products due to product withdrawals, and yet have not in large numbers sought out the readily available alternatives. It said that this supported

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[8]Customers received a one-page note setting out four different products the customer might want to consider—PPI, life insurance, personal accident plan, and accident, sickness and critical illness insurance.

a position that the loss of convenience from imposing a POSP has a negative effect on consumer behaviour.

92. We did not agree with RBSG that the events of 2009 formed a useful experiment. The withdrawals from the market we saw by large providers were driven largely by the timing of the FSA's work on single-premium PLPPI, and delays in re-entry by large distributors were driven by various factors.

93. The alleged lack of consumers seeking alternatives to motor finance PPI in 2009 was also, in our view, not good experimental evidence. We saw nothing to suggest that motor finance providers encouraged customers to seek PPI from other sources; further, we noted the lack of advertising of stand-alone products and the small number of providers of those products. In our opinion, looking at customer behaviour in 2009 is not a good proxy for considering how customers would behave with a POSP in place, a personal PPI quote provided at the credit point of sale, and more stand-alone providers offering products and advertising their availability.

Parties' internal estimates of the impact of the CC remedy package on PPI take-up

Introduction

1. In this appendix we set out information found in parties' internal documents on their assumptions about how the remedy package, and in particular the POSP, would impact on take-up of PPI.

2. We set out the evidence relating to PLPPI, MPPI, CCPPI and retail PPI, and evidence not specifically related to a particular type of PPI. We found no internal documents relating to the effect of the remedy package on take-up of SMPPI.

PLPPI

3. [✂] initial view after publication of the CC's 2009 report, as represented in a paper to the [✂] steering group set up to respond to our investigation [✂], was that POSP would be most disruptive for PLPPI. In March 2009, in a discussion paper on PPI strategy [✂], [✂] loans business estimated that PLPPI penetration levels would drop 50 to 60 per cent from the current levels.

4. In August 2009 [✂] internal document to the [✂] steering group [✂] noted that currently around [✂] per cent of customers who took a loan in [✂] branches also purchased PPI and that it was expected that this rate would drop to around [✂] per cent (a reduction of 40 to 50 per cent) with the remedies in place. It did not set out the background to this expectation.

5. As part of a financial analysis of the impact of the Tribunal's judgment [✂], [✂] modelled the potential implications of the POSP on take-up rates for [✂]. It modelled the transition in two stages and made assumptions for the drop in penetration rates that might be expected at each stage (it did not set out the basis on which these assumptions were reached):

   - A move from a single-stage sales process (as in [✂] branches) to a two-stage sales process [✂]. This was modelled as resulting in a 40 per cent drop in [✂] PLPPI sales.

   - A move from the two-stage [✂] sales process to the POSP. This was modelled as resulting in a further 20 per cent drop for PLPPI sales.

6. Following a pilot of the POSP sales process conducted in 2010 (see Appendix C) LBG told us that it assumed that there would be an 80 per cent reduction in take-up as a result of the POSP.

7. The [✂] document for January 2010 set out historic and expected commission levels for PPI products. These are set out for PLPPI in the Table 1.

TABLE 1 **[✂] historic and expected commission levels for PLPPI**

	Historic			*Forecast*	*Plan*				
	2006/07	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12*	*2012/13*	*2013/14*	*2014/15*
PLPPI commission	18.9	15.9	9.5	5.4	2.7	1.2	0.5	0.2	0.1
PLPPI profit share	3.7	5.9	1.4	2.2	1.2	0.5	0.2	0.1	0

Source: [✂].

8. In August 2009 a [✂] internal presentation by a Proposition Development executive entitled 'new PPI proposition post Competition Commission' set out what it expected in a post-remedies world for PLPPI. Of the personal loan sales in 2011 it expected 10 per cent of customers to be ineligible for PLPPI. Of the remainder (nearly 160,000 customers) it expected 10 per cent (15,981) proactively to buy PPI and a further 10 per cent (15,981) to buy life insurance at the point of sale. Of the remainder it expected that 15 per cent would opt for no contact. Of the remainder a contact rate of 53 per cent was assumed, and 8 per cent (5,183) of those would buy PPI. It therefore assumed that it would achieve 21,164 PLPPI sales (equating to a 13 per cent penetration rate among eligible customers, with an additional 10 per cent buying life insurance). It told us that, due to continuing economic conditions and lower volumes of credit products being written in the marketplace, in April 2010 it revised its forecast penetration rate down to 11 per cent. By way of comparison, in 2008 the PLPPI penetration rates achieved by [✂] were [20–30] per cent, suggesting [✂] expected the remedy package to result in a reduction in take-up of around 50 per cent.

MPPI

9. [✂] initial view after publication of the CC's 2009 report, as represented in a paper to the [✂] steering group set up to respond to our investigation [✂], was that POSP would be least disruptive for MPPI (because of existing multi-stage process). In March 2009, in a discussion paper on PPI strategy [✂], [✂] mortgages business estimated that MPPI penetration rates would not drop very much from then current levels as there is a multi-stage sales process.

10. As part of a financial analysis of the impact of the Tribunal's judgment [✂], [✂] modelled the potential implications of the POSP on take-up rates for [✂]. It modelled the transition in two stages and made assumptions for the drop in penetration rates that might be expected at each stage (it did not set out the basis on which these assumptions were reached):

- A move from a single-stage sales process (as in [✂] branches) to a two-stage sales process [✂]. This was modelled as resulting in a 20 per cent drop in [✂] MPPI sales.

- A move from the two-stage [✂] sales process to the POSP. This was modelled as resulting in a further 20 per cent drop for MPPI sales.

11. In March 2010 LBG told us that it thought that the impact of the POSP on MPPI would be similar to the impact on PLPPI and for modelling of the impact of the POSP assumed a reduction in sales of 80 per cent. LBG said that this was because it changed its estimates for mortgages as a result of further analysis of the draft Order and, in particular, the impact of the definition of the end of the credit sale included in the draft order.

12. The [✂] document for January 2010 set out historic and expected commission levels for PPI products. These are set out for MPPI in Table 2.

TABLE 2 **[✂] historic and expected commission levels for MPPI**

	Historic			*Forecast*	*Plan*				
	2006/07	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12*	*2012/13*	*2013/14*	*2014/15*
MPPI commission	22.1	20.2	17.2	16.6	20.9	18.2	17.0	16.1	15.3
MPPI profit share	11.2	16.8	5.8	1.8	1.0	0	0	1.3	1.5

Source: [✂].

13. In August 2009 a [✂] internal presentation by a Proposition Development executive entitled 'new PPI proposition post Competition Commission' set out what it expected in a post-remedies world for MPPI. Of the mortgage sales in 2011 it expected 10 per cent (5,535) proactively to buy PPI. Of the remainder it expected that 15 per cent would opt for no contact. Of the remainder a contact rate of 53 per cent was assumed, and 8 per cent (1,795) of those would buy PPI. It therefore assumed it would achieve 7,330 MPPI sales (equating to a 13 per cent penetration rate). It told us that, due to continuing economic conditions and lower volumes of credit products being written in the marketplace, in April 2010 it revised its forecast penetration rate down to 5.5 per cent. By way of comparison, in 2008 the MPPI penetration rates achieved by [✂] were [less than 20] per cent, suggesting that in August 2009 [✂] expected the take-up it could achieve with the remedy package to be either similar to, or larger than, existing take-up rates, but that by April 2010 it was expecting take-up to fall with the remedy package in place. [✂][1] said that our interpretation of its position in August 2009 was wrong, as the two sources of data (actual penetration rate and predicted penetration rate) were not directly comparable—[✂] said that the penetration rates used in the report were based upon discussions within the industry, insight provided by its Direct Marketing teams, and on the assumption of the impact on penetration rates based on what it was seeing at the time. We noted this; it did not change our view on what we drew from parties' internal estimates of the effects of a POSP on MPPI take-up.

CCPPI

14. [✂] initial view after publication of the CC's 2009 report, as represented in a paper to the [✂] steering group set up to respond to our investigation [✂], was that CCPPI was an intermediate case compared with PLPPI and MPPI in terms of the impact of the POSP (because of disruption to branch and telephone sales and end to tick-box applications, but with ability to conclude sales at activation). In March 2009, in a discussion paper on PPI strategy [✂], [✂] cards business estimated that CCPPI sales would drop 30 to 40 per cent from then current levels. The [✂] CCPPI business documents from February and April 2009 said that [✂] might be able to achieve 65 per cent of the then current new business sales volume by maximizing sales through existing channels and developing new sales channels (eg an inbound hotline for customers responding to the personal PPI quote and direct marketing) (see documents [✂]—an undated [✂] document, [✂], a February 2009 [✂] strategic proposal for life after the implementation of remedies by a [✂] executive, and [✂], an April 2009 [✂] update to the acquisition analytics teams by the same [✂] executive). A subsequent presentation ([✂]) also cited a 65 per cent of current volumes sales figure, but suggested that a higher take-up rate of 80 per cent of current volume might be possible if consumers were given a tailored recommendation and quote at the credit point of sale, which would, however, be more costly to implement. Another October 2009 internal document, a scenario modelling spreadsheet [✂], modelled a lower take-up rate (42 per cent of current

[1] [✂]

levels) if PPI were not offered at credit sale, but first offered during the activation call and subsequently followed up.

15. As part of a financial analysis of the impact of the Tribunal's judgment [✂], [✂] modelled the potential implications of the POSP on take-up rates for [✂]. It modelled the transition in two stages and made assumptions for the drop in penetration rates that might be expected at each stage (it did not set out the basis on which these assumptions were reached):

- A move from a single-stage sales process (as in [✂] branches) to a [✂] two-stage sales process with [✂] (as is already the case for [✂] PLPPI). This was modelled as resulting in a 40 per cent drop in [✂] CCPPI sales.

- A move from the two-stage [✂] sales process to the POSP. This was modelled as resulting in a further 20 per cent drop for CCPPI sales.

16. In a document considering alternative sales strategies to mitigate some of the loss from withdrawing from sales of CCPPI [✂], [✂] estimated that it could recover 65 per cent of current sales volumes if it gave a quote in branch, and completed PPI sales after the credit decision.

17. Following its 2010 pilot (see Appendix C), LBG assumed for modelling purposes that CCPPI penetration rates would fall by 50 per cent—less than for other products because of the repeated interaction with the customer (for example, at the point of activation).

18. For its credit card business [✂] has developed a new product which does not track the outstanding balance on the credit card. Internal documents show that [✂] most recent expectation was to sell [✂] policies in 2010 [✂], but expected this to fall in the following years as other providers start to offer similar products. [✂] per cent of the sales in 2010 were expected to be to non-[✂] customers. The expectation would be that the volume of sales would be lower than the CCPPI product it would be replacing, but that customers would, on average, take out more insurance as it would be marketing this product to cover a range of outgoings, not just credit cards.

19. The [✂] document for January 2010 set out historic and expected commission levels for PPI products. These are set out for CCPPI in Table 3.

TABLE 3 **[✂] historic and expected commission levels for CCPPI**

	Historic			*Forecast*	*Plan*				
	2006/07	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12*	*2012/13*	*2013/14*	*2014/15*
CCPPI commission	5.6	5.6	5.5	3.0	2.6	1.8	1.0	0.4	–0.1
CCPPI profit share	2.1	2.2	1.4	0.8	0.9	1.0	1.1	1.2	1.3

Source: [✂].

20. In August 2009, a [✂] internal presentation by a Proposition Development executive entitled 'new PPI proposition post Competition Commission' set out what it expected in a post-remedies world for CCPPI. Of the credit card sales in 2011 it expected 10 per cent of customers to be ineligible for CCPPI. Of the remainder (437,000 customers) it expected 8 per cent (43,700) proactively to buy PPI and a further 5 per cent (21,850) to buy life insurance at the point of sale. Of the remainder it expected that 15 per cent would opt for no contact. Of the remainder a contact rate of 53 per cent was assumed, and 8 per cent (14,174) of those would buy PPI. It therefore assumed that it would achieve 49,134 CCPPI sales (equating to an 11.2 per cent

penetration rate among eligible customers, with an additional 5 per cent buying life insurance). It told us that, due to continuing economic conditions and lower volumes of credit products being written in the marketplace, in April 2010 it revised its forecast down to 3 per cent. By way of comparison, in 2008 the CCPPI penetration rate achieved by [✂] was 4 per cent, suggesting that [✂] expected the remedy package to result in a reduction in take-up.

21. [✂] internal documents showed that it expected PPI penetration rates to fall significantly following the introduction of the CC remedies. A July 2009 presentation entitled 'CC impact summary' expected the move from selling at the point of sale to selling at the point of activation to reduce values by around 30 per cent.[2] It projected a further 30 per cent reduction in value from 30 per cent of customers being deterred from taking out PPI by information contained in the personal PPI quote. It also projected a further attrition of 10 per cent because of the annual review. This was based on an opt-in test performed in 2008, where customers were mailed with the opportunity to opt out of PPI. 12.9 per cent of prime and 6.3 per cent of sub-prime customers cancelled when prompted. This assumption appears to have a further substantial effect on value, reducing it by a further 30 per cent.

22. In August 2009 [✂], in its monthly update with four-year planning assumptions, by the [✂], assumed a 20 per cent drop in new CCPPI sales as a result of the CC's remedies. In its [✂] September 2009 update, [✂] forecast that insurance penetration would reduce from [✂] per cent in 2009 to [✂] per cent in 2011—a drop of about one-third—against a backdrop of CC regulatory pressure and high refund levels. However, [✂] later told us that these forecasts should be regarded as underestimates and provided some alternative figures shown below.

TABLE 4 **[✂] forecast impact of CC remedies**

Lost sales as a result of CC remedies	*2010**	*2011*	*2012*
Application	[✂]	[✂]	[✂]
Credit	[✂]	[✂]	[✂]
Call centre	[✂]	[✂]	[✂]
Total lost sales	[✂]	[✂]	[✂]
Lost sales as a proportion of [✂] total PPI sales (% approx)	15	50	50

Source: [✂].

*The impact of the CC's remedies for 2010 is lower than in subsequent years because the POSP was only scheduled to come into force in October 2010.

23. The reasons for the reduction were:

- some drop off (assumed 8 per cent) on the introduction of informational remedies;
- 50,000 reduction in sales because cannot sell PPI with credit application when POSP comes into force;
- cannot sell PPI when granting credit approval (around 10,000 sales a year);
- neutral impact on sales at point of activation—some sales which would previously have taken place at credit application or credit approval may now take place at credit activation, but some sales might be lost, for example if consumers are

[2] [✂]

deterred by information contained in the personal PPI quote. Overall the net effect of these two factors was assumed to cancel each other out; and

- some loss of sales for other channels (eg existing customers activating a new card) arising from the impact of informational remedies.

Retail PPI

24. [✂] told us that it expected substantial reduction in sales and incremental costs, which would result in [✂] fewer people being insured in Year 1, rising to [✂] by year 5. [✂] calculated the effect in year one of all the CC remedies would be to reduce PPI premiums from £[✂] million to £[✂] million—a drop of about 15 per cent.

25. [✂] carried out a trial of outward-bound telemarketing (OBTM) [✂] identified a segment of long-standing customers who had not purchased PPI in the past and attempted to contact these customers via OBTM. [✂] concluded that OBTM was much less effective than inbound calling because: less than 50 per cent of customers have opted in to receiving Telemarketing calls; of these, telephone contact is only made in approximately [50–60] per cent of cases; and when telephone contact is made, the 'Decision Maker' is only available in [50–60] per cent of cases. It sold policies to about [0–10] per cent of those decision makers. [✂] also told us that OBTM was much more expensive than inbound activity due to inefficiencies in call handling. It conducted a further OBTM trial in January–April 2010, which it said achieved a take-up rate of [0–10] per cent.

Comments not specific to a particular type of PPI

26. [✂] has developed a new product called [✂] for its [✂] business. As of February 2010 it expected to sell 55,230 policies in 2010, increasing to 136,760 for each of the years 2011 to 2013. It suggested that short-term income protection volumes would be lower than historic PPI levels but would build gradually.

27. A July 2009 [✂] paper [✂] said that 'current modelling suggests a group revenue impact [of CC remedies] of up to £[✂]m pa. However, this is potentially offset by revenue generation over four years of c. £[✂]m'.

28. In a presentation [✂] in August 2009 it was said that 'whilst the CC ruling will reduce PPI profitability there are still opportunities for PPI to deliver substantial value to [✂]'. Table 5 was presented.[3]

TABLE 5 [✂] **opportunities for PPI**

[✂]

Source: [✂].

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29. A [✂] internal presentation in October 2008 estimated the financial impact of the CC remedies as: 2008 PPI income impact of (<£1.0 million) vs budget; 2009 PPI income impact of (£16.5 million) vs budget. This assumed: Regular Premium PPI commission reduces due to CC remedies and a 5 per cent improvement in Strike Rate for RP PPI. The presentation also noted that the impact of stopping all Single Premium sales until Q2 2009 is (£3.0 million) 2008 and (£5.2 million) 2009.

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[3] [✂]

Review of survey evidence provided by the parties on the impact of the POSP on the loss of convenience

Introduction

1. This appendix sets out survey evidence we received from parties regarding the impact of the POSP on the loss of convenience.

Survey evidence received from parties

[✂]

2. [✂] was set up in 2008 in order to 'investigate various workstreams related to PPI in light of the various regulatory and competition-related developments. [✂].'

3. In June 2008, [✂] conducted research into customers' views on buying PPI. The areas that were researched included: when people would like to receive information on PPI for their loan; when they would like to actually purchase PPI cover for their loan; what they think of the current information provided; and what further information would they have liked.

4. A sample was drawn from the [✂]. Respondents were divided into two groups. The first group ('loan holders') had a personal loan and either held PPI cover for it or were open to acquiring PPI cover. The second group ('non-loan holders') did not currently hold a personal loan but were open to taking out a personal loan, and to taking out PPI cover for a personal loan, in the future. 529 interviews were achieved in total (317 loan holders—of whom 150 respondents already had PPI on the loan—and 212 non-loan holders) and the research found that:

   (a) [80–90] per cent of respondents wanted to hear about PPI options either before or when applying for a loan. For [70–80] per cent of respondents the best time to actually purchase PPI was when applying for the loan;

   (b) among both loan holders and non-loan holders, the majority want to hear about PPI options when applying for the loan; and

   (c) the majority of people that had bought PPI were satisfied with the quantity of information they had received.

5. In October 2008, [✂] recruited the research agency [✂] to conduct focus groups to 'build on the customer centricity aspect of PPI'. The aims of the research were to: gain insight into consumer attitudes towards PPI; gain customer feedback on the stand-alone product propositions; understand attitudes to pricing; and understand attitudes to other product refinements (sales process, 12- vs 24-month cover, includ-ing vs excluding waiver, loan repayment habits etc).

6. The research involved a qualitative study which included: four 1½-hour consumer mini groups (each with four respondents) and two 1-hour consumer/stakeholder sessions (each with eight respondents). The key findings included:

   (a) consumers have PPI to ensure peace of mind and continue to enjoy life if they are faced with unemployment, illness or, even worse, death;

(b) consumers want choices when purchasing PPI especially in the case of a purchase channel and methods of paying for the PPI cover. The branch is the favoured channel as consumers desire human contact when discussing important life issues such as PPI; however, customers also want to access the product through telephone and online channels;

(c) consumers want help not advice when purchasing PPI and making these choices—assistance not pushy 'sales'; and

(d) overall the majority of consumers would like to take out PPI when getting a loan; however, consumers do want the option to purchase at anytime.

7. In December 2008, to build on the learning gained from the qualitative research and to understand product preferences, an online survey utilizing 'trade-off' methodology to understand and rank consumers' preferences across a number of product features was conducted by [✂]. The sample included: 810 consumers aged 25 to 65 years old and cut the sample by earners over 40,000 and under 40,000 a year. Of the 810 consumers, 511 would consider taking out PPI in the future. The key findings included:

(a) price is the most important factor that is considered when purchasing PPI;

(b) there is potential for the stand-alone PPI proposition to succeed; and

(c) although one-third of people who completed the survey said that they would not consider buying PPI in the future, the majority of people were open to PPI in the future. In the light of the credit crunch more people were also likely to purchase PPI than they were about a year ago.

[✂]

8. In [✂] decided to cease selling PPI products. [✂]

9. Market research conducted by [✂] in September 2008 [✂] involved 1,000 online interviews with loan and/or credit card holders. The sample included: 509 PPI holders; 439 non-PPI holders; [✂]; 396 loan holders; 962 credit card holders; and 193 self-employed/small business owners.

10. The research showed that about [50–60] per cent of consumers decided to take out PPI whilst at the point of sale. [20–30] per cent of consumers knew that they wanted PPI before taking the loan/credit and [10–20] per cent of consumers researched PPI and took it out later. About [10–20] per cent did not know.

11. When asked whether respondents would prefer to take out immediate cover there and then or not to get cover straight away because they would want to think about it, [20–30] per cent of the 948 respondents indicated that they would prefer to take immediate cover and [70–80] per cent indicated that they would prefer not to take cover straight away.

12. This sample of 948 included a sample of PPI customers (509 respondents) and a sample of non-PPI customers (439 respondents). For the sample of PPI customers, [30–40] per cent indicated that they would prefer to take immediate cover and [60–70] per cent indicated that they would prefer not to take cover straight away. [✂] said that this indicated that over one-third of PPI customers placed significance on being able to take immediate cover and that these customers would face a loss of convenience associated with the POSP.

13. The [60–70] per cent of respondents that expressed a preference not to get cover straight away did so because they wanted to think about the product. [✂] said that this preference was consistent with a cooling-off period following the sale of a product as well as with the POSP. It said that the fact that a significant proportion of customers indicated a preference to have time to think about the product did not provide support for the imposition of a POSP as opposed to alternative remedies.

[✂]

14. In 2008, [✂] commissioned two agencies, [✂] with the key business objective 'to support and inform [✂] in developing a longer-term PPI strategy which satisfies the requirements of the regulator, provides customers with a product which meets their needs and gives a fair commercial return to the business'. This qualitative research was conducted in two parts: [✂] conducted the rational research and [✂] conducted the emotional research. The research objectives were:

    (a) to understand both the underlying emotional and rational drivers behind consumers' attitudes to risk, protection, general insurance and specifically PPI;

    (b) to understand the life events which consumers want to protect themselves against; and

    (c) to understand consumer behaviour and motivations in making a PPI purchase decision and the consumer journey which results in a transaction.

15. [✂] conducted 30 60-minute interviews, comprising 50 per cent [✂] current account customers; singles/pre-family/younger family/older family/single parents; a mix of credit product type; a mix of credit take-up channels; and all had taken credit out in last six months (or were planning to)—with an even split of 'with PPI' and 'without PPI'. [✂] conducted six mini focus groups and 24 in-depth interviews, comprising 50 per cent [✂] current account customers; singles/pre-family/younger family/older family; a mix of credit product type; a mix of credit take-up channels; and all currently taking credit—20 per cent of sample 'with PPI' and 80 per cent 'without PPI'.

16. In relation to the potential PPI remedies then under consideration (including a POSP) the research found that:

    > *(a)* when [purchased] alongside a credit product, PPI [is] an afterthought and the provider is the trigger to consider in most cases;
    >
    > *(b)* stand-alone purchasers (eg from IFA) are not as savvy as we might expect…often very similar level of consideration;
    >
    > *(c)* decision to take out PPI is more complex than price vs cover—a number of rational and emotional factors [are] interlinked in the decision;
    >
    > *(d)* rationally, the size of the debt impacts on [the] level of consideration consumers are willing to give to PPI;
    >
    > *(e)* perception of PPI is positive in principle in the context of a very sizeable loan—more negative and less feeling of it being essential in other contexts;
    >
    > *(f)* the likelihood of a bad outcome is an emotional driver, but is often used in a rational sense to justify not take-up;

(g) the ability to cover repayments if something was to happen is based largely on perceived financial security, which is made up of both rational and emotional considerations;

(h) regardless of all other factors, if PPI is not affordable, going without is a risk that customers are willing to take in the short term;

(i) customers with experience can feel obliged to take PPI—as a condition of loan acceptance; and

(j) underpinning all of these factors is the relative ease with which one can take out PPI currently.

17. The conclusion drawn from this was 'that the prevention of PPI being sold at the credit point of sale does not fit with consumer needs and is likely to result in those needing protection going unprotected'.

18. In March 2009, [✂] received the results of qualitative research by [✂] to test the desirability of a stand-alone protection proposition. The purpose of the research was to help understand the potential appeal and consideration levels of a stand-alone proposition. The research sample was weighted heavily towards the franchise base (ie customers with an existing relationship with [✂]) and included both PPI and non-PPI holders and a spread of pre-family, family and post-family groups. A combination of eight mini-focus groups and eight in-depth interviews among principal/joint account holders were held in Chippenham, Birmingham and Manchester.

19. Key findings of this research were as follows:

(a) the current economic climate is now creating real and widespread fear regarding threats to income and job insecurity;

(b) the stand-alone proposition was received well with franchise PPI holders but works less well with franchise non-PPI holders; and

(c) the key strengths of the proposition that was tested were the related elements of:

(i) flexibility/tailoring of cover in relation to needs—which improves perceptions of value and cover quality;

(ii) focus on life-style—which improves and widens appeal and relevance; and

(iii) its perceived status as a stand-alone product—which instils more confidence in the purchase/sales process.

20. In relation to the POSP the researchers found that for this kind of product, most 'with-PPI people' do not appear minded (or sometimes do not feel savvy) enough to shop around or to be more empowered to say 'no' after seven days ('I'd go to the bank and make my mind up based on what they said'. 'I shop around for car insurance, but this is more expert'). By the same token, there is little evidence that many will take the initiative to call [✂] directly for this protection or to revert to [✂] after 24 hours. Either way it was concluded that take-up would be largely determined by the quality of the sales process.

21. For nearly all 'non-PPI' people, the researchers concluded that the impact of the POSP was simply to make it easier to say no. Very few claimed that they would look around—the proposition having done something to awaken the need for protection.

Either way, the researchers concluded that the impact would be determined by the sales process.

22. [✂] also carried out various pilots of POSP type sales processes. We provide some detail below of the feedback given by customers in relation to the second pilot, conducted in January–February 2010.

23. The customer feedback from branches included:

    (a) Some customers reacted negatively to the idea of prohibition, firstly because it prevented them from purchasing what they wished to purchase, but secondly because they perceived that the bank was not performing its job as a service provider, and was instead forcing them to undertake more work in order to purchase.

    (b) At fulfilment, some customers were frustrated that they had to provide the same information (in terms of suitability) a second time—this was also perceived as a poorer service offering from the bank, because customers felt that their time was being wasted.

24. The customer feedback from the telephone channel included:

    (a) When told that they would not be able to purchase PPI at point of sale, a number of customers were happy with this process and the opportunity to shop around, while these were counterbalanced by a number of customers stating adamantly that they wanted to purchase PPI with their credit, and expressing their dissatisfaction that they could not call back earlier than 24 hours after the end of the credit sale.

    (b) Others expressed their dissatisfaction that the new process would be unduly time-consuming, and some customers misunderstood that they could not purchase at point of credit sale, and were frustrated that they could not do so.

25. A number of oral complaints (both branch and telephony) were received from customers unhappy about specific aspects of the process including:

    (a) Customers were not happy that they had to take further action themselves, to call back.

    (b) Several customers expressed dissatisfaction with having to go through the same process of determining suitability/eligibility at both credit point of sale and PPI point of sale.

    (c) A number of customers proactively contacted [✂] after the end of their validity period, wishing to purchase PPI.

26. Customer follow-up interviews were conducted with 98 customers who received a quote but did not make a purchase. [10–20] per cent of those customers said that they searched for and compared products elsewhere; [0–10] made a purchase elsewhere, though almost all of these were products from other parts of [✂]. The customers were asked if they would have purchased the product if it had been 30 per cent cheaper—[10–20] per cent said yes, [30–40] per cent said possibly or probably, [10–20] per cent said no or doubtful, [20–30] per cent said they did not need or want the product and [10–20] per cent made other responses.

[✂]

27. In its response to the CC's provisional findings and remedies notice [✂] cited June 2007 [✂], which it said showed that 91 per cent of respondents cited convenience as a reason for simultaneous purchase of PPI and credit.[1]

[✂]

28. In April 2009, [✂] recruited [✂] to conduct consumer research in order to 'understand and explore PPI purchasing as well as evaluate a potential route forward (product and sales process)'.

29. The research involved a qualitative study which included: four 90-minute focus group discussions (with seven or eight respondents in a group); eight 60-minute face-to-face depth interviews; and five 45–60 minute face-to-face [✂] interviews. Respondents were a mix of young professionals and middle income segments, both [✂] and [✂] customers and non-customers, and all had purchased PPI with a loan.

30. [✂] found a lack of detailed understanding and overall engagement with PPI. Customers stated that they were likely to be confused and/or concerned if there was a delay in the sales process and only a minority of these customers said that having an interim period would result in them shopping around. Introducing a delay between the credit sale and the PPI sale raised concerns among both customers and advisors.

[✂]

31. In its response to the CC's provisional findings, [✂] previously shared details of research undertaken in June 2008 by [✂] entitled 'Non-Point-of-Sale PPI Purchase' in order to understand the impact of PPI take-up during the period when [✂] did not offer PPI to personal loan and credit card customers.

32. [✂] temporarily stopped selling CCPPI and PLPPI in August 2007 and in June 2008 commissioned [✂] to review to what extent customers who were not able to purchase CCPPI and PLPPI at the credit point of sale did go on to search the market and purchase from stand-alone providers, and the reasons behind these customers' subsequent actions.

33. The research involved a quantitative study using a sample provided from the [✂] customer database of loan and credit card customers (aged 18 to 65) who took out their products between January and April 2008. Interviews lasted around 10 to 12 minutes. Of the sample of 4,737 customers: 3,285 refused to take part; 596 did not meet the interviewing criteria; and so there were 946 completed interviews. For unsecured personal loans: 504 interviews were achieved in total (with the following distribution of loan values: up to £3,000 (108 respondents); £3,001–£6,000 (130 respondents); £6,001–£10,000 (160 respondents); and over £10,000 (106 respondents)). For credit cards: 442 interviews were achieved in total ([✂]).

34. The research showed that:

[1] Paragraph 10.48 of the 2009 report.

(a) [90–100] per cent of respondents had some level of awareness of PPI products prior to applying for their product. (These levels of awareness were the same for loans and credit cards.)

(b) Despite advice from [✄] to do so, a high proportion of respondents ([40–50] per cent of loans customers and [60–70] per cent of credit card customers) did not even give PPI a second thought, with a relatively small amount considering it ([30–40] per cent loans and [20–30] per cent credit cards) and even fewer making an effort to research the product further ([10–20] per cent loans and [0–10] per cent credit cards actively having researched, more than two months after application).

(c) From the total sample of 946 people: only [40–50] of them went on to get at least one quotation for PPI (5 per cent); only [10–20] actually went on to take out a new PPI policy (1 per cent); and only [10–20] altered an existing policy so they would have sufficient cover for the new credit product they had taken out (2 per cent).

(d) Those customers who did research the market found it fairly or very straightforward to find and compare the different products on the market ([70–80] per cent of personal loan customers and [70–80] per cent of credit card customers).

(e) When asked if they would have preferred the opportunity to take out PPI at the credit point of sale of the loan or credit card, significantly more than half said they would ([60–70] per cent of loan customers and [50–60] per cent of credit cards).

(f) However, if PPI had been available from [✄] when they took out the product, the total sample was fairly split between whether they would or would not have taken out the insurance there and then (the research asked: 'Do you think that if this type of insurance had been available from [✄] when you took out your (Credit Card/Personal Loan), you would have bought it from them'—[50–60] per cent of the loans sample said they either definitely ([20–30] per cent) or probably ([20–30] per cent) would have taken it out, whereas [30–40] per cent of the credit card sample said either definitely ([10–20] per cent) or probably ([20–30] per cent).

35. The research concluded that:

> all things considered, consumers would be better off having the ability to take out PPI at the credit point of sale rather than rely on consumers taking PPI after the loan or credit card had been purchased. Preventing consumers from buying the credit and protection products together would result in both consumers and financial providers being exposed to the consequences of unprotected credit.

[✄]

36. Following the withdrawal of [✄] single-premium loan protection product [✄].

37. [✄]

38. The [✄] research reviewed a stand-alone sales process based on the likely impact of the proposed POSP. It involved an online qualitative tool called [✄] where 30 respondents individually looked at stimulus provided by [✄] and commented before taking part in an online forum to participate in a threaded discussion about financial protection. These 30 respondents were then contacted by [✄] and took part in a qualitative study (24 tele-depths and six face-to-face depth interviews). Half the

respondents were [✂] customers and half were non-customers. Essentially, the [✂] product was applauded as a concept. It was generally understood and simple to convey. Keeping descriptions clear and simple helped to differentiate [✂].

39. In terms of the sales process and stand-alone potential in the event of a POSP, the research concluded that [✂]; and that the sales process was felt to be the opportunity to purchase in a less pressured environment. The POSP does lend itself to a more genuine/catch-all protection product and gives potential for call to action.

[✂]

40. In April 2009, [✂] recruited [✂] to conduct a study to collate consumer understanding of the PPI sales processes when incorporating a POSP as planned.

41. The [✂] research involved a qualitative study in which six discussion groups were divided into four categories with eight respondents in each group. The categories included: two groups of young families; two groups of established families; one group of mature workers; and one group of committed couples.

42. Following the disclosure by the interviewer of the new legislation, including the POSP change, a proportion of respondents then appeared annoyed that they would be unable to purchase PPI immediately on acquisition of a new credit card or loan. These respondents felt that if they wanted the cover, they should be allowed to take it out straight away. In addition, some respondents thought that if they did not purchase PPI at the credit point of sale, the likelihood they would remember was minimal.

43. Telephoning back the provider after 24 hours to take out PPI was one of the preferred options but most respondents felt that in reality they would get caught up with other things or forget to call back to take out the cover. The majority of respondents were in fact not averse to the provider contacting the customer to prompt purchase of PPI. The next day was thought to be too soon for the customer to have had sufficient time to research and consider alternatives—anytime between 3 to 14 days was therefore considered appropriate. Respondents were not against further prompting from the provider, if the customer had not taken out PPI after the first seven days. One or two further prompts were considered appropriate, three, six, or 12 months after taking out the loan or credit card.

44. Most respondents felt that the provider should offer the customer the choice of how they would prefer to be contacted, and that the customer should be able to choose when and by what means they would be prompted about buying PPI—telephone, email, letter etc.

45. [✂]

[✂]

46. In October 2009, [✂] conducted a study into consumer attitudes to both PPI and IP to 'understand the perception of and reaction to the sales process following changes in recent legislation and potential impact on future purchase behaviour'.

47. Stage 1 methodology involved a quantitative study which included 300 telephone interviews. These were divided into three categories which each had 100 respondents. The categories were: those with IP; those with credit product with PPI; and those with credit product without PPI (where credit product was defined as: credit card/mortgage/personal loan/store card). Stage 2 included a qualitative study in

which nine one-hour-long depth interviews (combining face-to-face and telephone methodology) were conducted with respondents generated from Stage 1.

48. The study found that pre-POSP change, three out of four respondents would prefer to purchase their cover with either their bank or the company from which they purchased the credit and not from a company different from the lender.

49. With the POSP change, the study found that around eight out of ten respondents would be more comfortable taking out protection after a seven-day period. Whilst [60–70] per cent of respondents said that they would actively seek cover from other providers during the seven-day period, around four out of ten respondents would be less likely to take up cover after a seven-day period.

50. Of [30–40] respondents who had purchased a credit product with PPI, there was a roughly equal split between those who said that they would have taken out the PPI if there had been a POSP and those who said they would not have done.

51. Seven out of ten respondents felt that a 5+ day gap was the most appropriate in length; however, [10–20] per cent of respondents felt that there was no need for a gap at all.

52. The study found that around nine out of ten respondents thought that the waiting period between taking out credit and PPI would make the sales process fairer. Those respondents who already had IP or PPI stated that they would be more likely to actively seek out PPI if it was not offered (when taking out a credit product).

53. Respondents from the qualitative depth interviews said they would be more likely to shop around for the best deal and for different offers. [✄] summarized the research by saying that the change in legislation could cause a ‘shift in the market—from a ‘closed’ indirect (broker/credit vendor) model to a more ‘open’ direct model (with particular growth with comparison websites)’. [✄] said that it disagreed with [✄] conclusions as it did not think that consumers would shop around.

ABI

54. In November 2008 YouGov ran a survey of 1,978 Great Britain adults commissioned by ABI.

55. The survey found that:

    (a) 83 per cent of those who have never held a PPI policy were aware of PPI prior to taking part in the survey. 84 per cent of those who held or had held a PPI policy said that they bought it from their debt provider at the same time that they took out the mortgage, personal loan or credit card.

    (b) 58 per cent of respondents said that in the future they would prefer to buy PPI from their debt provider at the same time they take out their mortgage, personal loan or credit card.[2] When asked what they would do if they were not able to buy PPI at the same time they took out their mortgage, loan or credit card, 52 per cent said that they would probably not purchase PPI and a further 19 per cent said that they did not know. We do not have evidence of what the other 29 per cent said.

[2]Paragraph 10.48 of the 2009 report.

(c) When respondents (those who hold or have held PPI (830 of the 1,978 respondents) were asked to what extent they agreed or disagreed with the following statements:

(i) Buying PPI at the same time as getting the loan/mortgage/credit card is simple and straightforward (64 per cent agree strongly/agree; 27 per cent neutral/do not know; 9 per cent disagree/disagree strongly).

(ii) Buying PPI at the same time as getting the loan/mortgage/credit card means I would not have the hassle of finding PPI elsewhere or at another time (60 per cent agree strongly/agree; 27 per cent neutral/do not know; 13 per cent disagree/disagree strongly).

(iii) Buying PPI at the same time as getting the loan/mortgage/credit card is most convenient for me (56 per cent agree strongly/agree; 28 per cent neutral/do not know; 16 per cent disagree/disagree strongly).

(iv) I would rather my lender offered me PPI two weeks after I arranged the borrowing so I have time to consider my options (39 per cent agree strongly/agree; 37 per cent neutral/do not know; 24 per cent disagree/disagree strongly).

The Accent Survey

Introduction

1. We asked Accent to conduct a survey for us for PLPPI and MPPI customers. The objectives of this research were to:

    - understand consumer likes and dislikes in purchasing PPI at the same time as the loan/mortgage it is connected to;
    - understand how consumers view the convenience associated with taking out PPI at the credit point of sale and whether there is loss of convenience if they have to wait a period of at least 24 hours after the conclusion of the credit sale before being able to purchase PPI from the same provider; and
    - quantify any potential loss in convenience from the consumer perspective.

Why the survey was not conducted for some products

2. We did not conduct the survey for SMPPI, CCPPI and retail PPI customers. For SMPPI we found that there were not enough people who had recently taken out SMPPI for us to be able to run a statistically significant survey. We set out here why we did not conduct the survey for CCPPI and retail PPI customers.

3. The main difference, for the purposes of the survey, between retail PPI and CCPPI, compared with PLPPI and MPPI, is the pricing structure. Retail PPI and CCPPI premiums are different each month as the outstanding balance on the credit account changes. The pricing structure that consumers are used to is based on pence per £100 of outstanding balance. This metric does not tell the consumer how much they will pay in a month, does not relate to the amount that consumers will receive in the event of a successful claim, and is not necessarily how pricing will be set or disclosed with our remedies in place. Given the imperfections of the current way of disclosing the price of retail PPI and CCPPI to consumers, with which customers were most likely to be familiar, we thought that it would not be possible to conduct robust stated preference research to quantify the monetary value to consumers of a change in sales process by reference to the price of the policy.

4. In addition, retail PPI is a complex product for many consumers as both the main providers of retail PPI sell it bundled with product protection insurance—also known as merchandise cover. Merchandise cover insures against accidental damage to the actual product, and our experience of conducting focus groups with retail PPI customers (when ‘road testing’ the personal PPI quote and annual review forms) indicated that some consumers only remembered this part of the insurance.

5. This bundling of products causes issues of framing of questions in a quantitative questionnaire. These include:

    (a) it is hard to set the scene for customers regarding PPI cover when they only remember merchandise cover;

    (b) it takes time to explain the fact of the different levels of cover (for both the product and payment protection insurance);

(c) if the consumer is not aware of the different elements they have to be explained and this becomes more hypothetical for the consumer to understand quickly in the time available; and

(d) we need to ask hypothetical questions on what they would do with the proposed remedy in place, and coupled with *(c)* this can lead to hypothetical questions building on hypothetical questions which are hard to frame and hard for the consumer to understand and consequently answer. This is not good market research practice.

6. These issues in framing are then likely to lead to issues with the answers:

(a) it may not be possible to find enough consumers with understanding of the different elements of insurance to answer the questionnaire to gain a robust sample; and

(b) consumers could answer the questions as best they can, but as they are not fully informed answers, there may well be a wide range of answers giving rise to a figure that would not be robust enough for our purposes.

7. All these issues make conducting a short telephone interview very hard to implement and unlikely to result in robust results.

How the survey was run

8. The Accent consumer research consisted of initial qualitative research, which helped inform the design of a quantitative questionnaire. The quantitative questionnaire used a stated preference exercise to understand both the preference of customers and the strength of that preference. We consulted the parties on the questionnaire.

9. The quantitative questionnaire was piloted with 50 customers (26 MPPI and 24 PLPPI) to test the clarity, flow and language of the questions as well as the design and understanding of the stated preference exercise. Following the pilot, a few changes to the wording were incorporated and the range of costs for the premium in the stated preference exercise was altered. The main programme of research involved interviewing over 400 recent purchasers of each of PLPPI and MPPI. Interviewees were selected at random from a sample of 57,097 consumers provided by main parties to the investigation.[1] Of those, Accent spoke to someone in the household of 12,489 of those contacts. 1,813 people agreed to take part in the survey, and 806 completed the survey (403 PLPPI customers and 403 MPPI customers).

Conjoint analysis

10. The conjoint analysis part of the Accent quantitative survey presented consumers with a controlled set of potential PPI products and asked them to choose their preference. Via analysis of these preferences an implicit valuation of each element making up the product was determined. These implicit valuations are known as utilities and can be used to create willingness to pay estimates of the tested products.

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[1]We asked parties to provide us with a random sample of customers who had taken out PPI within the previous year in rough proportion to their share of supply of PLPPI or MPPI the previous year. For PLPPI we obtained customer samples from the main distributors. For MPPI we obtained samples from the main distributors, a selection of building societies and a provider whose products are sold by intermediaries.

11. As we were primarily interested in the impact of the POSP, and the cost to the consumer in terms of convenience, we used elements of time of purchase and price as variables in the conjoint analysis. However, to ensure that consumers did not realize this was the key area of interest, and cause any potential bias in answers, we masked these factors by adding others—length of cover and type of cover. This also ensured that the consumers were presented with realistic options to choose between.

12. Each consumer was presented with six pairs of options, and these were drawn for a total of 18 options. The 18 were chosen using a D optimal design which provides the smallest number of different options necessary to obtain robust results for each variable.

13. All the main parties to the investigation were consulted on the quantitative questionnaire, and their comments considered and, where appropriate, acted upon. The levels of each factor were determined via qualitative focus groups, and refined during the pilot stage of the quantitative questionnaire.

The findings of the survey

14. The survey[2] found that many customers preferred to buy PPI at the credit point of sale—with the main advantage of doing so being perceived as the ability to obtain immediate cover—but many other customers would prefer to buy later in order to shop around and to make an informed decision. It concluded that introducing a POSP led to a loss of convenience for those PLPPI customers who preferred to buy at the credit point of sale, but the preference of those who preferred to buy later was stronger. For MPPI there was no significant loss of convenience associated with introducing a POSP for those who preferred buying at credit point of sale, but the preference of those who preferred to buy later was strong. The overall effect was that both MPPI and PLPPI customers in aggregate actually attached a positive willingness to pay for a delay in PPI purchase.

15. For PLPPI 60 per cent of customers said they preferred to buy PPI at the same time as credit, whilst 31 per cent said they would prefer to buy it later. For MPPI 50 per cent of customers said they preferred to buy PPI at the same time as credit, whilst 36 per cent said they would prefer to buy it later. In both cases there were some customers who were indifferent to whether they bought it at the same time as credit or later.

16. Looking at only those customers who said that they preferred to buy PPI at the credit point of sale, for PLPPI the research found that the value of taking out PPI at the credit point of sale was £9.00 per month when compared with calling back after 24 hours and £7.30 per month when compared with being called after seven days, compared with a mean monthly PLPPI premium of £30.50 per month. The research found that the lower cost of convenience after seven days was a reflection of a preference for a longer delay, if there were to be a delay, rather than a preference for being called by the distributor over making contact with the distributor on the customer's own initiative.

17. MPPI customers did not attach a significant value to their stated preference for buying PPI at the same time as credit.

18. Looking at customers who said that they preferred buying PPI either 24 hours or seven days after the credit point of sale, PLPPI customers expressed a willingness to

[2] www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/100505_Accent_Survey_report_2FINAL.pdf.

pay £19 per month more to buy it 24 hours after the credit sale and £25.20 a month more to buy it seven days after the credit sale. For MPPI customers the equivalent figures were £18.70 and £30 per month.

Parties' responses to the survey

19. In response to our provisional decision many parties raised concerns regarding the design of the survey and the results from it. Some also raised concerns that they were unable to comment properly on the survey without access to the underlying data.

20. The nature of the survey was such that Accent's analysis of the data could only be replicated with access to the underlying data, including individuals' answers to each question. In order to help parties best understand and comment upon the survey we therefore made the underlying data available in a data room. Four parties accessed the data room and three parties subsequently provided further submissions on the survey.

21. We set out here the main issues regarding the survey raised by parties in their responses to the provisional decision and in submissions following the data room, and our responses on them. These are split out into four main areas:

- the qualitative survey run before the main quantitative survey;
- questions regarding the sample of customers interviewed;
- the design of the survey; and
- the results of the survey.

22. We then set out what we can conclude from the survey.

23. This appendix does not cover how the outputs of the survey should be used; this is covered in Appendix I.

The qualitative survey

24. LBG[3] said that the number of groups run in the qualitative survey was insufficient, and the duration of both grouped and individual interviews appeared inadequate and atypical for qualitative research, and that as a result the strength of conclusions could not be assessed.

25. We noted LBG's comments. The purpose of the qualitative survey, as set out in Section 2.2 of the Accent report,[4] was to help construct a robust quantitative survey, through gaining an understanding of issues such as to which variables—aside from time of purchase—customers attach importance, and defining the attributes to be tested and what scales to use for them. We were confident that the qualitative survey performed these functions successfully.

26. HSBC[5] said that the qualitative survey suffered from apparent changes in position by respondents as a result of discussion and acceptance of idealized claims, citing

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[3] LBG response to provisional decision, Appendix 1, p3.
[4] www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/Consumer_attitudes_to_Payment_protection_24_June_2010.pdf.
[5] HSBC response to provisional decision, Annex 1, p5.

Section 3.8 of the Accent report. HSBC said that as a result of this (and the other issues it raised) the qualitative survey could not be used for more than gathering ideas.

27. As noted in paragraph 25, the purpose of the qualitative survey was to help construct a robust quantitative survey. We noted that the Accent report did on occasion note that the qualitative survey results were in line with the quantitative results. We did not think this was problematic. We did not need to rely on the qualitative survey on its own to validate any conclusions in the quantitative survey; we noted that where such comparisons were made, the quantitative results were also generally in line with what was found in other surveys (reported in Appendix E).

28. HSBC[6] also said that the qualitative answers showed that there was inadvertent priming of respondents.

29. Accent told us that the issues that were raised were brought up by respondents and not moderators. In addition, we employed a survey moderator who attended some of the focus groups[7]. The role of the survey moderator is to ensure that the research is carried out to high quality standards by attending the research, as it is carried out, and producing a report of what she observed. She did not raise issues of priming of respondents, deliberate or inadvertent.

The survey sample

30. LBG and Barclays raised concerns about the representativeness of the sample of PPI consumers interviewed in the quantitative survey. LBG compared the sample interviewed with its own database of PLPPI customers, and said that the Accent survey appeared to be skewed with:

- a higher proportion of older people (45–64);
- a significantly higher proportion of customers buying PLPPI through the telephony channel (LBG said that the proportion of branch sales customers interviewed was only just over half the proportion of LBG customers who buy PLPPI in branches); and
- an under-representation of customers in lower-income brackets.

31. LBG said that the Accent data showed that a preference for delay increased with age, that individuals purchasing PPI over the phone and through other ‘passive’ channels tended to prefer a delay, and that higher household income customers showed a greater preference for a delay in sales channel. Hence LBG concluded that the results from the analysis were skewed towards a higher preference for delay. It said that if it corrected for what it said was an unrepresentative sample the results for delay coefficients were very different, in particular: when adjusting for population weight the coefficients on delay were no longer significant; the coefficients had a different sign for a 24-hour delay; and had a smaller insignificant coefficient for a seven-day delay.

32. Barclays compared the Accent survey against previous CC PPI research, and said it found that:

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[6]Ibid, p6.
[7]Payment Protection Insurance De-coupling Research (Mortgage and Personal Loans), Survey Moderator Report, May 2010.

- there was a significantly higher proportion of men interviewed in the Accent MPPI survey than women, whilst a 2007 Mintel report previously cited by the CC said that women were slightly more likely to have MPPI than men;

- the Accent survey interviewed more older people than a BMRB survey conducted for us in 2007; and

- the Accent survey had a significantly greater proportion of higher income household customers than the BMRB survey.

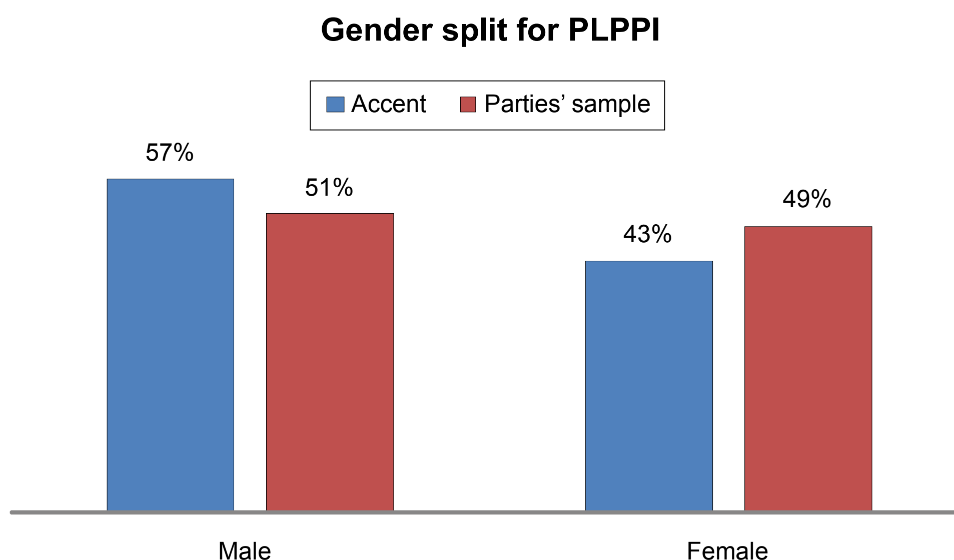
33. Barclays said that because the sample utilized by Accent was skewed, the results produced were unreliable.

34. We looked at the representativeness of our sample.

35. In terms of gender, we compared the sample interviewed with the overall list of customers provided to us by the parties.[8] The results are shown in Figures 1 and 2, and show that there is no significant difference in gender distribution between Accent's interviewed sample and the parties' sample, which led us to conclude that the Accent survey sample was unbiased in terms of gender split.

FIGURE 1

Gender split for PLPPI

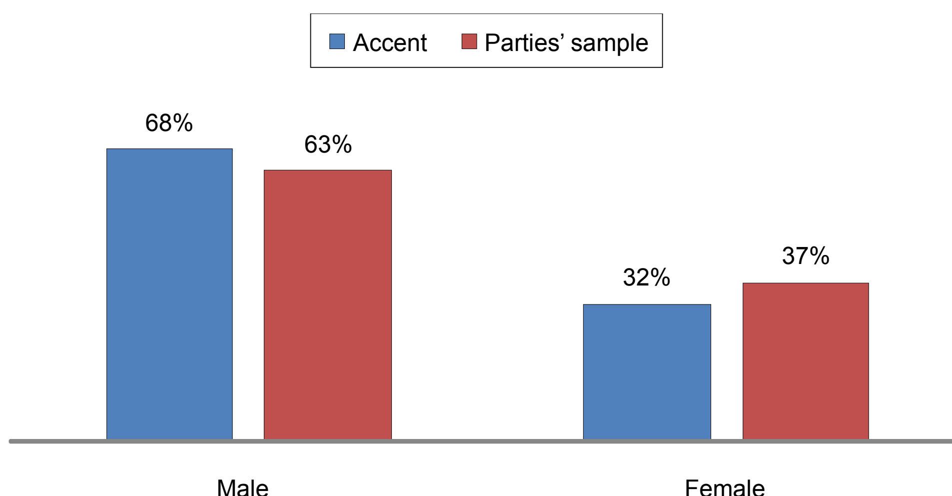


Source: CC analysis of sample surveyed for the Accent survey and the customer lists provided by parties.

[8]We did not ask parties to indicate the gender of each individual in providing us with customer lists. We derived these numbers by looking at customers' titles (Mr, Miss, Ms, Mrs). We did not therefore count the few people in the list whose title was either not provided or was not gender-specific (eg Dr).

FIGURE 2

Gender split for MPPI

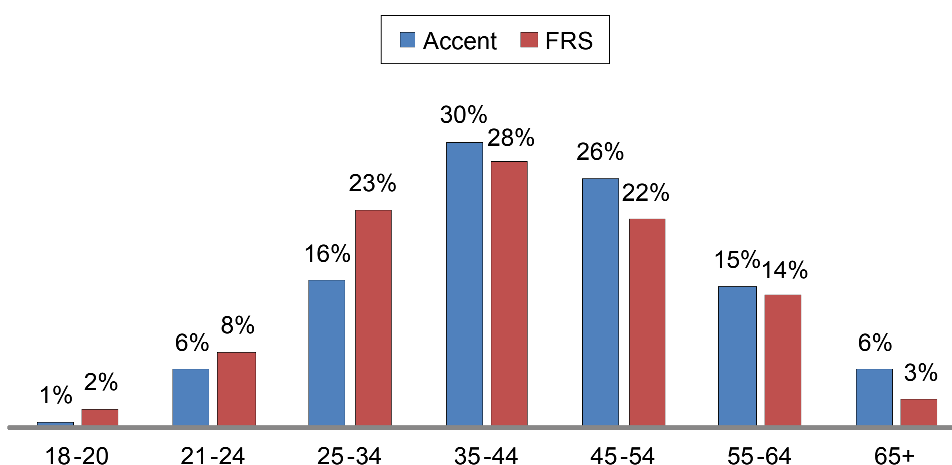


Source: CC analysis of sample surveyed for the Accent survey and the customer lists provided by parties.

36. We then looked at age of respondent. As we did not have data on age for the customer lists provided by the parties, we compared the Accent survey sample against data from the FRS[9] database for purchasers of PLPPI and MPPI in 2009. The results are shown in Figures 3 and 4. The results suggested to us that there might be a slight oversampling of PLPPI customers aged 35 and over and a slight oversampling of MPPI customers aged 44 and over. We looked at the results for the different age groups and did not see any statistically significant differences in results.

FIGURE 3

Distribution of PLPPI customers by age

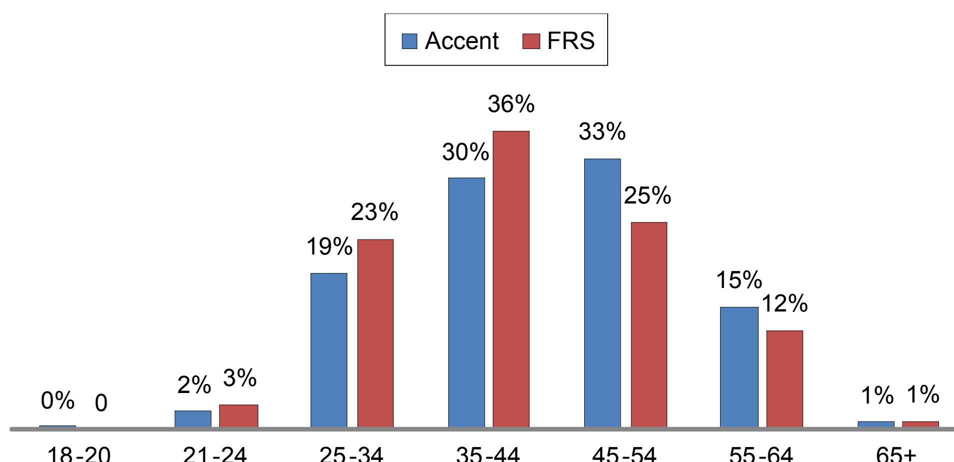


Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

[9]Financial Resources Survey—provided by GfK NOP for the 12 months to December 2009.

FIGURE 4

Distribution of MPPI customers by age

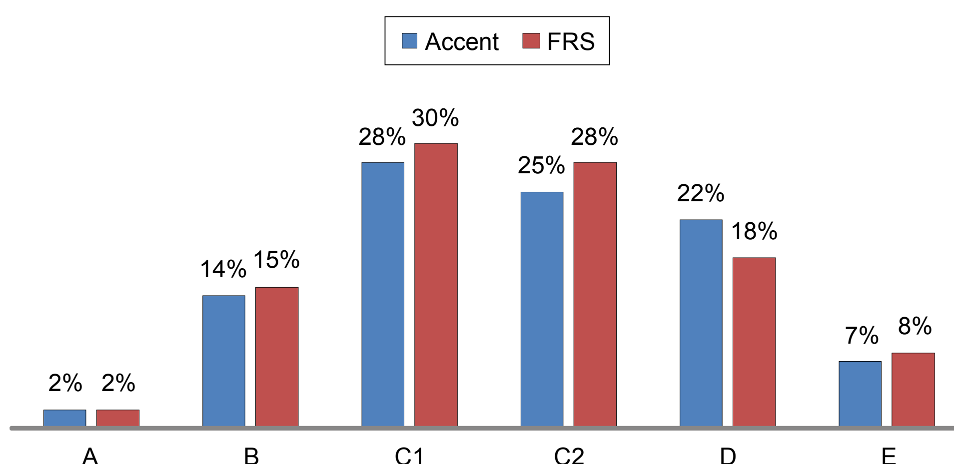


Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

37. We looked next at socio-economic group, and income. As with age, we relied on a comparison with the FRS database. The results are shown in Figures 5 to 8. We saw no significant differences between the two samples for socio-economic groups, which led us to conclude that the Accent survey sample was unbiased in terms of socio-economic group. In terms of income, both the PLPPI and MPPI samples had a greater proportion of higher income household customers than the FRS database. For PLPPI customers, Accent found that the respondents with household income of greater than £25,000 had a significant preference for delay. Those with lower household income had an insignificant preference for delay. This suggested that the coefficient for delay for PLPPI customers might be inflated by the sampling of higher household-income customers. We set out how we take account of this in our analysis in paragraph 5.71.

FIGURE 5

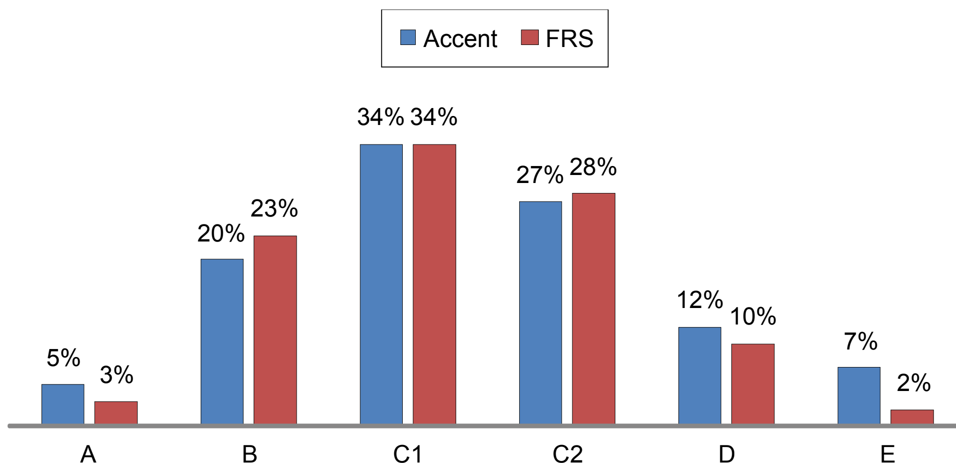
Distribution of PLPPI customers by socio-economic group



Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

FIGURE 6

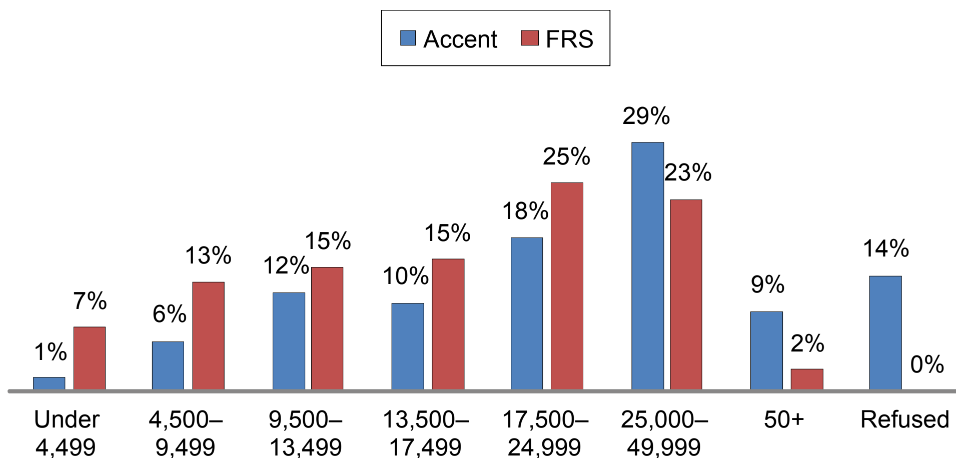
Distribution of MPPI customers by socio-economic group



Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

FIGURE 7

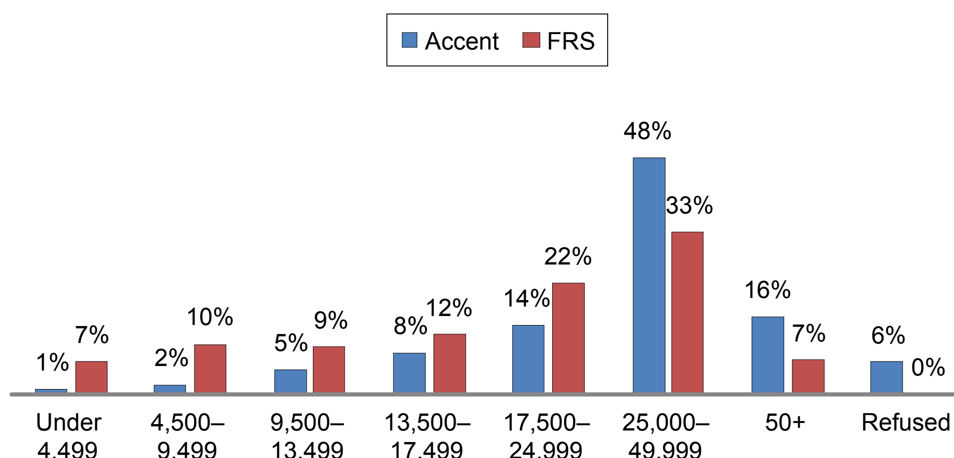
Distribution of PLPPI customers by income



Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

FIGURE 8

Distribution of MPPI customers by income



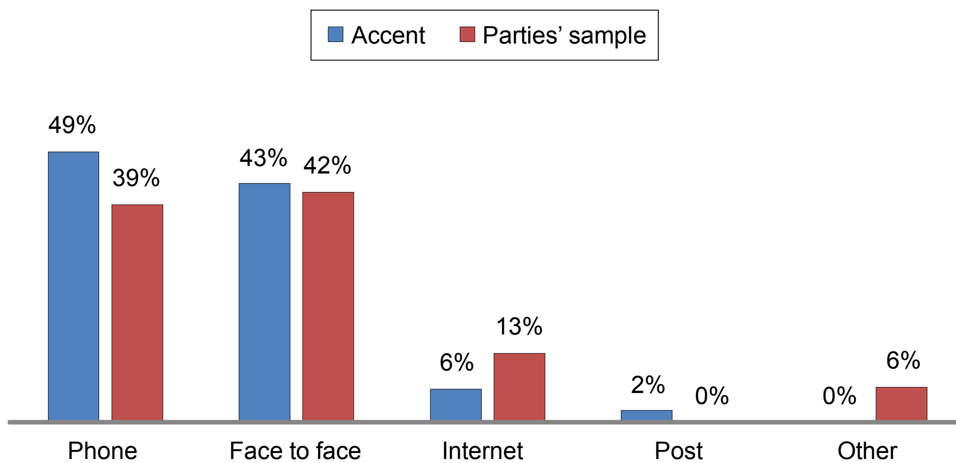
Source: CC analysis of sample surveyed for the Accent survey and the FRS provided by GfK NOP.

38. Finally, we looked at channel of purchase. We compared the Accent sample against the distribution channels for the customer lists sent to us by the parties. The results are shown in Figures 9 and 10. For PLPPI we found that the proportion of customers buying face-to-face (in branches) was almost exactly the same between the Accent sample and the customer lists provided by the parties. This was a very different result to LBG's result. We thought that LBG had a significantly higher proportion of PLPPI sales in branch than the average—which may be because Barclays has, since April 2009, only sold PLPPI in the telephony channel.[10] For MPPI the data showed a higher proportion of branch sales customers in the Accent sample than the overall customer lists. We noted that LBG's logic was that this would tend to overcount customers who favour no delay in their PPI purchase. The survey suggested that these customers tended to prefer buying with a 24-hour delay, suggesting that these results (which were not statistically significant anyway) were slightly overinflated.

[10]In July 2010 the product was withdrawn.

FIGURE 9

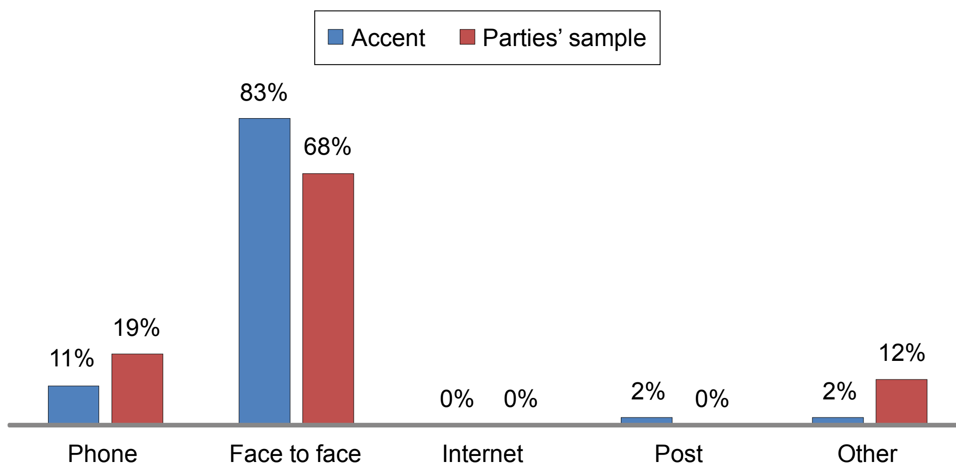
Distribution of PLPPI customers by channel of purchase



Source: CC analysis of sample surveyed for the Accent survey and the customer lists provided by parties.

FIGURE 10

Distribution of MPPI customers by channel of purchase



Source: CC analysis of sample surveyed for the Accent survey and the customer lists provided by parties.

39. LBG also said that the sample was likely to be biased as only 4 per cent of customers interviewed had made a claim; it said that if we had oversampled those who claimed, it might have demonstrated that PPI fulfilled its role as cover for the payments on the loan, and that the consumer was satisfied with the policy as it was sold and issued. LBG said that the sample might have overstated the desire of consumers to wish that they had shopped around—that it was 20/20 hindsight based on ex-post valuation of the product.

40. We were not persuaded by LBG's argument. We did not see the value in deliberately creating a biased sample from an unbiased one, because those people might have different views from others. And the purpose of the survey was to look at the convenience of when PPI is taken out, rather than the benefits or otherwise of taking out PPI.

41. LBG also expressed concern that customers will have based their answers on a different evaluation of the benefits of insurance from the evaluation they made at the time of purchase when they were able to focus their minds on the totality of the financial situation and financial exposure. Surveys conducted away from the actual transaction point will always need to ensure the customer is placed in the same mind set as when making that transaction. To achieve this, we requested lists of customers from the main parties who had taken out a PPI policy in the last six months to ensure it was a recent enough decision that they remembered taking out the policy. We also included questions to remind respondents of the conditions of the PPI purchase and the loan connected to it, and ensured that the choices offered in the conjoint exercise were a realistic set of choices—they not only showed customers a price but also length of cover, type of cover and how the policy was purchased.

42. LBG also said that the respondents to the survey might have experienced 'buyer's remorse': customers who had not had to claim on the policy might simply recognize that, viewing the matter ex post, they would have been better off without the insurance for the period which had elapsed without a claim. LBG told us that buyer's remorse was a recognized concept and a salient feature of insurance markets that could impact materially on consumer research.

43. We were not convinced by LBG's arguments. It was in direct contradiction with the argument put forward by many distributors during the PPI inquiry, which is that PPI is purchased mainly for peace of mind. While regret could occur once the policy has expired, respondents in our survey had purchased the policy for less than one year, so it is unlikely that any of these would have arrived at the expiry of their policy. In this context, we did not think that the respondents would suffer from buyer's remorse from not having claimed on the policy.

Design issues

Biased choices

44. The stated preference conjoint analysis element of the questionnaire asked respondents to choose between pairs of different product choices. Each respondent was given six pairs to choose between. Using a D-optimal design, Accent used 18 different pairs for 99 per cent of choice sets. LBG looked at the choices in these pairings and said that four of these pairs very strongly favoured delay, two very strongly favoured no delay, two strongly favoured delay, one strongly favoured no delay, and the others were ambiguous. It said that more choices presented to customers favoured delay, and if it evened these up by removing answers to some of the questions which favoured no delay this reduced the coefficient for delay by up to 24 per cent (and that removing all the questions which strongly—as opposed to very strongly—favoured one option or the other rendered the delay coefficient insignificant).

45. We were not persuaded by LBG's analysis on two counts. First, the econometric analysis should take account of any biased choices—so if the choice between two options very strongly favours delay and the respondent chooses the delay option, the econometric analysis will only attach a small level of preference to that choice, whereas if the respondent chooses no delay it will attach a high level of preference to the choice not to delay.

46. Secondly, we did not agree that there was a bias within the sample. We noted that in conducting its analysis, LBG took three choices—no delay, a 24-hour delay and a seven-day delay, and combined them into two categories—no delay or delay, and concluded that there was a bias towards delay. We replicated LBG's analysis, using

its classifications of whether or not one option was very strongly favourable when compared with another option (although we do not necessarily agree with those classifications) but using the three levels of timing attribute instead of the two and found that:

- there was one option very strongly favouring no delay over a 24-hour delay;
- there was one option very strongly favouring no delay over a seven-day delay;
- there was one option very strongly favouring a 24-hour delay over no delay;
- there were two options very strongly favouring a seven-day delay over no delay; and
- there was one option very strongly favouring a seven-day delay over a 24-hour delay.

47. This suggested to us that when the sample was looked at as it was constructed, with three options, the sample did not show a bias to favour one sort of transaction over another.

Separation of timing and mode of contact

48. Barclays[11] said that Accent should have separated out the timing of purchase (whether there was a 24-hour or seven-day delay) from the mode of contact (the customer contacting the provider or vice-versa). It said that this was an error in the design and that it was not possible from the evidence to conclude whether proactive contact and a 24-hour delay would have scored more or less positively than proactive contact and a seven-day delay.

49. The research included both the time of purchase and mode of contact aspects within the same attribute because we recognized that these aspects are all a part of the same sales process in the proposed remedy package. We wished to avoid giving undue importance to the issue over other attributes by splitting it into two. The analysis Accent conducted, using both the stated preference and conjoint analysis questions, showed what is driving respondent preferences, and we were content that this analysis was robust.

50. Aviva[12] said that the cooling-off period required by the FSA's rules was not taken into account in the CC's research. It said that awareness of this might have had an impact on the opinion of those who expressed a preference for a prohibition had they been made aware of it.

51. The survey was conducted among consumers who had taken out PPI within the past year. In our view that meant that, if sales had been conducted in a manner that was compliant with FSA regulations, the customers answering the survey would have been aware of the cooling-off period already, as they would have been through it recently. We were satisfied that to the extent that the cooling-off period was important for consumers, they would have factored it in to their answers without having to be reminded of it in the survey.

[11]Barclays response to provisional decision, Annex 2, section 4.3.
[12]Aviva response to provisional decision, p1.

The survey was not representative of real-world choices

52. LBG[13] said that respondents were asked to state a preference between alternatives that had less relevance for most PPI purchases. It said that unemployment-only PPI policies formed only a very small proportion of PPI policies issued, and asking a respondent to trade off unemployment against other types of cover might therefore produce biased results.

53. We disagreed with LBG. Unemployment-only policies do exist (in an oral hearing LBG accepted this, although said that they were more prevalent for MPPI than PLPPI) and it is a realistic parameter—we did not think consumers would have any difficulty in understanding the difference between unemployment-only policies and either ASU or ASU plus life and critical illness cover, or that they would have difficulty in trading them off against each other.

54. Barclays[14] said that the Accent survey was focused on the purchase of PPI at the same time as the loan, and that the data from it could provide no assistance in estimating or drawing conclusions about the loss of convenience to consumers from being stopped from purchasing from a chosen credit provider stand-alone PPI or short-term IP.

55. We noted Barclays' comments. We accepted that the survey did not address stand-alone PPI and short-term IP policies that were unconnected to credit. However, in Appendix 2.3 of the 2009 report we concluded that short-term IP policies sold as a result of a referral during a credit sale were effectively sales of PPI at the point of sale—and by inference that short-term IP policies sold at the credit point of sale were also PPI sales. We were therefore content that the survey did cover sales of stand-alone PPI and short-term IP policies that are linked to the sale of a credit product—either by being sold at the same interview as the credit sale or through a link such as the making of an appointment during the credit sale. In this respect the customer lists from which Accent drew the survey sample included customers who bought LifeChoices, an HSBC short-term IP product, within a set period of time of obtaining a personal loan or mortgage from HSBC, and the Accent sample contains a representative proportion of these customers.

56. HSBC,[15] RBSG and Barclays criticized the lack of an option for survey respondents to say that they preferred neither of the two options presented to them. HSBC said that in stated preference analysis a 'neither' option was advocated by some experts.

57. We discussed this criticism with Accent. Accent confirmed that some experts preferred a 'neither' option to be offered, and equally some preferred no such option to be offered. Moreover, Accent said that, in its experience, the inclusion or not of a 'neither' option did not make a significant difference to the results.

Respondents were directed

58. Barclays[16] said that the phrasing of some questions was leading.

59. Accent denied that there had been any leading questions or leading of respondents by interviewers. Our survey moderator did not raise this as an actual or possible issue, and checked the scripts for both the qualitative and quantitative surveys and

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[13]LBG response to provisional decision, Appendix 1 p2.
[14]Barclays response to provisional decision, Annex 2, section 2.2.
[15]HSBC response to provisional decision, Annex 1 p4.
[16]Barclays response to provisional decision, Annex 2, section 2.9.

did not find anything which led the moderator to believe that the respondents were led.

60. Barclays[17] also said that the research suffered from the 'research effect'. It said that:

- respondents who had bought PPI because they thought they had to would subsequently favour options which included a delay in the sales process;
- Accent would have obtained high values for delay because respondents knew the research was about uncompetitive practices and felt expected to reject status quo;
- there would be an artificial inflation of the appeal of delaying sale by identifying people who thought they had to buy PPI and then offering delay as a solution rather than making clear that PPI is optional currently; and
- people were shown to have changed their minds as a direct result of being involved in the qualitative research process.

61. We did not think Barclays' first point was a research effect. If respondents favour delay because they thought that they had to buy PPI sold alongside credit, we think that this is a valid reason to take into account in our assessment. The stated preference research was designed to mask our key interest—customers' valuation of buying at the same time as credit or later—by having four variables, and respondents were told only that the research was for the CC. We also noted that the research was aimed at investigating the question of loss of convenience, not the impact of remedies on any mis-selling that has taken place. We were therefore content that the research had minimized any possible 'research effect'.

62. HSBC[18] said that Accent should have mentioned peace of mind before the stated preference exercise in the same way it mentioned the possibility of a delay in PPI purchase was being introduced, as peace of mind was well known to be a very important factor in consumers' decision to purchase PPI.

63. We were not persuaded by HSBC's suggestion. The survey was conducted on recent purchasers of PPI and we believed that they would recall and understand the benefits of the status quo without being reminded of them.

64. HSBC[19] said that the responses to question 18, where respondents were asked to rank attributes in level of importance, would almost certainly have been primed by the Stated Preference exercise. It said that having just spent time analysing alternatives that included the time of purchase, which framed time of purchase alongside factors that were inherently important (ie price and cover), respondents might have been conditioned to think of this variable as more significant than would be the case otherwise.

65. We noted HSBC's comments. However, we noted first that the responses to question 19 showed that time of purchase was rated as the least important attribute, in line with what HSBC appeared to think should be the case, and secondly that, even if this theory were correct, it had no impact on the conjoint analysis element of the questionnaire or the use of its results.

[17]Barclays response to provisional decision, Annex 2, sections 2.7 and 2.8.
[18]HSBC response to provisional decision, Annex 1 p7.
[19]HSBC response to provisional decision, Annex 1 p6.

The questionnaire was too difficult

66. HSBC[20] said that the stated preference element contained a mix of product attributes (level of cover, length of cover and price of cover) plus one process attribute (when purchased). It said that different mental processing was needed for these two types of attribute and that and time of purchase was neither a cost nor a service but associated with emotions.

67. We were not persuaded by this analysis. The stated preference technique was developed to deal with hypothetical options, shown in this case as a mix of product and service aspects. Further, Accent conducted a pilot of 50 interviews of the quantitative questionnaire and did not see evidence to suggest that respondents were struggling to trade off these different attributes. We also did not agree that, if time of purchase was an emotional issue, that it was the only emotional issue. We thought that, for example, a decision of whether to purchase cover such as life insurance and critical illness cover would have at least as much of an emotional underpinning as when to purchase a policy.

The choice of attributes to vary

68. Barclays[21] said that the timing of the purchase was the weakest driver in the analysis, having a lower utility score than level of cover or length of cover. It said that the subsequent findings were less relevant and ultimately less credible when the aspect supposedly being examined was the least important issue being considered.

69. In our judgement the fact that respondents rated it as the least important aspect of those included in the exercise does not invalidate the findings. The findings were found to be statistically significant.

The results of the survey

The magnitude of the results

70. HSBC said that the willingness-to-pay results were counter-intuitive and should not be used. Barclays[22] said that the incremental willingness to pay from the stated preference exercise were so large in comparison to current premiums actually paid that they appeared to be totally irrational. Barclays[23] also said that the willingness-to-pay results were high (hysterically so for delay), but strangely negligible for MPPI customers who preferred not to delay purchase. Barclays said that interviewees must have been responding irrationally.

71. RBSG[24] expressed concerns about high consumer valuations attached to delay which were found. It said that it seemed unlikely that a consumer would pay £65 per month in total for PPI—nearly double the monthly cost of PPI—in order to obtain an extra seven days to consider the purchase. It questioned the credibility of this finding. It suggested that the survey respondents had not understood the hypothetical situation that was presented to them. Further, it said that for what it considered to be such a significant flaw, simply conducting a sensitivity analysis was inappropriate.

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[20]HSBC response to provisional decision, Annex 1 p3.
[21]Barclays response to provisional decision, Annex 2 section 4.2.
[22]Barclays response to provisional decision, Annex 2, section 2.8.
[23]Barclays response to provisional decision, Annex 2, section 4.4.
[24]RBSG response to provisional decision, section 2.3.2.

72. We noted these comments. However, the willingness-to-pay results obtained by Accent were significant (statistically significant at least at the 93 per cent confidence level, and mostly at or above the 95 per cent confidence level) and so appeared to us to be robust. We also noted that for all the other attributes (cover, length of policy, cost) the willingness-to-pay results are in the direction that would be expected so we saw no evidence that interviewees were responding irrationally.

73. We considered whether the high willingness-to-pay results obtained in the analysis (for all the different attributes) may be explained by the technique used to analyse the results. The willingness-to-pay results are derived by comparing respondents' valuation for each attribute to their valuation of cost. Therefore, it is possible that the high levels obtained for the willingness-to-pay results may be partly due to respondents not attributing a large negative valuation to the cost of the policy. This could have happened if the issue of price was 'over-masked' in the survey, ie if the difference in the price of the different options that respondents compared was not large enough. There was no evidence that this has happened; indeed the coefficients for costs valuations were all highly significant. Moreover, even if this had been a problem, this would have affected all the willingness-to-pay numbers in the same way (so that magnitudes may appear high, but relative values would be unaffected).

74. Aviva said that the weightings attributed to the consumer research were overstated. It said that consumers valued the type of cover and period for which a claim could be made far more than the time of purchase. It also said that consumers would not, in reality, be willing to pay more post-prohibition.

75. We did not agree that we had overstated the survey results. In this respect we noted that, in Section 4.8 of the Accent report, the Accent survey was in line with Aviva's comment that consumers valued the type of cover and the period of a claim more than when they took out cover. We also agreed that the demand of consumers was unlikely to increase at a given price given the opportunity to buy PPI away from the credit point of sale, and this is why we modelled the positive valuation of the opportunity to buy later as a pivot rather than a shift in the demand curve.

76. RBSG[25] said that the CC indirectly observed the effect of inconvenience through a consumer's willingness to pay. It said that the high value of willingness to pay for the choice of when to purchase PPI for both groups of consumers (ie those who preferred to purchase at the point of sale and those who preferred to wait) might indicate that many consumers would not purchase PPI due to loss of convenience if they did not have the choice of when to purchase.

77. We did not see any reason why the evidence should be interpreted in this way. We thought that the most reasonable interpretation of this evidence was that those consumers that would prefer a delay attached a significant benefit to that delay.

Inconsistency between the two parts of the survey

78. Barclays, HSBC and LBG all said that there were inconsistencies, or a degree of incoherence, between the stated preference results and the answers to conjoint analysis questions. We were told that those respondents who preferred a delay showed a strong preference in the conjoint analysis response, but this was not reflected in their answers to stated preference questions on the importance to them of the time of purchase, where a significant proportion of those who preferred delay did not voice this as a strong preference.

[25]RBSG response to provisional decision, section 2.3.3.

79. We noted these comments. However, we thought that this showed the value of conducting a stated preference conjoint analysis—by mixing the time of purchase in with other variables and asking respondents to make choices the stated preference exercise showed what mattered to respondents more clearly than a normal survey.

Sense-checking of results

80. LBG said that Accent had not adequately explored why respondents who favoured a delay expressed that preference, and that there had been no sense-checking of willingness-to-pay valuations with respondents.[26]

81. On LBG's first point, the research was not designed to explore why respondents felt the way they did, but to measure the value attributed to convenience. However, questions 16 and 17 of the survey gave some insight into why delay is favoured. On LBG's second point, it was not possible to sense-check an individual respondent's willingness-to-pay valuation as the monetary values are not estimated on an individual level. In order to be able to calculate this at an individual level Accent would have had to ask far more questions in the conjoint analysis, and risk respondent fatigue.

82. LBG[27] also said that Accent had not checked respondents' understanding of questions.

83. We disagreed. Accent ran the qualitative survey and a pilot of 50 interviews of the quantitative survey in order to check understanding of what was being asked. Further, it checked whether removing the respondents that interviewers thought had more difficulty undertaking the tasks had any effect on the results (see paragraph 72). It did not.

84. RBSG also said that neither Accent nor the CC had explained why consumers who preferred to delay purchase should have a higher willingness to pay for this option than those who preferred to purchase at the point of sale. It said that the POSP essentially depended on this difference in willingness to pay and the lack of an economic rationale for the finding and the unexpectedly large magnitudes suggested that the finding should be tested further—either further re-examination of the data and/or cross-checking with other surveys of consumers or controlled experiments.

85. RBSG is correct in saying that neither Accent nor the CC had explained why consumers who preferred delay had a higher willingness to pay for this option than those who preferred to buy both products at the same time—equally, there is no evidence to the contrary. As previously noted, the results are robust, statistically significant at least at the 93 per cent confidence level, and mostly at or above the 95 per cent confidence level. However, we did think that the absolute magnitudes were surprisingly high, and when we used the survey results in our modelling we conducted sensitivity checks on the effect of reducing the size of the willingness to pay associated with delay (see Appendix J).

86. LBG[28] said that the average willingness-to-pay figures were very large and raised the question of why, if these consumers so valued a delay, they did not delay in the first place. Similarly, RBSG said that the large valuation for those who preferred to buy PPI after the point of sale, was inconsistent with the number of respondents who had

[26]LBG response to provisional decision, Appendix 1, p2.
[27]LBG response to provisional decision, Appendix 1, p2.
[28]LBG response to provisional decision, Appendix 1, p5.

purchased at the point of sale even though the option to purchase later already existed.

87. We noted this point. However, the evidence we saw led us to believe that consumers do not believe they have the ability to delay a purchase and shop around. For example:

- In paragraph 3.45 of the 2009 report we said:

  > The CC's BMRB 2007 qualitative research found that there was low awareness among the group participants that it is possible to shop around for a separate or different PPI policy to the one they had been offered with their product. Although group participants were aware that it was possible to shop around for other insurance policies, they had not thought it possible to do so for PPI. Exceptions to this pattern were PPI consumers who had used a financial adviser for the purchase of their PPI (which was mainly MPPI).

- In paragraph 3.46 of the 2009 report we said:

  > The CC's GfK NOP 2008 quantitative survey found that many PPI consumers who did not compare products from different providers believed that they could only buy the PPI policy from their credit provider—42 per cent of MPPI non-comparers (based on 792 respondents), 72 per cent of SMPPI non-comparers (based on 1,836) and 73 per cent of PLPPI non-comparers (based on 2,359).

- The evidence we saw on how PPI is sold showed that consumers are encouraged to buy PPI at the point of sale. They are not encouraged to think about it and return to the salesperson later—or positively discouraged from doing so—and in some cases PPI will not be sold after the point of sale. For example, in Q&A for staff on running the LBG 2010 pilot, LBG staff were told to tell customers who wanted to buy PPI more than 21 days after the loan was obtained that 'you can take it but you'll have to come back into the branch. We will then have to start a new loan application and reassess your need for Loan Protection at that time. I cannot guarantee that the loan decision or terms of the loan will be the same in 21 days time'. We thought that this positively discouraged customers from delaying a decision for more than three weeks. Similarly, the training for advisers said that 'Quotes are valid for 21 days from first being given, thereafter customers are no longer able to take the LP [PPI]'.

88. RBSG[29] said that the willingness-to-pay results related to the average value of the sample as a whole. They said that, if there were significant differences in willingness to pay between subgroups of customers then using the mean in any welfare calculations would lead to biased estimates of the effect on overall consumer welfare. More generally it said that consumers who needed PPI the most were also likely to have the highest willingness to pay for it, and the price elasticity to similarly vary across customer groups. It said that this, among other things, should be subject to sensitivity testing.

89. [✂]

[29]RBSG response to provisional decision, section 2.3.4.

Conclusions about the Accent survey

90. We looked closely at the Accent survey and the views of the survey put forward by various parties. We concluded first that the proportions of consumers in the Accent survey who expressed preferences for buying PPI at the same time as credit and for buying it sometime afterwards (see paragraph 15) were credible, and did not overstate a preference for delay. Whilst different surveys asked different questions we found the results of the Accent survey were in line with surveys conducted by parties –the proportion of respondents who preferred to buy PPI at the same time as credit was lower than that found in a survey conducted by [✂], about the same as that found in an ABI survey but significantly higher than that found in surveys conducted by [✂] and [✂] (see paragraph 5.45).

91. We therefore concluded that it was realistic to conclude that a majority of consumers would prefer to buy PPI at the credit point of sale, but that a significant minority would prefer to have a delay between the two purchases.

92. The Accent survey is the only survey we have seen which attempts to place a value on the importance of convenience to consumers. We considered in depth the validity of the results of the stated preference element of the survey, aided by parties' comments in response to our provisional decision and following access to a data room.

93. We concluded that the stated preference element was fundamentally robust, and showed that consumers who prefer a delay between purchases of credit and PPI value delay more highly than customers who prefer buying both at the same time.

94. We thought that the magnitudes of the willingness-to-pay results were higher than we would have expected, both for delay and for simultaneous purchase. We looked carefully at whether the sampling had introduced a bias such that the willingness to pay for delay was too high, but we concluded that there was no significant bias.

95. We also looked at whether the technique used to analyse the results may somewhat explain the magnitude of the valuations of the delay and of the point of sale. There was no evidence that this had occurred, given the highly significant results we found for respondents valuation of costs. If such over-masking had occurred, it would affect the magnitude of both the willingness to pay for delay and for buying PPI at the credit point of sale, but not their relative values.

The reactions of parties to the possible introduction of a POSP

Introduction

1. In this appendix we set out the evidence received in internal documents on how parties reacted to the remedies set out in our Notices of Possible Remedies, our provisional decision on remedies, and the 2009 report.

Evidence from parties' internal documents

Barclays

2. [✂]

3. [✂]

4. [✂][1]

5. [✂]

6. [✂]

7. [✂]

8. [✂][2]

9. [✂]

10. [✂]

HSBC

11. [✂]

12. [✂]

13. [✂]

14. [✂]

15. [✂]

16. [✂]

LBG

17. [✂]

18. [✂]

[1] [✂]
[2] [✂]

19. [✂]

20. [✂]

21. [✂]

22. [✂]

23. [✂]

24. [✂]

25. [✂]

26. [✂]

27. [✂]

28. [✂]

29. [✂]

30. [✂]

31. [✂]

32. [✂]

33. [✂]

34. [✂]

35. [✂]

36. [✂]

[✂]

37. [✂]

38. [✂]

39. [✂]

40. [✂]

41. [✂]

42. [✂]

43. [✂][3]

[3] [✂]

Developments during the remittal

44. In July 2010 LBG informed the FSA and CC that it would stop selling PPI policies. For MPPI, all mortgage customers who bought PPI before 23 July would still be provided with PPI up to 20 November. For other PPI products it would stop offering PPI with effect from 23 July 2010 (with all sales to be completed by 31 July).

45. LBG told us that this decision was because it found itself in a position where it would soon no longer be economic for it to offer its current payment protection solution to customers for a number of reasons, including the ongoing consideration of issues raised by the FSA and FOS in relation to PPI. It said that it did not make sense economically and in terms of compliance to produce new sales processes and products when it was awaiting the CC's final decision on what remedies to adopt to bring its markets investigation to an end. Even if the current provisional decision to impose a POSP was not adopted in the CC's final report it still expected any alternative to be a material intervention in the market requiring substantial changes to its products and sales processes. It said that it could not justify the introduction of interim changes in such circumstances, especially when it also had significant integration-related changes to implement.

46. [✂]

47. We looked at internal documents relating to the decision that LBG sent us. [✂]

48. [✂]

49. [✂]

50. [✂]

51. [✂]

CYB

52. [✂]

53. [✂]

Nationwide

54. [✂][4]

55. [✂]

56. [✂]

57. [✂][5]

58. [✂]

59. [✂]

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[4] [✂]
[5] [✂]

60. [✂]

61. [✂]

RBSG

62. [✂]

63. [✂]

64. [✂]

65. [✂][6]

66. [✂][7,8]

67. [✂]

68. [✂]

69. [✂]

Santander

70. [✂]

71. [✂]

72. [✂]

73. [✂]

Distributors—credit card

Capital One

74. [✂]

75. [✂]

76. [✂]

77. [✂]

MBNA

78. [✂][9]

79. [✂]

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[6] [✂]
[7] [✂]
[8] [✂]
[9] [✂]

Distributors—retail credit

SDGFS

80. [✂]

81. [✂]

82. [✂]

Underwriters

Aviva

83. [✂]

84. [✂][10]

85. [✂][11]

86. [✂][12]

Axa

87. [✂]

Cardif Pinnacle

88. [✂]

89. [✂][13]

90. [✂]

91. [✂]

Genworth

92. [✂]

93. [✂]

Stand-alone providers

British Insurance

94. [✂]

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[10] [✂]
[11] [✂]
[12] [✂]
[13] [✂]

Paymentcare

95. [✂]

Paymentshield

96. [✂]

97. [✂]. Paymentshield has a stand-alone short-term IP product available for consumers.

POFS

98. [✂]

99. [✂]

100. [✂]

Summary of responses to the consultation on our modelling approach

Introduction

1. We consulted the parties on our suggested approach to modelling the impact of the remedies on consumer welfare. In this appendix we summarize the responses to the modelling consultation.

General approach to modelling

2. Some parties told us that the model did not take into account some factors which might impact on the welfare implications of the package of remedies.

3. ABI and Aviva told us that differences in providers' distribution costs, expenses and margins were not taken into account, and that factors such as brand and customer loyalty, marketing and product quality were also likely to change the results of the model.

4. The FLA told us that the model did not address different types of customer behaviours, which might vary depending on where the customers were on the risk scale (for example, prime or sub-prime customers).

5. MBNA told us that the model was too simplistic and did not take into account adverse selection and asymmetric information, as well as heterogeneity of consumers and product differentiation. It told us that the assumption of linear demand might be too simplistic and might not be appropriate for modelling large changes in price. It also commented that the CC should not extrapolate costs from margin data in the profitability analysis for the modelling.

6. RBSG told us that the CC analysis was incomplete because it looked only at overall consumer welfare and did not take into account the impact of the POSP on high-risk consumer groups who were likely to be disproportionately impacted by the waterbed effect, because of the prospect of an extreme reduction in availability of credit to these groups which is a particular concern in the current economic climate. It also told us that adverse selection would increase with the POSP in place—if PPI was less convenient to acquire because of the POSP, then only those who derived the most utility from PPI would still make the effort to buy it. It would then be reasonable to assume that this group of people are more likely to claim on the policy. Recognition of this adverse selection by firms could lead to the price of PPI increasing rather than decreasing. RBSG also told us that the elasticity estimates that we used which were based on incremental price changes were not appropriate for an analysis which took into account significant regulatory change such as the POSP.

7. Barclays told us that it was sensible for the CC to focus on the 'myopic case' (non-system remedy) model, because it was the simplest case to consider. Barclays told us that the CC should develop a model which allowed for the cross-effects between credit and PPI prices to be identified and then evaluated empirically, and that a natural framework would be a model of monopolistic competition, where long-run effect on credit prices from removal of PPI excess profits could be obtained by introducing the zero-profit constraint of monopolistic competition models.

8. We noted these comments. Any economic modelling relies on some degree of simplification, and we acknowledged that such simplification means that we are

unable to take into account every factor which might have an impact on the effects of the remedies. However, we were confident that our assumptions enabled us to take into account the most important factors which would determine the impact of the remedies on consumer welfare, such as the removal of the waterbed effect and the possible loss of convenience to some consumers.

9. We did not agree with the parties that the package of remedies would increase adverse selection. This was an issue that we had considered carefully in the 2009 report. In paragraphs 10.23 to 10.28 of the 2009 report, we noted that there were likely to be a number of conflicting factors affecting the balance of low- and high-risk customers. We thought that the remedies would reduce adverse selection risks in the stand-alone market. While it was possible that adverse selection for some distributors might increase, if their penetration rates were to fall significantly, we considered this unlikely in the context of falling prices for PPI, which we expected to result from our remedies. We found in paragraph 10.495 of the 2009 report that there were increased costs of supplying PPI at high prices due to adverse selection and that this was an element of the consumer detriment arising from the AEC, which we were unable to quantify.

10. We disagreed with MBNA that we had extrapolated costs from margin data: rather, the margins in the profitability analysis were derived from estimates on the costs of selling PPI. We noted the comments from RBSG and MBNA on the fact that the elasticity estimates we used might not be appropriate for estimating the impact of large price changes. However, in the absence of any data on the impact of large price changes in the PPI market, these were the best possible estimates available.

11. Barclays disputed the assumption in the CC model that credit prices are below credit cost (an assumption which is a consequence of the assumption of a waterbed effect with perfect competition in the credit market). Barclays told us that this assumption contradicted the results of the profitability analysis, where we found that profitability of personal loans was very low, but not negative. Barclays told us that if we started from the assumption that credit price was equal to credit cost, there was a twofold welfare loss after the remedies:

(a) value of contributions lost from PPI, which were now recovered from the credit price (that is, increase in price of credit); and

(b) the loss in volumes of credit because of higher price.

12. Barclays told us that the latter effect should be included in the spreadsheets. We disagreed with Barclays' interpretation of our model. The model does not rest on the assumption that the price of credit is currently below marginal cost, but rather that the price of credit is below the price which would prevail if there were no pass-through of PPI profits to credit (ie no waterbed effect). We agree with Barclays that both of the effects above are important, and they are included in the modelling: the results take into account the fact that credit volumes reduce after the remedies (when consumers are myopic) because of the higher price of credit, as well as of the impact of the increase in the price of credit on the surplus of remaining credit consumers.

13. Barclays submitted a model where it assumed that: the elasticity of PPI demand was lower than in our original modelling (by about half), there was a 20 per cent loss of volumes due to convenience, and credit price was equal to marginal cost pre-remedy. It said that it showed the detrimental effect of the remedies on welfare. We noted that there was a mistake in Barclays' calculations in this respect, and that in fact the assumption that credit price is equal to cost does not materially change the results from the modelling. We noted Barclays' results, but we disagreed with the

values it attributed to the inputs on market elasticity of PPI demand and the impact of the loss of convenience.

14. LBG and HSBC told us that the model should contain a more explicit assessment of the timing of effectiveness of the remedies. In particular, LBG told us that the assumption of immediate vigorous competition was inconsistent and unlikely. We noted LBG's comments on the timing of effectiveness of remedies, and deal with the timing of effectiveness in Section 8 and Appendix M. As a consequence, we discounted the results of the modelling in the earlier years of implementation of the remedies to allow for the possibility that the remedies would not be fully effective from the first day of implementation.

15. LBG told us that any assumption on the likely price reduction from the POSP should be justified through explicit modelling of the likely costs and market share of new entrants and stand-alone providers. It told us that distributors would retain some form of point-of-sale advantage, and stand-alone providers would face higher adverse selection costs, and this should be included in the model. We did not agree that it was sensible or practicable to attempt to model all possible business strategies that providers might undertake with our remedies in place. Nor did we agree that the constraint on PPI prices with the remedies in place necessarily relies on the presence of new entrants. We thought that existing distributors would have both an incentive and an increased opportunity to compete with each other for stand-alone sales and this was consistent with internal documents (see paragraph 8.94. We thought that the package of remedies would decrease adverse selection costs for stand-alone providers (see paragraph 10.25 of the 2009 report). However, we checked that the results of the modelling were robust if we assumed that the price of PPI did not fall to the point where all excess profits were removed, which would be consistent with distributors retaining some form of point-of-sale advantage after the remedies are in place.

16. LBG also told us that it expected the price reduction to be less for CCPPI because stand-alone providers would find it more difficult to compete in CCPPI. We disagreed that this would be the case, and our reasoning is set out in paragraph 8.13

17. LBG also told us that the analysis did not address the question of the impact of remedies on relative profitability of protected/unprotected credit, or of the welfare implications of targeted credit price increases including increase in cut-offs, even though the CC identified the failure to capture these as likely to lead to under-estimates of the downside risks of intervention. We thought that modelling the impact of the remedies on credit prices as an impact on the average price of credit was the best available proxy for the overall welfare effect of the remedies on credit consumers.

18. LBG also told us that it considered a base case that relied on the output of only one of the models was inappropriate. It said that it would be more appropriate to identify where along the spectrum of possible remedy packages the relevant remedy package lay and to take account of increases in searching over time that would lead one to rely more on the system model. We therefore introduced an extension of our model to allow for the fact that we expect a proportion of consumers to be aware of the price of PPI prior to making credit decisions after the remedies are in place, so that we take into account the fact that the package of remedies is expected to have 'system' effects.

19. HSBC told us that the modelling consultation did not explain clearly how the assumption of myopic consumers would be removed. Our approach is explained in Appendix I.

Effectiveness of the POSP

20. Some parties told us that they disagreed with the assumptions in the modelling on the impact of the package of remedies on prices and PPI demand.

21. ABI and Aviva told us that they did not believe that marketing would increase post-remedies as providers would not be able to sell PPI alongside credit, and therefore would not have an interest in marketing; and stand-alone sales were a very small percentage of the market. We think that this is contradicted by evidence from distributors that they will continue to sell PPI post-POSP, both to their credit customers and in many cases on a stand-alone basis, and therefore they will have an interest in marketing the product to their credit customers.

22. ABI and Aviva also told us that there was no evidence for the assumption that competition for PPI customers would be vigorous post-remedies, and that consumers would not seek alternative providers or would not compare prices. They told us that the POSP might result in reduction in quality of PPI, as evidenced by the lower quality of existing stand-alone PPI policies. We disagreed that stand-alone PPI policies were of lower quality: the evidence for this is presented in paragraphs 10.58 and 10.59 of the 2009 report. We concluded in the 2009 report that the remedies would be substantially effective in addressing the AEC, and this element of our decision was not quashed by the Tribunal. Our consideration of new evidence during the remittal did not give us cause to depart from our conclusion that there will be sufficient choice for a dynamic market to develop (see paragraph 8.94).

23. HSBC told us that the CC should compare the POSP against a remedy without the POSP in the assessment. Our reasoning for why we did not use this approach is set out in Section 3.

24. Cardif Pinnacle told us that it agreed that competition would be vigorous after the POSP and that it was seeing significant interest from potential entrants to PPI.

25. Barclays told us that the modelling did not give sufficient weight to the possibility of providers exiting the market, rather than the remedies leading to vigorous competition. We considered the evidence on whether providers might exit the market in paragraphs 6.13 to 6.27; we were satisfied that this would not be the case.

Updating the data

26. ABI told us that, as single-premium PPI was no longer being sold, it followed that 2009 was the only year's data that correctly reflected the current market. It told us that the data on secured lending from 2009 was almost certainly a better reflection of the market over the next few years than the pre-recession data.

27. GMAC told us that, for a significant sector of the PLPPI market (the motor vehicle finance market), there was a significant shift in 2009 that would not be reversed in future years, so that we should not ignore 2009 data. It told us that the motor vehicle finance market almost without exception ceased writing PPI at the point of sale in 2009, due to the increased focus by the FSA on sales practices coupled with the negative publicity surrounding the product.

28. The FLA told us that it welcomed the fact that the CC would include inputs to reflect recent market conditions.

29. HSBC told us that the CC should consider other causes for the decline in PPI, for example the impact of negative media coverage. It told us that it was not clear that

market conditions in 2011 and beyond would be more similar to an average of past conditions than current conditions, and told us that profit margins were likely to fall. It told us that penetration rates would continue to fall up to 2011 and beyond, and this was what the CC should use.

30. Cardif Pinnacle told us that penetration might increase in future because of consumers' concerns caused by recent economic conditions. It told us that the recession would overstate loss ratios and understate excess profit margins, and agreed with the CC's approach to updating.

31. MBNA told us that there had been a fall in CCPPI penetration rates. It told us that CCPPI was not excessively profitable, and that the CC should not rely on its earlier profitability model.

32. Legal & General told us that gross earning premium was a better measure than GWP for calculation of excess profit margins.

33. RBSG told us that 2009 should be taken into account for PLPPI margins, as for other products. It told us that the fall in penetration and increase in claims in 2009 [✂], and therefore that an average across 2005 to 2009 would be appropriate.

34. LBG told us that we should take into account 2009 data for calculating PLPPI margins because of the shift to regular premium. LBG said that, for PLPPI, regular-premium policies had lower profit margins than single-premium policies for the following reasons: (1) there was a loss of net interest income associated with the single-premium loan; (2) regular-premium policies had shorter average length; and (3) they had keener pricing.

35. Regarding penetration rates, LBG told us that the appropriate forecast was to develop a counterfactual with no or very limited CC remedies. There might be some evidence that the decline in penetration rates was bottoming out and/or the rates might be expected to increase given the state of the economy. LBG also told us that the relative price of PPI had gone down, because of an increase in credit prices.

36. Aviva told us that the prices of credit and of PPI were both increasing (credit because of restricted credit supply, PPI because of increasing claims).

37. In summary, on margins and profitability, we noted that the parties did not generally disagree with our approach of using averages between 2005 and 2009 for updating the data. However, many parties disagreed that we should use the 2005 to 2008 average for PLPPI margins.

38. We tested LBG's assertion that regular-premium policies had lower margins than single-premium policies. To do this, we looked at the income as a percentage of GWP from the data we had collected from each of the distributors, for both 2006 and 2008.

39. We did not find consistent evidence to confirm LBG's assertion. The data for 2008 showed that margins were higher for single- than regular-premium policies, with single-premium income 69 per cent of GWP and regular-premium income 47 per cent of GWP. However, the 2006 data showed that regular-premium policies had the same margin as single-premium policies, with 74 per cent of GWP.

40. We asked the distributors whether they considered that regular-premium policies had lower profit margins than single-premium policies, specifically asking for evidence on the three points LBG made in paragraph 34.

Loss of net interest income

41. All distributors that provided evidence to us agreed that the loss of net interest income arising from the single-premium policy would reduce profitability, although Barclays noted that this would impact on the profitability for the lending product and not the PPI. We agreed with Barclays; we did not include net interest income in our model of PPI profitability as we considered it rightly to be analysed as part of the profitability of the loan business (see Appendix 4.4, paragraph 37, of the 2009 report).

Shorter average policy length

42. Parties were generally unable to comment on this point, as regular-premium PLPPI products had only recently been launched, but initial analysis from one party (Barclays) showed that customers were more likely to cancel a regular-premium policy than a single-premium policy.[1] LBG told us that there were higher levels of attrition and a change in the cancellation profile. We considered that any change in the cancellation profile may be due to the lower barrier to switching associated with regular-premium policies.

Keener pricing

43. Parties were generally unable to provide evidence to confirm this point. Those which provided evidence to us stated that it was difficult to make comparisons, as the policies were not comparable on a like-for-like basis, but one party which was able to comment (CYB) stated that commission and profit share rates were higher for single-premium policies. We noted that this was not borne out across all the distributors in the data we collected.

44. Thus, we considered that the shift from single- to regular-premium policies would not materially affect the margins for PLPPI.

45. The reason for using the 2005 to 2008 margin for PLPPI was mainly due to measurement problems for 2009, as set out in Section 4. However, we agreed that we should account for the fact that the 2005 to 2009 average margin may be lower than the 2005 to 2008 average margin, and therefore we adjusted the 2005 to 2008 average down by four percentage points. We also conducted some sensitivity tests to our assumption on the margins, to check the robustness of our results if the margins were lower.

46. Regarding the penetration rates, we noted that some parties thought that penetration rates would increase in the absence of remedies (because of the impact of recession), while others thought it might continue to decline absent the remedies because of the impact of negative publicity. We therefore used 2009 levels, but conducted some sensitivity tests to check the robustness of the results to higher and lower PPI penetration rates pre-remedy. For the price of PPI relative to credit, we also conducted sensitivity checks on the robustness of our results if the price of credit increased relative to PPI.

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[1]Barclays' comparison was made using regular-premium non-loan-related policies, as it had no regular-premium loan-related policies to assess.

Elasticity of demand for PPI

47. [✂] told us that the evidence it had submitted to the CC on the PPI price sensitivity suggested a market elasticity for PPI demand substantially lower than 1.5.

48. Barclays told us that it did not agree that the market elasticity of demand for PPI was close to the firm elasticity level. It told us that, based on its interpretation of the results from a previous CC survey, the cross-elasticity of substitution between PPI providers was about 0.85. If so, the market elasticity should be 1.67 – 0.85 = 0.82 (about half of the firm-level elasticity).

49. We address these submissions on the elasticity of demand for PPI in Appendix I.

Waterbed effect

50. Cardif Pinnacle told us that the credit crisis might have removed the waterbed effect; its opinion, as an insurer, was that it was likely that consumers were now charged the risk price for the credit product.

51. Legal & General told us that, given that MPPI was in many cases provided by stand-alone insurers that were not part of the same business group as lenders, it questioned whether the waterbed effect applied for MPPI.

52. LBG told us that any relaxation of the waterbed assumption needed to be supported by concrete evidence that the credit market was not simply in some way less competitive, but also that it was less than effectively competitive.

53. SGDFS told us that it did not agree with the CC that there was no waterbed effect for retail PPI.

54. We noted these comments. We explain our reasoning on the waterbed assumption in Appendix I.

Costs of implementation/marketing

55. Legal & General said that terms and conditions were likely to allow increased costs as regulatory/legal changes could be passed on to customers. Given this, it believed that it was possible that firms might consider the fixed IT costs of implementing the remedies when reviewing the ongoing cost of cover and that such costs might in future be passed on to consumers.

56. [✂] told us that it intended to recover one-off implementation costs from consumers, and therefore these costs should be included in the model in the form of higher marginal costs, as was the case with the ongoing costs of remedies.

57. LBG told us that fixed costs should be taken into account in the modelling because they would impact on new entrants.

58. RBSG told us that marketing costs should be included in the model as higher marginal costs following implementation. We included some marketing costs in the modelling. RBSG also told us that the potential impact of adverse selection on the costs of PPI following the POSP should be incorporated into the model. As set out in paragraph 8, we disagreed that adverse selection would increase following the introduction of a POSP.

59. Barclays told us that one-off costs should be included, and that spreading the one-off costs over a number of years seemed sensible and consistent with how fixed costs were apportioned in other sectors.

60. Our reasoning on the inclusion of the one-off costs of implementation is set out in Appendix I. Although we did not include one-off costs of implementation in the post-remedy price in the base case for the modelling, for the reasons set out in the appendix, we conducted some sensitivity analysis to check whether the inclusion of the one-off costs of implementation in the price would change the results of the model.

Convenience

61. HBSC, MBNA and LBG told us that the modelling consultation did not clearly set out how the CC would account for the loss of convenience in the modelling.

62. MBNA told us that, if convenience was modelled only as a cost, it would ignore adverse effects of customers failing to take out insurance even though it would be in their interest to do so. We did not agree with this: we thought that, if customers fail to take out insurance, this is because the value of the insurance to them is less than the sum of the price of the insurance and the possible costs of loss of convenience to them. Therefore, the failure to take out insurance is taken into account in the model by modelling the loss of convenience to consumers who value convenience as a cost.

63. LBG told us that the key issue was to understand how consumers were likely to react, and that the most weight should be given to evidence that explored this directly—ie pilot studies. We discuss this evidence, and the weight we attribute to this evidence, in paragraphs 5.23 to 5.33 and Appendix C.

64. LBG told us that the loss of convenience factor should reflect both those who did not buy at all and those who bought at greater cost in terms of time spent. We took this into account in our modelling, by considering the welfare impact of loss of convenience to consumers who value convenience, both as the possible reduction in PPI volumes due to the cost of convenience, and the reduction in surplus because of the cost of convenience to consumers who continue to buy PPI even though they value convenience.

65. Barclays told us that the loss of convenience should be modelled as a shift downwards of the demand curve for PPI. We agreed with this, and our approach was to model the loss of convenience as a shift downwards of the demand for PPI of consumers who value convenience, as set out in Appendix I. Barclays told us that the best way to address the magnitude was to consider possible reductions in the volume of PPI sold at current price that might flow from the loss of convenience, and that this could help inform the counterfactual demand curve. We noted these comments, though we did not think that the evidence on the reduction in PPI take-up in the experiments was necessarily an indication of the convenience effect. This evidence is discussed in Appendix C.

Mis-selling

66. [✂] told us that benefits from a reduction in mis-selling were uncertain and were not directly related to the POSP. It told us that alleged mis-selling was not identified as a feature of the AEC, or a detrimental effect from the AEC, in the 2009 report. It also

told us that evidence from the FOS was inappropriate because negative publicity had created a bias.

67. Cardif Pinnacle told us that, in a recent consultation paper, the FSA identified that the cost incurred by firms in paying redress for mis-selling might be recovered in the form of higher pricing, and that no account of this appeared to have been taken in the modelling.

68. The BBA told us that there was no hard evidence that mis-selling had taken place in the market.

69. [✂] told us that it was not clear that the POSP would lead to a reduction in mis-selling. [✂] told us that there was no evidence of significant mis-selling in the past.

70. Barclays told us that mis-selling and the POSP were two separate issues.

71. Aviva told us that the FSA had repeatedly stated that there was a significantly lower risk of mis-selling with MPPI.

72. We decided not to account for the possibility of mis-selling in the modelling, but conducted some sensitivity checks.

Dynamic benefits

73. HSBC told us that it was not clear how dynamic benefits would be quantified, and that these benefits were not linked specifically to the POSP.

74. The BBA told us that the CC proposal to evaluate dynamic benefits outside the model created a risk that the importance of the modelling exercise was diminished.

75. LBG told us that the dynamic benefits should be quantified, and that it was possible to value the benefit of PPI moving to best in class in terms of benefits to consumers (range of exclusions, handling claims etc).

76. We decided not to account for dynamic benefits in the modelling, because of the difficulties in quantifying these benefits (see paragraph 7.13).

Modelling of static consumer benefits from the remedies: methodology, assumptions and inputs

Introduction

1. In this appendix we set out our approach to the modelling of static consumer benefits from the package of remedies. The approach to modelling was subject to a consultation, which informed our views on approach and inputs to the modelling. The responses to the consultation on the modelling approach are summarized in Appendix H.

2. We first describe our methodology and the main assumptions of the model, and explain how we take into account the effects of the loss of convenience from the POSP in the modelling. We then explain how we updated the inputs to the model; including our approach to including the costs of the remedies in the model and our approach to updating the estimates for the market elasticity of PPI demand. We present the results of the modelling in Appendix J.

Methodology

3. In the 2009 report, as part of our analysis of a possible waterbed effect, we constructed a number of Excel-based economic models of the markets for credit and PPI in order to simulate the effects of remedy options on prices and volumes of credit and PPI sold, as well as on the welfare of consumers and firms that participate in the PPI and credit markets. The possible removal of a waterbed effect complicates the assessment of the consumer welfare implications of remedies designed to increase competition in the PPI markets, and so the models simulated the effects of remedies both on PPI consumers (whose welfare is likely to increase because of increased competition) and credit-only consumers (whose welfare may decrease because of a possible increase in the price of credit following the removal of waterbed effects).

4. In the 2009 report, we used two different models to analyse the effects of remedies on consumer welfare: the 'non-system model' and the 'system model'. The difference between the two models was that the non-system model assumed that all credit consumers were myopic after the remedies are in place, in the sense that they do not anticipate the lower price of PPI prior to making decisions on credit, whereas the system model assumed that all credit consumers observed the price of PPI prior to making decisions on credit when the remedies are in place. The extent to which we expect a package of remedies to have system effects depends on whether the remedies increase the proportion of consumers that shop around for PPI, or otherwise anticipate secondary market conditions, prior to the credit point of sale.

5. These models were then used for two purposes in the 2009 report:

   (a) to understand the implications of the waterbed effect on the effect of different types of remedies on welfare (comparing the effects of system and non-system remedies); and

   (b) to estimate the net consumer benefits that we expected from the remedy package. This was done using the non-system model, and, wherever possible, the likely or conservative values for the inputs to the model.

6. Our approach in the remittal has been to continue to use the non-system model as the base model for estimating the effects of the package of remedies on consumer welfare. The assumption that all consumers are myopic before the remedies and continue to be myopic after the remedies should be thought of as a simplifying assumption. Indeed, there is evidence that some consumers currently search for PPI before the point of sale of credit (see paragraphs 35 to 42), and we think that the remedies will increase this type of search. This is also a cautious assumption, because consumer welfare after the remedies is higher if the remedies increase the amount of search and/or awareness of PPI prior to the credit point of sale (as explained in paragraph 29).

7. While we continue to use the non-system model where all consumers are myopic as the base model, rather than work with two different models (representing two extremes of the effects of the remedy package) as in the 2009 report, we instead introduced 'system' elements to the base non-system model by introducing a variable which allows for a proportion of consumers to search for PPI prior to purchasing credit after the remedies are in place.

8. We first describe the main assumptions for the base model, which are similar to the assumptions for the non-system model in the 2009 report. We then set out how we modified the model in the 2009 report to take into account the cost/gain from the loss of convenience after the POSP. We then explain how we removed the assumption that all consumers are myopic, by introducing a variable that represents the proportion of consumers who search for PPI prior to purchasing credit in the base model.

The base model

9. The base model mirrors the non-system model that was presented in the 2009 report.

Underlying assumptions for the base case model

10. The basic assumptions underlying the model prior to the imposition of remedies are:

(a) There are 'n' identical firms which compete in the markets for credit but are monopolists over PPI sales to their respective credit customers. This assumption reflects the market definition in the 2009 report, where we found that distributors were effectively monopolists over the supply of PPI to their own credit customers.

(b) Only those customers who have taken out credit go on to observe PPI prices (ie PPI information is provided after the credit decision). This assumption reflects our finding that the majority of consumers do not currently 'full life cost' in that, when choosing their credit product, they do not consider the subsequent price of PPI.

(c) We assume that there is a waterbed effect: competition for credit customers is vigorous, such that most of the excess profits from PPI are passed on to credit consumers in the form of lower credit prices.

(d) We assume that the observed prices and volumes of PPI and credit are optimal and the firms are profit maximizing.

(e) We assume that the demand curves for PPI and for credit are linear.

11. As in the 2009 report, we calibrated the model using observations on PPI and credit prices, penetration rates, and elasticity of demand for PPI and credit pre-remedy. Our approach to updating these inputs is set out in paragraphs 64 to 141 below. Our starting point was the inputs that were used in the 2009 report for estimating the benefits from the package of remedies (ie, the inputs that were used in order to calculate the benefits in paragraph 10.493).

The relationship between PPI and credit demand

12. We made assumptions on the relationship between the demand for PPI and the demand for credit. In our base model, we assume that consumers are myopic before and after the remedies (assumption 10*(b)* above). The implication of this assumption is that, whereas the demand for PPI is conditional on credit demand, the demand for credit is independent of PPI.

13. In order to model the impact of a reduction in credit demand on the demand for PPI, we assume, in the base model with myopic consumers, that the inverse demand curve for PPI shifts inward when quantities of credit consumed reduce. In order to calculate this demand shift, we continue to make the same assumption as in the 2009 report: at a given PPI price, the new PPI demand function for lower credit volumes is such that the penetration rate of PPI would remain the same at constant PPI prices.[1]

Assumptions on extent of competition after the remedies

14. We expect that the remedy package will result in increased competition between PPI distributors. We therefore expect that, after the remedies are in place, competition between PPI providers will be vigorous, and drive the PPI price down. In the base case, we assume that the price of PPI will reduce to a level such that distributors no longer earn excess profits on PPI with the remedies in place. However, we tested the robustness of the results of the modelling to lower price reductions after the remedies.

15. Although we also expect the remedies to increase awareness and search of PPI prior to the credit point of sale, in our base model we continue to assume (like in the 2009 report) that, after the remedies are in place, all consumers are myopic, ie credit consumers do not anticipate the lower PPI price before making credit purchase decisions after the remedies are in place. We relax this assumption in the robustness checks, and examine the benefits from the remedies when a proportion of consumers anticipate the lower PPI price prior to making credit decisions.

Modelling of the cost from the loss of convenience

16. In the 2009 report, the modelling did not account for the possible impact of the loss of convenience after the remedies are in place on the demand for PPI. We set out here how we incorporated the costs to consumers from the loss of convenience after the POSP is in place.

17. In the consultation document, we stated our intention of modelling the loss of convenience following the imposition of the POSP as a cost to PPI consumers: at any given PPI price, the surplus that consumers derive from PPI will decrease due to the

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[1]As a result of this assumption, the inverse demand function for PPI pivots down if credit volumes decrease. An implication of this assumption is that the elasticity of PPI demand at an unchanged PPI price remains constant for different credit levels.

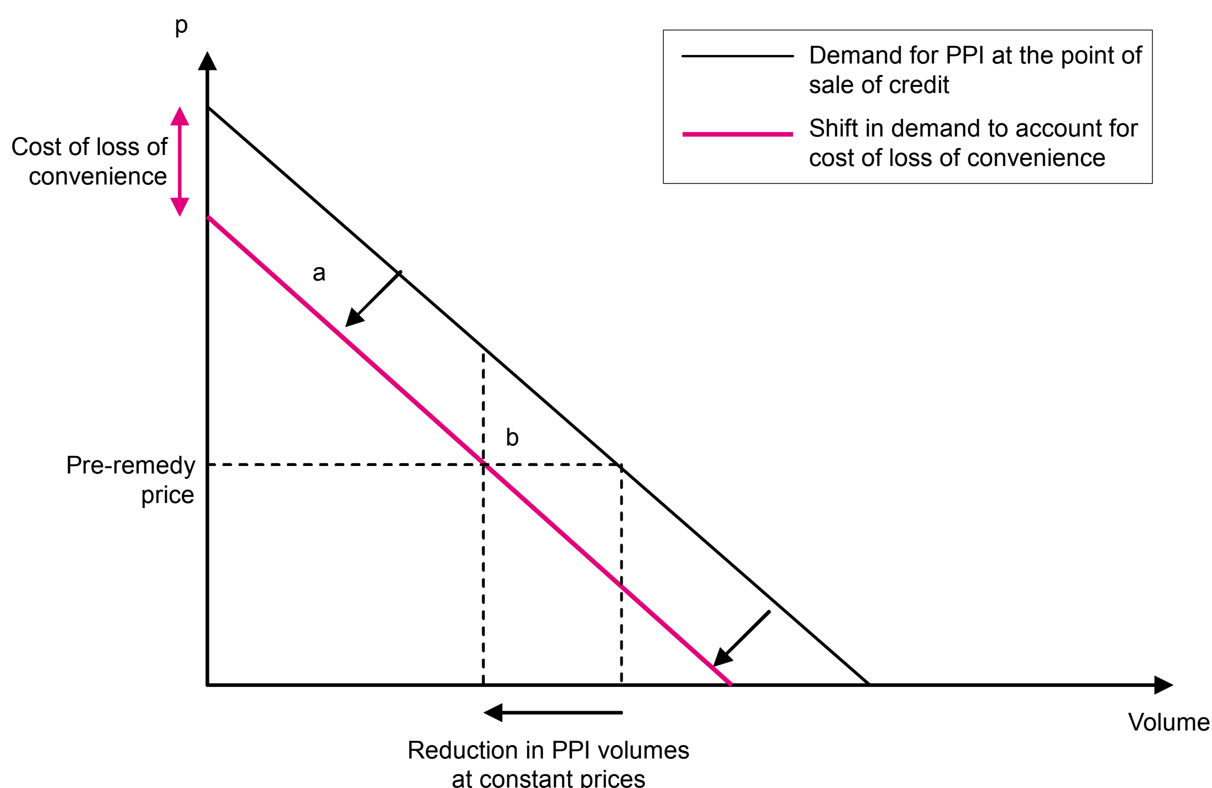
cost of convenience, so that the inverse demand curve for PPI effectively shifts down. We illustrate the way in which we intended to model the loss of convenience in Figure 1. At constant prices, the impact of the loss of convenience on consumer welfare is:

(a) a reduction in the total demand for PPI (consumer welfare reduction of area b); and

(b) a reduction in the surplus derived by consumers who continue to purchase PPI, because they incur an additional cost (the cost of loss of convenience)—this is area a.

FIGURE 1

Modelling the impact of the loss of convenience from the POSP on PPI demand



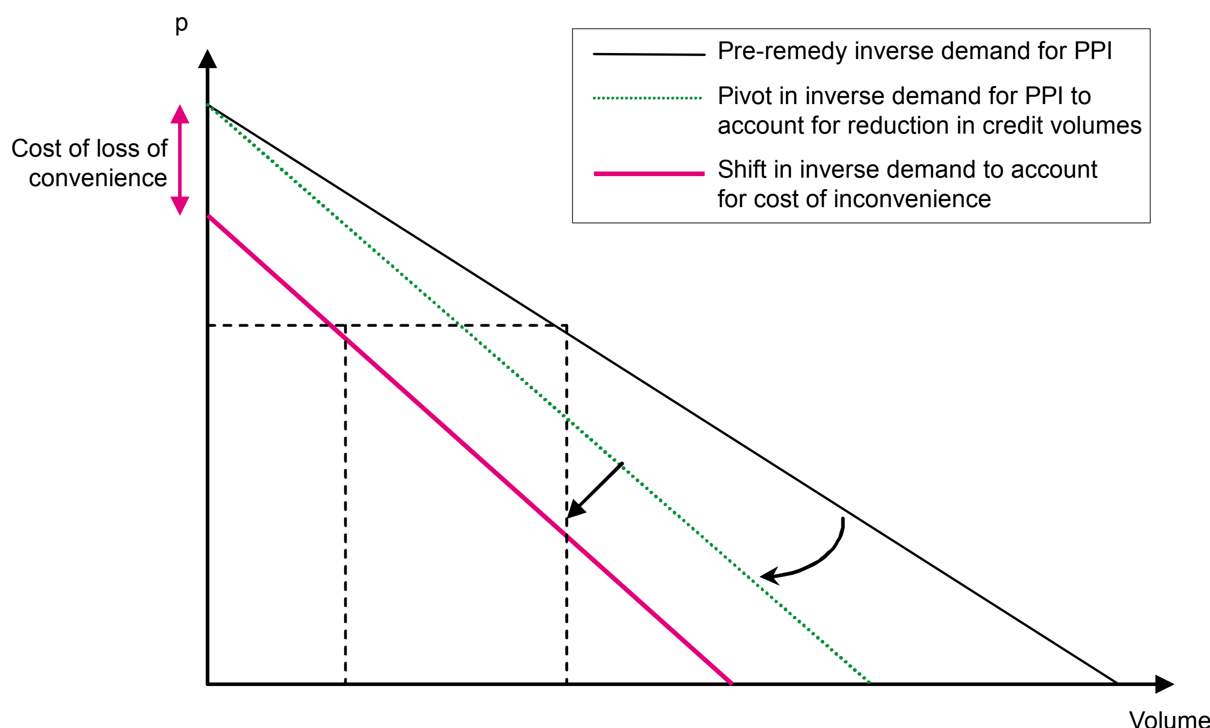
Source: CC analysis.

18. This approach takes into account both the effect of loss of convenience on quantities consumed and the effect on the surplus for consumers who continue to take out PPI.

19. Figure 2 shows how the pre-remedy inverse demand curve for PPI changes after the introduction of remedies using the base case assumption of myopic consumers, taking into account the reduction in credit demand because of consumer myopia, and any possible costs due to the loss of convenience. At constant PPI prices, demand for PPI reduces because of the reduction in credit volumes and the possible costs arising from the loss of convenience.

FIGURE 2

Modelling the impact of reduction in credit volumes and of loss of convenience after the POSP on PPI demand



Source: CC analysis.

The value of the cost of convenience

20. We commissioned a survey from Accent to estimate the value that PPI consumers attach to buying PPI at the same time of credit. The results from the survey are presented in paragraphs 5.48 to 5.52 and 5.63 to 5.67. In summary, the Accent survey found that:

(a) 60 per cent of PLPPI consumers, and 50 per cent of MPPI consumers, prefer to buy PPI at the point of sale (all other things being equal). These consumers associate the loss of convenience from purchasing PLPPI after the credit point of sale with a cost of £7.30 per month on average if they buy seven days later, and £9 if they buy 24 hours later; that is, between 23 and 30 per cent of the average monthly cost of PLPPI. For MPPI, the consumers who prefer to buy at the point of sale do not associate any significant cost with the POSP.

(b) 31 per cent of PLPPI consumers, and 36 per cent of MPPI consumers, prefer to buy PPI after the credit point of sale; these consumers associate buying PPI after a delay with a monetary gain (of £19 to £25 per month for PLPPI customers, and £18.70 to £30 per month on average for MPPI customers).

(c) 8 per cent of PLPPI consumers, and 14 per cent of MPPI consumers, are in-different as to the time of purchase. They do not associate the loss of conven-ience with any significant cost (or gain).

(d) Overall, on average, buying PPI after the credit point of sale is associated with an increase in the willingness to pay for PPI, of £3.70 per month for PLPPI customers, and £8.10 per month for MPPI customers. This is because the

preferences of the group of consumers who prefer to buy later are stronger than the preferences of the group of consumers who prefer to buy at the point of sale.

21. On average, therefore, the Accent survey results could suggest that, rather than shifting down, the demand for PPI will shift up after the remedies are in place (for a given amount of credit demand), because on average consumers associate the ability to buy PPI after the credit point of sale with a net gain (all other things being equal).

22. However, the average results from the survey hide the fact that there are three different types of consumers who will be impacted differently by the POSP: those who value the ability of buying PPI at the credit point of sale, those who prefer to buy PPI after the credit point of sale, and those who are indifferent between buying at the credit point of sale and buying later. Rather than using the average gain from the loss of convenience in the modelling, which would have implied a shift up of the demand for PPI after the remedies because of the delay in the purchasing, we therefore decided to model the impact of the remedies separately on the three different types of consumers.

23. In order to do so, we made some assumptions on the preferences for buying at the credit point of sale of potential 'new consumers' to PPI; that is, those who do not purchase PPI at current prices, but would purchase PPI if the price of PPI were lower. We assumed that these consumers would have similar preferences to existing consumers, and therefore could be split out into three different groups, in the same proportions as existing consumers. Indeed, we did not see any reason to assume that new consumers would be different from existing consumers in their preference for buying at the credit point of sale or later.

24. We therefore modelled the individual demand function for PPI after the remedies are in place of the three different groups of consumers:

   (a) Group 1 consumers (prefer to buy at the credit point of sale): their inverse demand for PPI will shift down after the remedies. However, when we take into account the reduction in price after the remedies, these consumers may still be better off after the remedies if the reduction in the PPI price is sufficient to compensate for the cost of loss of convenience.

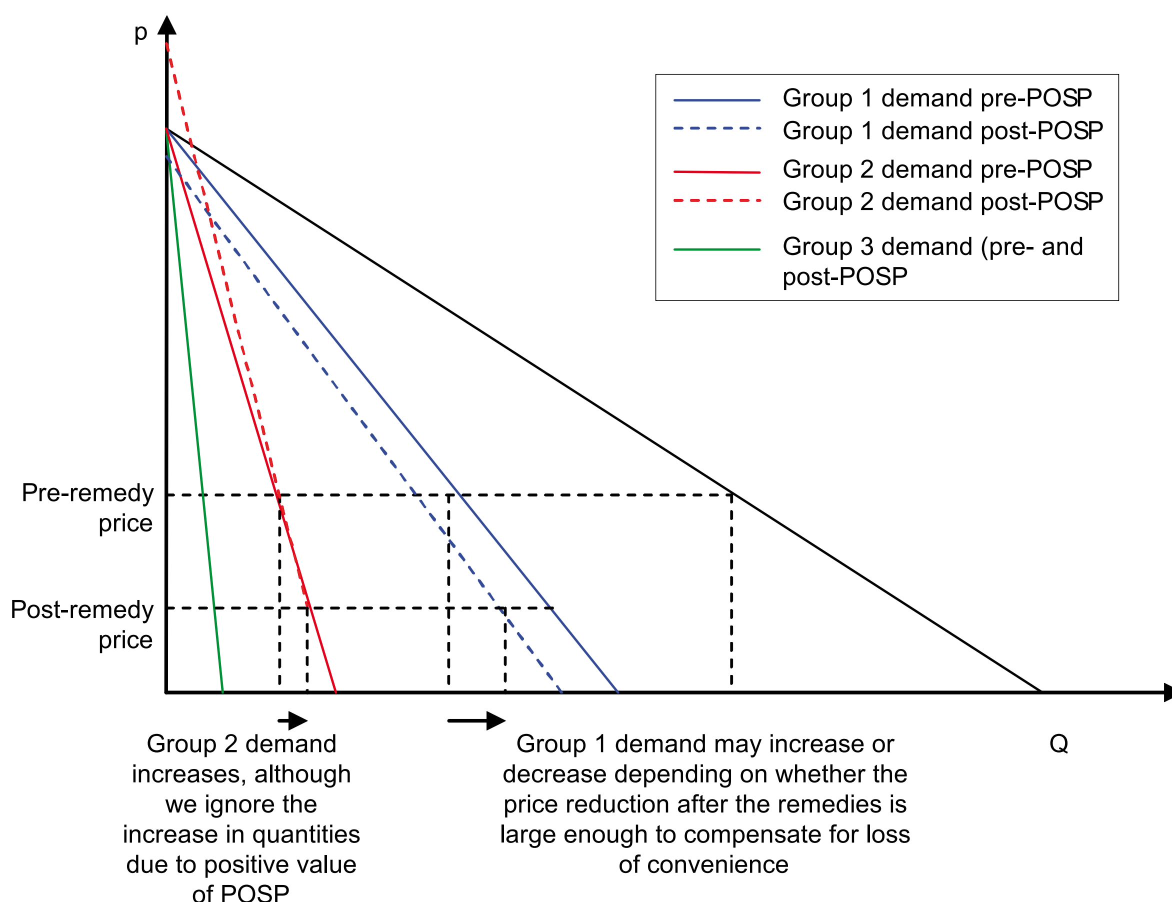
   (b) Group 2 consumers (prefer to buy later): these consumers derive a positive utility from buying PPI after the credit point of sale. The inverse demand curve of these consumers could shift up after the remedies; however, to be conservative we assume that the quantities consumed by this group of consumers do not increase because of the ability to buy later, but we assume that the surplus that these consumers derive from purchasing PPI increases for each unit of PPI purchased by the gain they associate with buying later. The surplus derived from PPI of these consumers increases after the remedies whatever the impact of the remedies on the price of PPI.

   (c) Group 3 consumers (indifferent between buying at the credit point of sale and buying later): the PPI inverse demand curve of these consumers is not affected by the loss of convenience from the POSP.

25. Figure 3 shows the pre-remedy inverse demand curve of each group of consumers.

FIGURE 3

Pre-remedy inverse demand curves



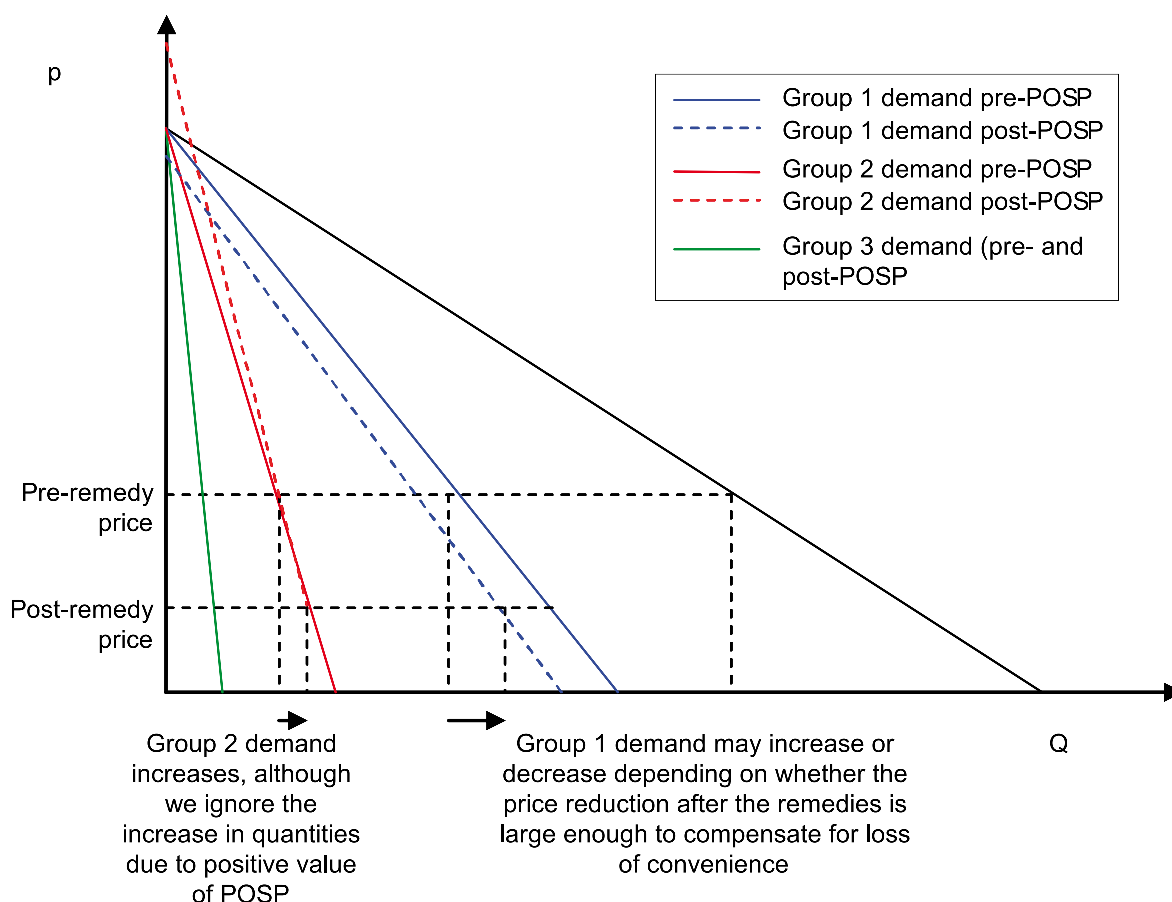
Source: CC analysis.

26. Figure 4 shows the inverse demand curve of each group of consumers after the remedies are in place (for a constant level of credit demand). The PPI inverse demand curve of Group 1 consumers (who prefer buying PPI at the credit point of sale) shifts down by the average cost of convenience for these consumers. The PPI inverse demand curve of Group 2 consumers (who prefer to buy PPI after the credit point of sale) should shift up, because these consumers associate an increase in surplus with buying later. However, in the modelling, we ignore the increase in volumes demanded due to the ability to buy PPI later for this group of consumers, but we do take into account the fact that the surplus of these consumers increases after the remedies. In practice, this means that we model the impact on the demand of these consumers as a pivot in the inverse demand curve.[2] The PPI inverse demand curve of Group 3 consumers remains the same at constant credit volumes, as these consumers do not attach a significant cost or gain to buying PPI after the credit point of sale.

[2]This reflects a cautious approach: if we modelled the impact of the remedies as a shift up of the inverse demand by consumers who prefer to buy later, the quantities of PPI purchased would increase more and therefore consumer welfare after the remedies would be higher.

FIGURE 4

Post-remedy inverse demand curves, at constant credit demand



Source: CC analysis.

27. In Figure 4, the PPI inverse demand curves are drawn for a constant credit demand. The actual inverse demand curves after the remedies are in place for each group of consumer will pivot inwards because of the reduction in credit demand if we assume myopic consumers. This is taken into account in the modelling.

28. We used the Accent survey results to derive the proportion of PPI consumers in each group, as well as the average cost or gain that each group of consumer associates with the delay in the purchase of PPI. For PLPPI, we used the results of the Accent survey of PLPPI consumers. For MPPI, we used the results of the Accent survey of MPPI consumers. For SMPPI and CCPPI, we used the PLPPI survey results. We thought that preferences of SMPPI were likely to be very similar to those of PLPPI consumers (see paragraph 5.86). We thought that the costs to CCPPI consumers who prefer to buy at the point of sale were likely to be lower than for PLPPI consumers, because the CCPPI purchasing process is more similar to MPPI (see paragraph 5.86). However, to be cautious we used the PLPPI results for CCPPI too.

29. HSBC, LBG and RBS told us that there would be a double counting problem if we took into account the positive valuations of the delay by consumers who prefer a delay in our modelling. This is because consumers who value the delay may have included, in their valuation of the delay, the expectation that they will be able to buy PPI at a lower price if they delay the purchase and shop around. HSBC argued that this, together with all its other concerns regarding the willingness to pay results from the accent survey meant that we should therefore not take into account any of the

positive willingness to pay for the delay; whereas LBG said that in its view, for almost half of the respondents the CC's use of the Accent results involved double counting with the additional welfare gains of price cuts, and suggested we only take into account the positive willingness to pay for the delay of consumers who said they preferred the delay because of reasons other than for shopping around.

30. The Accent survey was designed to estimate consumers' willingness to pay for a delay or for buying PPI at the credit point of sale at a given price. In principle, therefore, we would not expect the willingness to pay results to include an expectation of a lower price by consumers. However, we recognized that, while in principle this should not occur, in practice some consumers may have factored this in to their responses. We thought this might be the case for consumers who said that they preferred the delay because it gave them the ability to shop around for PPI (and for no other reason). Even then, we did not think that these consumers' valuation of the delay would only reflect the discount they expect to obtain by shopping around: there are other benefits to consumers from shopping around than the expectation of a better price (such as product characteristics and quality of product, and being able to satisfy themselves that they had obtained good value for money). Moreover, the fact that a respondent only mentioned the ability to shop around as a reason for preferring the delay does not necessarily mean that this consumer does not perceive other benefits to the delay (time to think, etc).

31. Therefore, we did not take into account the positive valuations for the delay by consumers who said that they preferred the delay only because it gave them the ability to shop around; this was very similar to the approach that LBG had suggested. 32 per cent of PLPPI consumers who preferred to buy after a delay, and 39 per cent of MPPI consumers who preferred to buy after a delay, gave as the only reason for this preference the ability to shop around. We therefore discounted the average positive willingness to pay figures so as not to count the valuation of the delay by these consumers. In practice, for PLPPI we therefore assumed the willingness to pay for the delay by consumers preferring a delay was 68 per cent of the value found in the Accent survey; for MPPI, we assumed the willingness to pay for the delay was 61 per cent of the value found in the Accent survey.[3]

32. LBG told us that it did not agree with the way in which we had modelled the impact of the remedies on consumers who preferred the delay. It said that, setting aside buyer's regret and removing valuations motivated by the prospect of attaining lower price, the only sensible interpretation of the remaining positive valuations of delay was that some consumers may have had their demand artificially boosted by the availability of PPI at the credit point of sale. In other words, LBG said that, the positive willingness to pay for the delay, when not explained by double counting or buyer's regret, implied that some consumers had bought PPI when in retrospect they would only normally do so at a lower price. LBG said that, if this were the case, the only sensible interpretation was that the availability of PPI at the credit point of sale had artificially shifted out the demand curve for these consumers. LBG said that to estimate more accurately the welfare impact of these positive valuations would involve shifting the demand curve inwards to reverse the increase in consumer surplus for each consumer, and then identify the number of consumers for whom the purchase decision had been artificially inflated.

33. We did not agree with LBG's interpretation of the survey responses. Consumers may derive positive surplus from having the time to think about their purchase and making

[3]This is in fact equivalent to assuming that consumers preferring the delay only because of the ability to shop around are in fact indifferent as to whether they buy at the credit point of sale or later (at given price)—so categorizing these as Group 3 consumers rather than Group 2 consumers.

sure that they are obtaining good value for money. This does not necessarily indicate that they would not have bought PPI if given the time to think, but that they would be more satisfied with their purchase if they had been given time to think. We therefore did not agree with LBG that the positive valuations in the survey were an indication that the availability of PPI at the point of sale had artificially boosted the demand for PPI.

34. Even if some of the consumers who said that they preferred the delay were expressing regret, we did not agree with LBG's interpretation of the survey results. There is no reason to assume that the willingness to pay for the delay was an estimate of the amount by which these consumers had overestimated their demand for PPI; rather, the willingness to pay measures the amount by which these consumers' surplus will increase if they are able to buy later. By interpreting the positive willingness to pay as a measure of the regret, LBG's modelling approach did not allow for the fact that the consumer surplus of consumers who prefer to buy later will increase after the POSP is in place. We did not agree with this; we think it is correct to assume that consumers who expressed a strong preference for buying PPI later will be made better off by our remedies.

35. While we did not agree with LBG that the positive willingness to pay results were related to 'buyer regret', we thought that it was possible that some PPI consumers may not have bought PPI if they had had the time and space to think about their purchase ('unwanted sales'). These unwanted sales come from the fact that some PPI customers, given the possibility to think about their purchase, may decide that their valuation of PPI is less than the price they paid for PPI. The possible presence of PPI consumers who would not have bought PPI if they had the time to think was not taken into account into our base case for the modelling. However, we conducted a sensitivity test to check the robustness of the results from our model to the presence of consumers who would not have bought PPI if they had had time to think. If some sales of PPI were in fact unwanted, we considered that the impact on welfare calculations would be the following (compared to our base case):

(a) PPI consumer surplus pre-remedy will be lower than in our base case, because a proportion of consumers are purchasing PPI even though the surplus they derive from PPI is lower than the price they pay.

(b) PPI consumer surplus after the remedy may be lower or higher than in our base case: total PPI sales after the remedies would be lower than in our base case, which tends to decrease consumer surplus, but the customers who cease buying PPI given time to think may be better off.

36. The impact of unwanted sales is therefore to depress the amount of PPI sales pre and post remedy which are relevant to the calculation of consumer welfare. To take into account the possibility of unwanted sales, we therefore conducted a sensitivity check to the size of the PPI market. We assumed that PPI 'wanted sales' before the remedy were in fact half of their level in the base case. The results of these sensitivity checks are reported in Appendix J.

37. LBG also told us that it made no sense to attribute additional positive valuations for the delay to consumers who have not bought the product in the past (and enter the market due to price cuts brought about by the remedy). We did not agree; we did not see any reason to assume that consumers who would start buying PPI because of lower prices would be fundamentally different from consumers who are currently buying PPI in their preferences for buying at the point of sale or buying later. Accordingly, for PLPPI, we assumed that 60 per cent of new PPI consumers would be in-

convenienced by the delay, but that 30 per cent of new PPI consumers would prefer buying after a delay.

Evidence on consumers' 'myopia'

38. As set out above, in the base model we assumed that all consumers were myopic after the remedies are in force. The implication of this assumption is that, in our base model, the volumes of credit purchased decrease when the remedies are in place. Indeed, the lower PPI prices after the remedies feed through to higher credit prices. If consumers are myopic, so that they do not anticipate that the total price of purchasing PPI and credit has decreased, but only observe that the credit price has increased, the demand for credit is likely to decrease after the remedies are in place.

39. The assumption that all consumers are myopic can be thought of as a conservative assumption. If we remove the assumption that all consumers are myopic, and instead assume that a proportion of consumers anticipate the lower price of PPI prior to making credit decisions, the demand for credit and PPI after the remedies will be higher than if we assume that all consumers are myopic. This is because some consumers now anticipate the lower PPI price before making decisions about credit decision. This implies that consumer welfare is higher, after the remedies, the larger the proportion of consumers who search for PPI prior to making decisions on credit.

40. There were several reasons why we did not think that all consumers could be expected to act myopically once the remedies are in force.

41. First, a proportion of consumers currently search for PPI prior to purchasing, and we saw no reason for them to search less if remedies to encourage search were introduced.

42. A survey conducted for us by GfK in 2008[4] found the following for PLPPI, MPPI and SMPPI.

> 21% of MPPI customers, who had not bought their PPI through a broker or IFA, compared either protected loans or stand-alone PPI policies, as did 11% of SMPPI and 12% of PLPPI customers. MPPI customers were more likely to compare both protected loans and stand-alone PPI policies, whereas SMPPI and PLPPI customers were more likely to compare protected loans only.
>
> Those who had not compared either protected loans or stand-alone PPI policies from another company were asked whether they were aware at the time they applied for the credit that they could buy from another provider. 42% of MPPI Non-Comparers believed they could only buy from their credit provider, as did 72% of SMPPI and 73% of PLPPI Non-Comparers. Among those aware they could buy from another provider, the main barriers to shopping around were lack of time, a preference among Non-Comparers for dealing with a company that they already know, and the convenience of buying credit and PPI at the same time from the same provider. This was evident for each type of PPI product.

[4]PPI Search Behaviour, April 2008, paragraphs 2 and 3. See: www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/consumer_research_behaviour_report.pdf.

43. A survey of PLPPI, MPPI, SMPPI and CCPPI customers conducted for us by BMRB in 2007[5] found that the percentage of consumers who had considered buying PPI before the credit point of sale was as set out in Table 1.

TABLE 1 **How the customer felt about PPI before approaching the lender**

per cent

	MPPI (477 respondents)	*SMPPI (617 respondents)*	*PLPPI (588 respondents)*	*CCPPI (601 respondents)*
Had not considered PPI	49	66	70	76
Considered PPI and decided to purchase	31	21	18	15
Considered PPI and wanted to discuss with lender	19	10	8	6
Considered PPI and decided not to purchase	2	1	3	2
Don't know	-	2	1	1

Source: CC, based on BMRB 2007 survey results.

44. We also noted that BMRB found that many consumers thought they could not buy PPI elsewhere (between 60 and 65 per cent of PLPPI, SMPPI and CCPPI consumers; for MPPI the proportion was 34 per cent) and between one-quarter and just over half of respondents for each product thought that their credit application was more likely be accepted if they bought PPI (Figures 4.5 and 4.6 of the BMRB report). In our view, if more of these consumers had realized they could have bought PPI elsewhere, and that buying PPI at the same time as credit did not affect their credit application, the levels of search could have been expected to have been higher.

45. Second, we expect that the remedies will improve the ability of consumers to search for PPI price at the same time as credit price (see paragraph 10.487 of the 2009 report). We noted in paragraph 10.487 that we were confident that the POSP would give providers an incentive to increase advertising of their stand-alone products. We also note that it will be in distributors' interest to inform consumers in order to reduce consumer myopia and thereby increase credit and PPI sales after the remedies are in place.

How the model was amended for non-myopic consumers

46. In the base case model, there are some consumers who cease taking out credit because they observe an increase in the price of credit, even though some of these consumers would have taken out credit and PPI if they had observed that the price of taking out both together has decreased. We built on the base model to introduce a proportion of consumers who take into account the lower price of PPI before making decisions about credit—that is to say that a proportion of consumers who see the credit price rise still take out credit because they also see the PPI price reduce.

47. Compared with the base model where no consumers search for PPI before making credit decisions, we expect the following to happen if a proportion of credit consumers now search for PPI before deciding whether to purchase credit:

   (a) The demand for unprotected credit should not change compared with the base model. Indeed, the consumers who bought credit in the base model and decided not to take out PPI having observed the price of PPI should not change their purchasing behaviour if they can observe the price of PPI before the credit sale.

[5]See: www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/consumer_research_ppi_feb.pdf.

(b) The demand for protected credit, however, should increase, because some consumers now observe that the price of purchasing credit and PPI together has decreased.

The second effect is difficult to model because we need to make assumptions on the demand by consumers for the bundle of credit and PPI depending on the total price of credit and PPI.

48. We built on the results of the base model by examining the demand by consumers who cease purchasing credit if they cannot observe the price of PPI prior to making the decision about credit. We started by observing that, if there were perfect information on PPI prices prior to the credit point of sale, the effect of remedies on the total demand for credit is indeterminate:

(a) demand for credit by consumers who value PPI very little will decrease because the price for credit alone has increased; but

(b) the demand for credit by consumers who attach value to PPI at the lower post-remedy prices increases because the price of purchasing PPI and credit together has decreased.

49. In the absence of information on the size of each of these effects, we assumed that total credit demand would not increase after the remedies are in place. Starting from the output of the base model where all consumers are myopic, we assume now that a proportion of the credit consumers who did not buy credit in the base model now observe the price of PPI prior to making credit decision. We assume that the consumers who ceased purchasing credit in the base model are equally as likely, if they had observed the PPI price, to have purchased PPI and credit together as the consumers who bought credit. This approach is used to derive the impact of the remedies on consumer welfare if a proportion of credit consumers can observe the price of PPI prior to making decisions on credit after the remedies are in place.

50. With these assumptions, if we now assume that all credit consumers observe the price of PPI prior to making decisions on credit, the inverse demand curve for PPI after the remedies will not pivot inwards because of the reduction in credit volumes (before taking into account effect of convenience). If the proportion of consumers who search for PPI before buying credit is between 0 and 100 per cent, the inverse demand curve for PPI will pivot inwards (before taking into account the effect of convenience), but less than in the base model.

Other possible effects on consumers not taken into account in the modelling

51. In our consultation on our approach to modelling, several parties commented that some possible effects of the package of remedies were not taken into account in the model we developed. These comments, and our response to these comments, are set out in Appendix H.

52. After the publication of the remittal provisional decision, one distributor (LBG) commented that our modelling approach was incomplete, and that:

(a) the model overstated the extent of the welfare problem associated with above-cost PPI prices by failing to analyse the extent to which the existing price structure leads to prices of protected and unprotected credit being out of line with underlying costs; and

(b) the model systematically underestimated the adverse impact on both credit and PPI demand of targeting of credit price increases and use of cut-offs.

53. LBG said that the model materially overstated the welfare distortion associated with the current price structure, because the extent to which current prices deviated from the underlying costs of providing protected and unprotected credit was much less material than our analysis suggests. LBG said that this was because PPI consumers tended to have higher impairment costs than other credit consumers. In other words, LBG argued that the high PPI price was partly explained by the fact that PPI consumers had higher credit costs.

54. We had already considered this in the 2009 report. In the 2009 report, we found that credit consumers who had purchased PPI—and those with higher credit risk scores in particular—were more likely to enter into arrears or default on credit repayments than credit consumers without PPI (paragraph 10.436). However, our analysis showed that much of the difference in impairment experience between insured and uninsured credit consumers was likely to have been caused by the interaction of high PPI prices and adverse selection. We concluded, that, as this information was not used efficiently by distributors, and much of the difference in impairment could be explained by high PPI prices, there was no relevant customer benefit lost if distributors would not find out when selling credit whether or not a consumer would take out PPI (see paragraph 10.441 of the 2009 report).

55. LBG said that the CC's reasoning set out in the 2009 report for dismissing the relevance of this issue was unconvincing, a comment we noted but disagreed with. It also said that the extent to which the CC's estimate of welfare distortions was overstated was likely to have increased since the 2009 report, reflecting further deterioration in loan performance since 2008.

56. To support this, LBG provided evidence according to which the ratio of impairments to loan balances had increased in 2009, across both Lloyds TSB and HBOS: impairments ratios were [✂] per cent in 2006, [✂] per cent in 2007, [✂] per cent in 2008, and [✂] per cent in 2009. However, the argument put forward by LBG relates to the difference in impairment experience between PPI and non-PPI credit consumers. We therefore asked LBG to provide data on the ratio of impairments to loan balances for PPI consumers and for non-PPI consumers. [✂] Given that [✂], it was not clear to us that there was a trend towards an increase in the gap in impairments, and we concluded that the reasoning set out in the 2009 report still held.

57. LBG told us that our welfare analysis systematically underestimated the adverse impact on both credit and PPI demand of targeting of credit price increases and use of cut-offs. LBG said that, if distributors target credit price increases to consumer segments with higher PPI penetration rates, the potential loss of consumer surplus is much more significant than the CC's estimates. Indeed, some customer segments have higher PPI take-up rates than others. If LBG targets credit price increases to these consumers, the fall in credit demand after the remedies are in place will be geared towards the consumers who are more likely to take out PPI, and therefore the effect of the fall in credit demand on PPI demand could be larger than estimated by our model.

58. We recognized that there was a possibility that this could occur (as set out in footnote 5 of Appendix 10.9 of the 2009 report). However, there are a number of conditions for this to hold, and we do not think that these will hold.

59. If distributors target credit price increases to consumer segments with higher PPI penetration rates, we do not think that this will necessarily have an impact on the

demand for credit by consumers in segments with high PPI penetration (relative to the situation where distributors cannot target price increases). Indeed, the hypothesized fall in credit demand by these consumers that has been suggested by LBG relies heavily on the assumption that these consumers are myopic and do not anticipate that the price of the bundle of credit and PPI (which is most relevant to these consumers with high PPI penetration rates) has fallen. Even if these consumers are myopic, at the point of choosing whether or not to ask for credit, most consumers will be aware of average APRs as advertised (rather than the actual APR based on their credit risk). Therefore, these consumers are unlikely to be deterred from applying for credit compared with the situation where credit price increases are not targeted (the average APR should stay about the same).

60. Most likely, the high-risk consumers will only know the actual price of credit that they will pay when they receive a quote from a credit provider. At that point, they should also be made aware of the PPI price. Therefore, at the point of making a decision on credit, they will know that the PPI price is low, and therefore the fact that the credit price has increased for the consumers with high PPI penetration is unlikely to dissuade these from taking out credit and PPI. In other words, the consumer myopia argument works mainly at a very initial level, which is whether or not to approach a credit provider for a quote. Consumers may be dissuaded from asking for a quote by higher average APRs, but the distribution of APRs by credit risk is more information that they would have at that time.

61. This is the main reason why we think that targeting of credit price increases will not have a material impact on our welfare estimates. In addition to this, even if targeting of price increases did have an impact on the demand for credit by consumers with high PPI penetration, it is not necessarily the case that this will result in a fall in PPI demand. Indeed, the demand for credit by consumers with low PPI penetration rate should increase compared with the situation where there is not targeting. These consumers, although they demand little PPI at present, may be those whose demand for PPI increases most after the remedies because these are the consumers who were dissuaded from buying PPI by the high PPI prices. In other words, the low penetration today does not mean that these consumers could in fact suggest that these consumers are those whose demand for PPI is most likely to increase if the price of PPI falls.

62. LBG also said that we had ignored the impact of the contraction of credit associated with distributors seeking to restore system profitability by raising cut-offs. LBG said that the use of cut-offs had a particularly adverse impact on welfare because it led to lost credit demand from consumers who may place a high valuation on purchasing PPI and/or credit, so that the remedy would deter not just marginal consumers but infra-marginal consumers too. In other words, if distributors raise credit cut-off scores rather than increase credit prices after the remedies are in place, LBG submitted that this would have additional negative effects on consumer welfare not captured in the CC's welfare modelling. LBG submitted analysis which it said demonstrated the sensitivity of welfare estimates to this issue.[6] However, it was not clear to us why it would be in distributors' interests to increase credit score cut-offs (thereby restricting even more their credit sales) rather than increase credit prices. We asked LBG to explain why this would be the case, and its response was: [✄].

63. LBG's answer made it clear to us that [✄]. We noted that, [✄], it would be rational for [✄] distributors to increase credit prices (rather than raise cut-off scores) as there are profits to be made by doing so. [✄]. As long as some distributors do not raise

[6]LBG response to provisional decisions, Appendix 2, paragraphs 2.5.7–2.5.9.

cut-offs, credit consumers would not be pushed out of the market, and therefore we do not think that [✄] has a material impact on our welfare estimates.

Updates to the inputs of the model

64. We now set out how we updated the inputs to the model. We started from the inputs which were used in the 2009 report to estimate the net consumer benefits from the remedies. We updated these inputs to reflect changes in market conditions since the 2009 report was published, to incorporate the costs of the remedies, and to take into account the difference between the market-level and firm-level price elasticity of demand.

Updates to reflect changes in market conditions

65. Many parties told us that market conditions had changed since the 2009 report was published, and that this should be taken into account. We set out here our approach to updating the different inputs to the model. Our general approach to updating the inputs was to try to model what we expect to happen in 2011 and beyond, when we would expect the package of remedies to be in place.

Margins

66. We assumed that, after the remedies, the price of PPI would reduce to the level such that distributors no longer make excess profits on PPI ('competitive PPI price'). To calculate the competitive PPI price, we used information on excess profit margins, as derived from the profitability analysis in Appendix A. These indicate the amount by which the PPI price in the absence of the remedy is in excess of the price that we would expect in a competitive market.[7] These are equal to:

$$m = \frac{\text{Pre - tax excess profit – Capital cost}}{GWP}$$

67. We consider that neither 2006 nor 2009 are representative of excess profit margins from 2011 onwards. 2006 may be a period of lower claims and higher sales, whereas 2009 may be a period of higher claims and lower sales. We therefore used the average excess profit margin on PPI for the five years to 2009 for MPPI and CCPPI. For SMPPI, we used the average margin for 2005 to 2008 because the 2009 figure was abnormally high and only included data from one provider.

68. For PLPPI, we used the average for the years 2005 to 2008. This is because margins for 2009 were not comparable to the margins in previous years because of the move to regular-premium policies. As set out in paragraph 24 of Appendix A, the move from single-premium to regular-premium policies[8] coupled with rebates on cancelled single-premium policies outweighing the sum of GWP received on existing and new policies, had a large impact, resulting in negative GWP for PLPPI in 2009.

69. To allow for a possible increase in claims in 2009, we adjusted the average margin for years 2005 to 2008 down by seven percentage points. We considered this to be a very cautious assumption. Indeed, in order for the average PLPPI margin for 2005 to

[7] This is before consideration of the costs of the remedies, which were then added to the competitive PPI price to derive the price that we expect after the remedies are in place.
[8] Because, with regular-premium policies, the GWP is spread over the life of the policy, whereas with single-premium policies all the premiums are received in the year in which the policy is sold.

2009 to be equal to 55 per cent (the value we used in the modelling), margins for 2009 would have needed to be around 28 per cent. This is very low compared with the margins in previous years: a drop between 50 and 60 per cent.

70. The margins used in the model are set out in Table 2.

TABLE 2 **Margins used for modelling**

per cent

Margin	*2005*	*2006*	*2007*	*2008*	*2009*	*Average margin, 2005 to 2009*	*Margin assumption in the modelling*
PLPPI	58	54	64	73	–8	62*	55
MPPI	43	46	48	46	25	42	42
CCPPI	60	60	63	63	49	59	59
SMPPI	37	39	40	56	88	43*	43

Source: CC, based on data from PPI distributors.

*For PLPPI and SMPPI, average 2005 to 2008.

71. LBG told us that we had overstated the potential effectiveness of the remedy, because the assumed price cut was based on an unreasonable extrapolation from historic data. It said that, implicit in the CC's updated profitability analysis was an assumption that all costs were variable, but that in practice, costs might only fall by those costs that are avoidable.

72. We do not agree with LBG. We did not assume that all costs are variable. For cost of capital we maintained the equity for 2009 at 2008 levels despite the fall in GWP/ revenues (the equity is based on a percentage of revenues). But we decided that it is fair to assume that other costs (namely cost of selling PPI) are variable. We were cautious in our estimate of the cost of selling PPI (see paragraph 56 of Appendix 4.4 of the 2009 report). Therefore, we do not think that the way in which we calculated the margins overstates the potential effectiveness of the remedy.

Excess profits

73. The output from the model is an estimate of the change in consumer welfare as a proportion of pre-remedy PPI excess profits. Data on excess profits is therefore used to translate the results of the model to an estimate of annual consumer benefits or detriments after the remedies are in place.

74. To estimate the effects of the package of remedies on consumer welfare, we used as our starting point the average excess profits for the period 2005 to 2009 for each type of PPI. These are set out in Table 10 of Appendix A.

75. The rationale for using average excess profits for the period 2005 to 2009 as our departing point was the following: we are interested in what will happen in 2011 and beyond, when we would expect the package of remedies to be in place. Rather than trying to predict what the sales of PPI would be in the absence of remedies, we started from the position that past sales were a reasonable starting point. For the reasons set out above (see paragraphs 67 and 68), we do not think that PPI sales and excess profits in 2009 are representative of the level of excess profits and sales that may prevail from 2011 if no remedies are in place. We therefore decided to use average excess profits over 2005 to 2009 as a starting point—ie including both years of high PPI sales and low PPI sales.

76. This should not be interpreted as a prediction regarding the size of the PPI market going forward. Indeed, there are many factors which mean that the volume of PPI sales (with or without remedies) may be smaller, or larger, than the average of sales over the past five years. It is difficult to predict whether, absent the remedies, the adverse effect of the negative publicity associated with high prices may reduce, stabilize, or continue to have a negative effect on sales of PPI. Sales of PPI are also highly dependent on sales of credit, which we cannot predict. The size of the PPI market with remedies in place is equally difficult to predict. There are several factors which are not taken into account in the modelling, which could mean that sales of PPI after the remedies increase more, or less, than predicted by our model. On the one hand, there may be some sales lost to PPI because of the fact that some consumers decide not to purchase PPI given the time and space to think about PPI.[9] On the other hand, we expect that, over time, greater competition will produce longer-term benefits: for instance, by arresting the decline of the PPI sector due to negative publicity, which could lead to a greater volume effect than that arising from the price reduction.

77. To take into account the degree of uncertainty regarding future sales of PPI and excess profits, we therefore tested the sensitivity of our results to level of PPI sales and excess profits, by calculating the welfare implications of the model if the size of PPI excess profits were only half as large as the average for 2005 to 2009.

Penetration rates

78. Penetration rates are set out in Table 4 of Appendix A. PLPPI and SMPPI penetration rates have continued their declining trend in 2008 and 2009, whereas CCPPI penetration rates have not changed significantly since 2006, and MPPI penetration rates increased slightly in 2009.

79. We used 2009 data for penetration rates for PLPPI, MPPI and CCPPI. For SMPPI we used 2008 data: 2009 is highly unusual being based on data from only one distributor.

Price of PPI relative to credit

80. The evidence we received from distributors suggested that, in many cases, the price of credit had increased since 2006, while the PPI price had remained constant in many cases. This indicated that the price of PPI relative to credit is likely to have decreased since 2006.

81. However, we did not have as precise information on the relative price of PPI to credit as we had gathered in the 2009 report. We therefore continued to use the same inputs on PPI and credit prices as in the 2009 report, but conducted sensitivities to check how the results changed if we assumed that credit price had increased relative to PPI.

82. Barclays told us that the price we used for credit in the modelling was not the same as the price that was used in the 2009 report. We noted that we had used several assumptions for the price of credit in the 2009 report. To quantify the benefits from the remedies (estimated in paragraph 10.494 of the 2009 report), the calculations were based on a price of PPI equal to 53 per cent of the price of the bundle of credit

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[9] Although we do not expect this effect to be significant when the remedy is in place—see paragraph 5.18.

and PPI for PLPPI. This is the number which we used as our base case for the remittal.

Extent of the waterbed effect

83. In the 2009 report, we assumed a pass-through of PPI profits to credit of 80 or 100 per cent to calculate the benefits arising from the package of remedies. The assumption of 100 per cent pass-through was presented as a cautious assumption: even if there was 100 per cent pass-through, we found that consumer benefits from the remedies would be in excess of £200 million per year (see paragraph 10.494 of the 2009 report).

84. Further analysis of the evidence suggested to us that it was likely that the amount of pass-through would be below 100 per cent.

85. First of all, we noted in the 2009 report that the credit crunch may have had an effect on the amount of waterbed (see paragraphs 10.461 to 10.463 of the 2009 report).

86. We also found some indications that the recent economic conditions may have had an impact on the amount of cross-subsidization. There is strong evidence that the price of credit has increased as a result of the credit crunch. LBG disputed that this was an indication that the waterbed effect was less. We accept that this evidence, on its own, does not indicate that the waterbed has reduced, as there are many other reasons for which the price of credit has increased.

87. We also found some references to a reduction in cross-subsidization in internal documents. [✄] presented the pricing for the regular-premium product replacing [✄] single-premium PPI product. The document stated that 'In the past, loan PPI prices were set in conjunction with the APR of the underlying loan as there was a cross-subsidy between the two. However loans are now priced to be self-funding and so the cross-subsidy no longer needs to be considered'.

88. One major distributor (Barclays) told us consistently from the start of our investigation that it did not cross-subsidize credit prices with PPI profits. We thought that this was strong evidence that, for the market as a whole, the waterbed effect would be well below 100 per cent, and this was reinforced by the evidence in the previous paragraph.

89. This would suggest that a conservative approach on the waterbed could be to assume 80 per cent waterbed as our upper bound, rather than between 80 and 100 per cent as in the 2009 report.

90. Barclays told us, in the response to the modelling consultation, that it would be useful for the CC to develop an economic model which allowed for the cross effects between credit and PPI prices to be identified, and then evaluated empirically, and that a natural framework would be a model of monopolistic competition. We attempted to relax the assumption of perfect competition in the credit markets in order to derive the optimal amount of waterbed. We found that this model tended to support the assumption that the waterbed effect was less than 100 per cent. Using the same base values for inputs used in the base case model, we found that, if the degree of competition between loan providers is such that firm-level elasticities of demand for loans are around –3 to –5 at current credit prices, the prices of personal loans before intervention are about 13 per cent lower than they would be if there were no cross-subsidy from PPI. This translates, in our model, to a waterbed effect of about 80 per cent of PPI excess profits competed away in the credit market. We

noted that Barclays' estimate of the firm-level elasticity of demand for personal loans was about –3 (see below).

91. We also note that, in [✂] had forecast that loan prices would need to increase to coincide with the PPI decoupling in October 2010. In this document, [✂] forecast an increase in [✂] average APRs by about one percentage point (from 14 per cent to 15 per cent), ie a 7 per cent increase. It forecast a smaller increase in [✂] APRs to coincide with the decoupling. These levels of price increases in credit would be compatible with a degree of pass-through of PPI profits below 80 per cent.

92. Barclays, LBG and HSBC commented on the assumption of 80 per cent pass-through for our base case. Barclays told us that there was no evidential basis for assuming a waterbed effect of 80 per cent, and that a theoretical model could not be used as evidence for using 80 per cent as our base number.

93. HSBC said that the basis for the change in assumption (from 100 per cent or 80 per cent, to 80 per cent) was not robustly set out. HSBC told us that the reduction in cross-subsidization, if it had occurred, appeared to be related to the current conditions in credit markets, and that the CC had not considered whether these conditions would persist in this context.

94. LBG said that the CC revised its waterbed assumption based on what appeared to be weak reasoning and there was little or no empirical support for the revised assumption of 80 per cent. LBG said that the move to stand-alone profitability by some distributors might reflect the need for distributors to prepare for a post-remedy world where PPI take-up rates might be substantially lower. LBG disputed our use of the model suggested by Barclays to derive the amount of waterbed, and pointed out the possible inconsistency which arose by using this model to derive the waterbed, but not following through to use it to derive the effects of the remedy. LBG said that, if we assumed the same degree of competition in credit as was assumed for PPI in the imperfect competition model, this would imply a waterbed effect in the region of 95 per cent.

95. We agreed with Barclays and LBG that the use of the model of imperfect competition to derive the amount of waterbed could be inconsistent with our use of a model of perfect competition for quantifying the benefits, and therefore could not be used as a basis to justify a specific amount of pass-through.

96. However, we did not agree with the parties that using an 80 per cent waterbed pass-through as our base case represented a large change in approach compared with the 2009 report. Indeed, the 2009 report calculated consumer welfare from the remedies using two different assumptions: a 100 per cent pass-through assumption, and an 80 per cent pass-through assumption. The assumption of 100 per cent pass-through was presented as a somewhat extreme assumption, reflecting a cautious approach.[10] Consumer welfare was also calculated for an 80 per cent pass-through assumption.

97. We think that the evidence on the impact of the credit crunch on incentives to lower credit prices, the evidence that some large distributors (eg Barclays and HBOS) do not currently cross-subsidize prices, and one says that it never did (Barclays), strongly suggest that the degree of pass-through is likely to be well below 100 per

[10]In paragraph 10.491 of the 2009 report, we noted that under certain circumstances, where a number of fairly extreme assumptions combined, intervention might not be welfare enhancing. The degree of pass-through of 100 per cent is one of these 'fairly extreme assumptions'. In paragraph 10.494, where we calculate the consumer benefits from intervention, it is made clear that the 100 per cent pass-through assumption is a conservative assumption: 'Even if we assumed that all PPI profits are used to fund lower credit prices, we found that these considerations implied an annual net deadweight loss [..] in excess of £200 million.'

cent. In our view, the strongest evidence that the amount of pass-through was likely to be at most 80 per cent was the fact that Barclays told us that it did not pass through PPI profits to credit, and the evidence that HBOS had ceased to cross-subsidize. Given that these two players account for at least 25 per cent of sales of PPI, we think this would imply that, on average for the whole market, the amount of pass-through of PPI profits is unlikely to be more than 80 per cent. Although it is not possible to determine precisely the degree of pass-through, we thought that using the 80 per cent assumption that was used in the 2009 report would be reasonable, and checked the sensitivity of our results to higher, and lower, degrees of profit pass-through.

The costs of implementing the remedies

98. There are two categories of costs of implementing the remedies: ongoing costs, which are incurred yearly, and one-off implementation costs. We incorporated the ongoing costs of implementing the remedies in the model, adding the estimated unit ongoing costs of implementation to our calculation of the post-remedy unit costs, and therefore to the estimate of the price that will prevail when the remedies are in place.

99. Regarding the one-off implementation costs, because of their nature, we did not expect that these would be passed on to consumers in the form of higher PPI prices, unless they affected the long-term profitability of selling PPI. Given the evidence presented in Section 6 of the report of distributors' plans with the POSP in place, we did not think that these one-off costs would affect the long-term profitability of selling PPI. Therefore, we did not incorporate the one-off costs of implementation in our estimate of the price that will prevail after the remedies are in place in the base case. Instead we used the model to calculate a net benefit or detriment to consumers and compared that number with the one-off implementation costs.

100. However, a number of parties told us, in response to the modelling consultation, that one-off implementation costs might in future be passed on to consumers, and should therefore be taken into account in the modelling in the form of higher costs after the remedies. Barclays told us that spreading the one-off costs over a number of years would be the appropriate way to model the impact of the one-off costs on PPI pricing.

101. We therefore conducted some sensitivity analysis to see whether the inclusion of one-off costs into the pricing of PPI after the remedies would change the results of the modelling. To do so, we included an allowance for the one-off costs of implementation in the average costs after the remedies (which are used to estimate the price of PPI after the remedies), such that the one-off costs are spread over a period of three to five years.

102. In light of the new evidence available to us we concluded in Appendix K that the one-off costs of implementing the remedy package for PLPPI, MPPI, SMPPI and CCPPI would be in the range £61–£69 million and the ongoing costs of implementation in the range of £37–£42 million.

103. We split these costs between the different PPI products, based on the proportion of policies sold in 2007, as set out in Table 7.1. This gave us the split of ongoing and one-off implementation costs set out in Table 3.

TABLE 3 **Split of ongoing and one-off implementation costs between PPI products**

Product	*Number of policies sold in 2007*	*Proportion of total PPI sales %*	*Upper bound ongoing costs of implementation £m*	*Upper bound one-off costs of implementation £m*
PLPPI	1,667,123	48	20.2	33.2
MPPI	427,354	12	5.2	8.5
CCPPI	1,293,514	37	15.7	25.7
SMPPI	78,524	2	1.0	1.6
Total	3,466,515	100	42	69

Source: CC, based on data from distributors.

104. Table 4, which uses information on the 2008 GWP and the margins as set out in Table 1, shows how the inclusion of the ongoing costs of implementation of the remedies affects our estimates of the overall costs of selling PPI after the remedies. We use the upper-bound estimates for the ongoing costs here.

TABLE 4 **Impact of ongoing implementation costs on the costs of selling PPI**

£ million

	PLPPI	*MPPI*	*CCPPI*	*SMPPI*
GWP	1,224	287	622	169
Pre-remedy costs (including capital costs and underwriter commission)	551	166	255	96
Ongoing cost of implementation	20	5	16	1
Increase in costs after the remedies (%)	4	3	6	1

Source: CC analysis, based on data from distributors.

105. If we add the ongoing costs of implementation of the remedies to the other costs of selling PPI, the total costs per policy increase by between 1 per cent (for SMPPI) and 6 per cent (for CCPPI). We used these results in order to estimate the post-remedy unit cost per policy in the modelling.

106. As set out above, we conducted sensitivity analysis to check whether the results changed if we also included an allowance for one-off remedies implementation costs to be passed on to consumers in the form of higher PPI prices. To do so, we assumed that one-off costs would be recovered from consumers over three to five years. Table 5 shows how including the one-off and ongoing implementation costs changes the estimates of the costs of selling PPI after the remedies are in place.

TABLE 5 **Impact of ongoing and one-off implementation costs on the costs of selling PPI**

£ million

	PLPPI	*MPPI*	*CCPPI*	*SMPPI*
GWP	1,224	287	622	169
Pre-remedy costs (including capital costs and underwriter commission)*	551	166	255	96
Ongoing cost of implementation	20.2	5.2	15.7	1.0
One-off costs of implementation, spread over three years	11.1	2.8	8.6	0.5
One-off costs of implementation, spread over five years	6.6	1.7	5.1	0.3
Increase in costs taking into account ongoing costs of implementation and one-off costs spread over 3 years (%)	6	5	10	2
Increase in costs taking into account ongoing costs of implementation and one-off costs spread over 5 years (%)	5	4	8	1

Source: CC analysis, based on data from distributors.

107. The costs of selling PPI then increase by between 2 per cent (for SMPPI) and 10 per cent (for CCPPI) after the remedies are in place, if we take into account both ongoing and one-off implementation costs (spread over three years) in the pricing of PPI. These estimates were used to conduct sensitivity analysis.

Marketing and advertising costs

108. For the marketing and advertising costs, we included these additional costs to the post-remedy price.

109. There is little, if any, information on the amount of expenditure on advertising in the post-remedy world in the distributors' internal plans. Looking at 'comparable industries', the advertising statistics yearbook of 2009 reports the following advertising-to-sales ratios in the insurance and finance products sectors in 2007:

- motor insurance: 8.79 per cent;
- home insurance: 4.13 per cent;
- motorcycle insurance: 0.23 per cent;
- private healthcare insurance: 1.08 per cent;
- life protection: 0.28 per cent; and
- other financial services: 0.58 per cent.

110. The 2006 Mintel report on travel insurance reported total advertising spend of about £4.21 million for a total market (GWP) of about £660 million; ie an advertising-to-sales ratio of 0.6 per cent.

111. There is clearly some variation in the amount of advertising across different insurance and credit products. The average advertising-to-sales ratio across all insurance

products and credit products for which we have data is around 2 per cent, and we used this figure to estimate the expenditure on advertising post-remedies.

The elasticity of the demand for PPI

112. The Tribunal said in its judgment that the wrong elasticity of demand for PPI was applied in the modelling (firm-level rather than market-level elasticity of demand), and that this error of methodology ought to be reconsidered as part of the CC's general reconsideration whether to impose the POSP (paragraphs 171 to 175 of the Tribunal's judgment).

113. In principle, we agree that we should use the market elasticity of demand for the modelling, and that the market-level elasticity will be lower than the firm-level elasticity. The difference between firm and market-level elasticity is the amount of cross-substitution in the event of a price increase by a PPI distributor: if a PPI distributor increases PPI prices, the overall effect on this distributor's sales of PPI (ie the firm-level elasticity) will be a combination of the market-level substitution (amount of sales which are lost to PPI) and cross-substitution (amount of sales which are diverted to a different PPI distributor).

114. We first examine the evidence in the 2009 report on the level of cross-substitution between PPI distributors. We then examine the evidence put forward by the parties on the level of the market-price elasticity for PPI.

Evidence on the amount of cross-substitution between PPI distributors in the 2009 report

115. We did not obtain direct estimates of the amount of cross-substitution between PPI providers in the event of a small price increase by one PPI provider. However, the evidence which is presented in Sections 3 and 4 of the 2009 report generally points towards very low levels of cross-substitution between PPI providers.

116. We concluded in paragraph 3.4 of the 2009 report that there was limited substitutability between PPI policies offered by different distributors and intermediaries, and limited switching by consumers between PPI providers. This was supported by the evidence from the internal documents and oral evidence from distributors, which indicated that relatively few consumers shop around for PPI policies or combinations of PPI and credit, as well as our analysis of the evidence on consumers' search and switching patterns, which indicated that relatively few consumers shop around for PPI policies or combinations of PPI and credit (see paragraphs 3.34 to 3.74 of the 2009 report).

117. In Section 4 of the 2009 report, we analysed evidence on the extent of competition between PPI providers. We concluded, on the basis of this evidence, that there is no effective competition in the supply of PLPPI, MPPI, SMPPI or CCPPI (paragraph 4.96). The evidence of lack of competition between PPI providers also suggests to us that the amount of cross-substitution between PPI providers is very low, in the absence of a finding of coordinated behaviour between PPI providers.

118. In conclusion, in our judgement the balance of evidence presented in Sections 3 and 4 of the 2009 report strongly suggests that the amount of cross-substitution between PPI providers is likely to be very low, and therefore that market-level price elasticity of demand is likely to be very similar to the firm-level elasticity of demand.

Evidence put forward by the parties

119. Barclays told us (in its response to our consultation document on the approach to modelling and again in response to the provisional decision on remedies) that the evidence and reasoning in the 2009 report indicated that there was a significant difference between firm and market-level elasticities for PPI.

120. Barclays told us that the GfK survey results, and the use of these results in Appendix 3.9 of the 2009 report, implied that substitution was not trivial in magnitude. Barclays said that a number of different elasticities, measuring switching among PPI products, were given in Table 4 of Appendix 3.9. The average value of these elasticities is about 0.85. We note that the elasticities in Table 4 of Appendix 3.9 which Barclays referred to were labelled as 'own price elasticities'. They are not cross-price elasticities.

121. We do not agree with Barclays' interpretation of the analysis in Appendix 3.9. Appendix 3.9 was one of the sources for our estimates of PPI firm-level demand elasticities (with the econometric analysis of PPI price increases, the analysis of margins, analysis of searching and switching etc). In Appendix 3.9, we analysed the GfK survey results on the proportion of consumers who search prior to purchasing credit in order to derive some estimates of the own-price elasticity of demand for PPI. The analysis in Appendix 3.9 implicitly assumed that the consumers who said that they had searched for PPI were the most price sensitive and hence the most likely to switch in the event of an increase in the price of PPI. However, this switching could be to an alternative PPI product, to a different type of insurance, or to self insurance (ceasing to buy PPI altogether).

122. We acknowledge, however, that it was not always made completely clear in Appendix 3.9 that we were looking both at substitution to other PPI distributors and substitution to different insurance or self insurance. While paragraph 15 clearly set out what we meant by own-price elasticity of demand, in other paragraphs (eg paragraphs 27 and 41), it was not made clear that switching could be to another provider of PPI, to another type of insurance, or ceasing purchasing PPI altogether. However, in Table 4 (which Barclays refers to), it is made clear that the elasticities calculated in column 2 (and which Barclays uses as cross-price elasticities) are own-price elasticities.[11]

123. Therefore, while we acknowledge that there may have been some scope for misunderstanding of the analysis presented in Appendix 3.9, we do not agree with Barclays' interpretation of this analysis. We conclude that the analysis presented in Appendix 3.9 does not enable us to infer the level of substitution between PPI distributors by consumers. The analysis in Appendix 3.9 derives some estimates of the firm-level elasticities of demand, which are consistent with estimates derived from other sources, and in particular the Lerner indices based on profit margins, which suggest elasticities very close to the levels derived from the analysis in the survey.

124. In its response to our consultation document, LBG told us that we should take into account the following pieces of evidence to estimate the market elasticity of the demand for PPI:

(a) The results from an econometric analysis by HBOS of past PPI sales, to establish a link between price and penetration rates for PPI.

[11] In Table 4, the third column entitled 'cross price' refers to the elasticity of credit demand to increases in PPI prices (as defined in paragraph 15 of the appendix), not to cross-price elasticities between PPI providers.

(b) The results from a pilot run by HBOS on the pricing of its new Lifestages product, comparing penetration rates four weeks before and four weeks after an increase in price by [50–60] per cent.

(c) The results from an econometric study by LBG of past PPI prices and penetration.

125. We considered this evidence. We first noted that the evidence submitted by LBG related to firm-level price elasticities of PPI, and did not shed light on the difference between market-level and firm-level price elasticity of demand for PPI. The econometric study submitted by LBG was not conclusive. Although the two studies by HBOS (paragraph 124*(a)* and *(b)* suggested that the firm-level elasticity of the demand for PPI may be lower than the estimate we found in the 2009 report, on inspection of the results we did not find that these were incompatible with our estimates of the firm-level elasticity of the demand for PPI. Our estimates were derived from a range of different sources (econometric analysis of all sales of PPI, Lerner indices and analysis of survey results), and encompassed a broader sample of sales because they covered all the main distributors of PPI. We are therefore confident that the balance of evidence supports our estimates of the own-price elasticity of demand for PPI.

126. The HBOS econometric analysis (paragraph 118*(a)*) found that there was a low level of sensitivity for small price decreases, but for larger price decreases, the results from its analysis suggested elasticities which are very similar to the estimates we derived in the 2009 report.

127. The results from the HBOS pilot (paragraph 118*(b)*) were that, when the price of Lifestages was very low, the price elasticity was lower than that implied by our analysis. However, the level of price at which this elasticity was calculated was apparently suboptimal, given that HBOS decided to increase the price by 50 per cent for Lifestages as a result of this pilot. The elasticity of the demand for a product will often be lower for lower price levels. We calculated that, with our estimate of the PPI elasticity and linear demands, the elasticity of demand if the price of PPI were 35 per cent lower than it is now would be very similar to that implied by the HBOS pilot. Moreover, the large variations in weekly penetration rates in the HBOS pilot (for weeks where the price was the same) suggested to us that there were large measurement errors in inferring levels of elasticity from the results of this pilot.

128. We therefore concluded that the evidence provided by LBG was not incompatible with the estimates of the firm-level elasticity of demand in the 2009 report. We noted that the estimates in the 2009 report were based on a number of different pieces of analysis, which all pointed to similar results. On balance, we therefore concluded that the own-price elasticities of demand for PPI that we used in the 2009 report were good estimates.

129. LBG told us that the CC's quantitative analysis in the 2009 report produced estimates using its preferred models of –0.4 to –1.2 for the firm-level elasticity of demand for PPI, suggesting that the market elasticity of demand for PPI may be lower than the estimate used in the modelling. We were not persuaded by this interpretation of the quantitative analysis in the 2009 report: the econometric analysis produced a range of estimates for the firm-level elasticities, some of which were lower and some of which were higher than the elasticity estimates based on the survey results and on the Lerner indices. We noted that a firm-level own-price elasticity of demand of –1.2 would suggest mark-ups of more than 83 per cent according to Lerner indices. Firm-level elasticities of around –1.5 would correspond to a mark-up of around 60 per cent, which is close to the mark-ups we found in the profitability analysis.

130. In the response to the provisional decision, LBG told us that the CC's dismissal of its own empirical evidence relied heavily on its cross-check to distributor price-cost margin. LBG told us that this ignored the fact that, in particular for vertically-integrated distributors, true price-cost margin would be much higher than that suggested by the CC's analysis. We did not agree with LBG's comment. First of all, we do not dismiss the empirical evidence, but note that it produces a wide range of estimates, and that in order to narrow the range we used the evidence on price cost margin. Second, we noted that, even if price cost margins were 70 to 80 per cent, this would imply firm-level elasticity of –1.2 to –1.4.

131. LBG also told us that, more fundamentally, the CC's cross-check for PLPPI failed to take into account the cross-price elasticity of demand for credit. We agree that we did not take these into account. However, for PLPPI, we found that the profitability of a 5 per cent increase in PLPPI prices was almost entirely dependent on the impact of PPI sales alone (see paragraphs 24 and 25 of Appendix 3.9 of the 2009 report). This is because of two factors: the majority of the revenue earned on a combination of loan and PPI consists of PPI premium and interest charged on that premium. Secondly, the profit margin on personal loans is very low, so the interest income earned on personal loans has a small effect on firms' overall profits. For these reasons, the firm-level elasticity estimates derived from standard Lerner indices will be a good indicator for the elasticity for PLPPI.

132. In conclusion, we think that the balance of evidence suggests that we used the correct levels for the firm-level price elasticity of demand for PPI, and that, in the absence of direct estimates of the amount of cross-substitution, the balance of evidence we gathered in the 2009 report indicates that the amount of cross-substitution between PPI distributors is very low. For these reasons, we think that the market-level price elasticity of demand is likely to be very similar to the firm-level price elasticity of demand. In the modelling, we therefore adjust the firm-level price elasticity estimates to allow for some limited cross effects; such that the market elasticity of demand is 10 per cent lower than the firm-level elasticity of demand in our base case. We also conduct sensitivity analysis, to check whether our results are robust to lower levels for the market elasticity of PPI demand.

Elasticity of credit demand

133. Welfare estimates derived using the waterbed model of the PPI market are dependent on the parameter used to reflect the responsiveness of credit demand to changes in the price of credit—the credit market elasticity. We conducted a survey of the academic literature in order to obtain a better-informed estimate of this parameter. We also examined information provided by the parties on the elasticity of demand for credit. We found that this supported the assumption we had made in the 2009 report that the market elasticity of demand for credit was likely to be around –0.8 for personal loans and credit cards. For mortgages, the evidence from the literature suggested that the elasticity may be somewhat higher, and therefore we updated the elasticity of demand to –1.

134. It seems probable that demand for personal loans will be inelastic. This is because, in most cases, we would not expect substitutes for personal loans to be widely available, and often consumers will have insufficient savings to prevent the use of credit from being a necessity. We would expect mortgage demand to be somewhat more responsive to changes in the interest rate because of the greater value of interest payments on mortgage loans as a proportion of income, and so the greater incentive for buyers to make an informed and well-timed decision.

Personal loans/credit cards

135. We are only aware of a small number of empirical analyses for the elasticity of credit (personal loans/credit cards). We examined whether any studies of consumer behaviour towards credit could shed light on the appropriate hypotheses to use in our model. Several studies (Hall (1988), Ausubel (1991), Gross and Souleles (2002), Attanasio, Goldberg and Kyriazidou (2007))[12] find low levels of market-wide elasticities of credit. The most relevant study is Gross and Souleles (2002). The authors analyse (among others) the elasticity of debt to interest rate using data on individual credit card accounts from several card issuers in the USA. They find that the average long-term elasticity of debt to interest rate is approximately –1.3. Less than half of this elasticity represents balance-shifting across cards (ie switching between firms in the market); the net long-run market elasticity is –0.85. Another relevant study is Attanasio et al (2007) on the demand for car financing loans in the USA. This paper seeks to estimate the elasticities of automobile loan demand with respect to interest rate and maturity; it finds low elasticities of demand for loans to interest, but the authors cannot reject the hypothesis that the elasticities are significantly different from zero. The authors conclude that consumers are highly sensitive to loan maturity, but unresponsive to changes in interest rates.

136. We note that all these studies use US data. The only study on elasticity of demand we found using EU data is a study of Italian instalment credit in Italy by Alessie, Hochguertel and Weber (2005).[13] This study, while highlighting the peculiarities of the Italian market, finds elasticities that are consistent with the findings for the US market, albeit slightly higher.

137. However, it should be noted that these estimates are based on data on credit applications received by the leading provider of consumer credit in Italy (Findomestic), and therefore the elasticity estimated may be closer to a firm-level elasticity than a market-level elasticity. The authors note that they do not have industry-wide demand data. However, the authors argue that Findomestic faces more competition in the North than in the Centre and in the South of Italy. In particular, in Central and Southern regions Findomestic has exclusive deals with retailers for many goods. Consequently, the authors argue that they may be able to interpret the estimates for these regions as relating to market demand function. The estimates for the South and Central regions lie between –0.8 and –1.5 depending on the particular assumptions made.

Mortgages

138. Evidence from Portugal on the behaviour of the demand for credit in the mortgage market was also evaluated, and this suggested that mortgage demand may be somewhat more elastic than demand for other types of credit, with a derived parameter of –2.4.[14] It should be noted that the validity of generalizing this estimate to less-specific situations is undermined by the study's use of a highly-specific sample. This result should be contrasted with a study of loans made by a network of French mortgage providers at the start of the 1990s, in which, using a simultaneous equation

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[12] Robert Hall (1988), 'Intertemporal substitution in consumption', *The Journal of Political Economy*, vol 96, n2, pp339–357. Lawrence M Ausubel (1991), 'The failure of competition in the credit card market', *American Economic Review*, vol 81, n1, pp50–81. David B Gross and Nicholas S Souleles (2002), *Quarterly Journal of Economics*, vol 117, n1, pp149–185.

[13] Rob Alessie, Stefan Hochguertel and Guglielmo Weber (2005), 'Consumer credit: evidence from Italian micro data', *Journal of the European Economic Association*, vol 3, n1, pp144–178.

[14] Martins, N and E Villanueva (2004), 'The impact of interest-rate subsidies on long-run household debt: Evidence from a large program'.

technique, the authors estimated the average interest rate elasticity of demand for housing loans to lie roughly in the region 0.8 to 1.0.[15]

139. For the UK, E Fernandez-Corugedo and J Muellbauer (2006)[16] estimate the determinants for the change in the stock of secured (mortgage) debt for the period 1976 to 2001 in the UK. They find that a rise in the nominal mortgage rate from 6 to 7 per cent, other things being equal, would reduce the mortgage stock by 6.2 per cent in the long run (implying a long-run elasticity of around –0.4). They also find that the spread between the credit card rate and the mortgage rate has a positive impact on the stock of mortgage debt, which they interpret as implying that a fall in the mortgage rate relative to the credit card rate encourages a switch from unsecured to mortgage lending.

140. D Lecce (2006) tests a theoretical model of mortgage demand on UK data, where the estimation of mortgage demand is corrected for endogenous housing demand, for different types of borrowers (annuity mortgage holders and endowment mortgage holders). Their estimate for the elasticity of demand for mortgages by annuity mortgage holders is not statistically significant. For endowment mortgage holders, they find an elasticity of –0.3.

Conclusion

141. Because of the limited number of available studies, we were unable to estimate the elasticity of demand for credit with precision. However, the available evidence does support the contention that demand for personal loans is inelastic, and our best guess places the parameter in the range –0.6 to –1.0. The demand for mortgages may be somewhat more responsive to interest rate changes; our best guess places the parameters in the range –0.8 to –1.5.

142. We also examined distributors' internal documents and submissions on the elasticity of demand for credit. Most of this evidence related to the firm-level elasticity of demand for credit, which we would assume to be higher than the market-level elasticity given that distributors compete for credit consumers. We found that the evidence in distributors' internal documents (which mainly related to personal loans) was consistent with a low level for the market elasticity of demand for credit.

Inputs to the model for PLPPI, MPPI, SMPPI and CCPPI

143. Following the approach set out above, Tables 6, 7, 8 and 9 set out the inputs used for the model for PLPPI, MPPI, SMPPI and CCPPI, and the sensitivity checks that we conducted.

144. In the 2009 report, we had not undertaken a modelling exercise for CCPPI because of a lack of information on the elasticity of PPI demand for CCPPI. However, the elasticities of demand for MPPI, PLPPI and SMPPI are in similar ranges (between –1.22 and –1.72); therefore we think that the CCPPI elasticity is likely also to be in that range. The margin for CCPPI is very similar to the margin for PLPPI; application of Lerner indices would therefore suggest that the firm-level elasticity of demand for CCPPI is likely to be similar to the PLPPI level. To be cautious, we used the MPPI elasticity figure in the model, which is the lowest number and therefore tends to

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[15] Gary-Bobo, R and S Larribeau (2003), 'The bank's market power and the interest-rate elasticity of demand for housing', *Annales d'economie et de statistique*.
[16] E Fernandez-Corugedo and J Muellbauer (2006). 'Consumer credit conditions in the United Kingdom'. Bank of England Working Paper 314, November 2006.

produce more conservative estimates for consumer welfare after the remedies (1.22 for the firm-level elasticity).[17]

145. For prices, we used data on credit card APRs with and without CCPPI (for a price of CCPPI of 0.79p per £100 cover, which seems to be the average price for CCPPI). For margins over ‘normal economic profit margins’, and penetration rates, we followed the approach set out above.

[17]The lower the elasticity of the demand for PPI, all other things being equal, and the lower the benefits from the remedies to consumers.

TABLE 6 **PLPPI inputs and sensitivities**

Variable	*Input for the base case*	*Source/comment*	*Sensitivities*
Price of PLPPI	0.78	As in 2009 report	
Price of credit	0.693	As in 2009 report, but this may be conservative as there is evidence that credit prices have increased relative to PPI prices	Credit price increase relative to PPI by up to 20 per cent; this reflects the evidence that credit prices may have increased relative to PPI since 2006
Market elasticity of demand for PPI	–1.38	Firm-level elasticity of demand for PLPPI is –1.54; we assume market-level elasticity is 10% lower to allow for some cross-substitution	Lower market elasticity of PPI demand (to account for more cross substitution); down to –0.8 (ie, assuming 50% of firm-level elasticity is cross elasticity)
Market elasticity of demand for credit	–0.8	Value suggested by review of literature	–0.6 to –1
Proportion of PPI profits passed through	80%	Updated to recent market conditions	Between 0 and 100% pass-through
Amount by which the pre-remedy PPI price is in excess of 'competitive' PPI price	55%	Derived from the profitability analysis; we use the average 2005–2008 margin over normal profits, minus seven percentage points. Note that the profitability analysis errs on the cautious side, by allowing high costs of selling PPI.	We checked the robustness of the results to lower/higher margins (between 35 and 62%)
Competitive PPI price post-remedy	0.373	Such that PPI providers get normal profits; and allowing for an increase in unit costs by 4% (ongoing implementation costs); and advertising/marketing costs such that advertising to sales ratio post-remedy is around 2%	We conducted sensitivities to allow the one-off implementation costs to be passed on in the price of PPI (such that the one-off implementation costs are recouped in the price of PPI over 3 years)
Post-remedy PPI price	0.373	Assumption that remedies are fully effective in driving the PPI price to the competitive level	We conducted sensitivities to allow for smaller reductions in PPI price after the remedies, so that between 50% and 100% of PPI excess profits are competed away with the remedies in place
Penetration rate	30%	Based on 2009 penetration rate	Between 20 and 40% pre-remedy penetration
Cost/value of purchasing after the point of sale of credit	60% of consumers have a cost of 24% of pre-remedy PPI price; 30% of consumers associate a positive gain of 41% of pre-remedy PPI price; 10% of consumers are indifferent (no cost or gain)	Based on the Accent survey results, but adjusted to account for the possible double counting problem. There were different valuations of the costs of convenience depending on whether the consumer called after 24 hours, or was called after 7 days. We used the value which minimized the cost of convenience to consumers, because consumers would be able to choose the option which causes the least cost for them.	We ran sensitivities to allow lower, and higher, valuations of the delay in buying PPI by consumers who prefer to buy later (0–80% of the pre-remedy PPI price). We also ran sensitivities to the magnitude of the costs and gains associated with the delay in the sales process (keeping relative values constant). Finally, we ran sensitivities of the results to the costs of loss of convenience to consumers who prefer to buy at the point of sale.
Amount of awareness of PPI prices prior to the credit point of sale	0% (all consumers are myopic)	Conservative assumption	We ran sensitivities to allow a proportion of credit consumers to be aware of PPI prices before purchasing credit; this proportion varying between 0 and 100%

Source: CC analysis.

TABLE 7 **MPPI inputs and sensitivities**

Variable	*Input for the base case*	*Source/comment*	*Sensitivities*
Price of MPPI	0.1	As in 2009 report	
Price of credit	1	As in 2009 report; but this may be conservative as there is evidence that credit prices have increased relative to PPI prices	Credit price increase relative to PPI by up to 20%; this reflects the evidence that credit prices may have increased relative to PPI since 2006
Market elasticity of demand for PPI	–1.1	Firm-level elasticity for MPPI is –1.22, we assume the market-level elasticity is 10% lower to allow for some cross substitution	Lower market elasticity of PPI demand (to account for more cross substitution); down to –0.8
Market elasticity of demand for credit	–1	As suggested by the literature review	–0.8 to –1.2
Proportion of PPI profits passed through	80%	Updated to recent market conditions	Between 0 and 100% pass-through
Amount by which pre-remedy PPI price is in excess of competitive price	42%	From profitability analysis; using average 2005–2009	We checked the robustness of the results to lower margins (between 35 and 42%)
Post-remedy competitive price	0.063	Increase in unit costs by 3%; and advertising to sales ratio of 2% post-remedy	Sensitivities to allow for one-off costs to be passed on in the competitive price of PPI (spread over 3 years)
Post-remedy PPI price	Equal to post-remedy competitive price	Assumption that remedies are fully effective in driving the PPI price to the competitive level	We conducted sensitivities to allow for smaller reductions in PPI price after the remedies, so that between 50% and 100% of PPI excess profits are competed away with the remedies in place
Penetration rate	12%	Based on 2009 penetration rate	Higher penetration rates (up to 30%); this is because there are indications that, for MPPI, penetration rates may be higher from the GfK survey
Cost/value of purchasing after the point of sale of credit	50% of consumers have a cost of 5% of pre-remedy PPI price; 36% of consumers associate positive gain of 31% of pre-remedy PPI price; 14% of consumers are indifferent	Based on Accent survey results; with 5% as the cost of convenience to consumers who prefer the point of sale (the survey found this number not statistically significant), and adjusting for possible double counting	We ran sensitivities to allow lower valuations of the delay in buying PPI by consumers who prefer to buy later (0 to 50% of the pre-remedy PPI price). We also ran sensitivities to the magnitude of the costs and gains associated with the delay in the sales process (keeping relative values constant). Finally, we ran sensitivities of the results to the costs of loss of convenience to consumers who prefer to buy at the point of sale.
Amount of awareness of PPI prices prior to the credit point of sale	0% (all consumers are myopic)	Conservative assumption	We ran sensitivities to allow a proportion of credit consumers to be aware of PPI prices before purchasing credit; this proportion varying between 0 and 100%

Source: CC analysis.

TABLE 8 **SMPPI inputs and sensitivities**

Variable	*Input for the base case*	*Source/comment*	*Sensitivities*
Price of SMPPI	0.18	As in 2009 report	
Price of credit	0.468	As in 2009 report	Credit price increase relative to PPI by up to 20%; this reflects the evidence that credit prices may have increased relative to PPI since 2006
Market elasticity of demand for PPI	–1.5	Firm-level elasticity for SMPPI is –1.72, we assume the market-level elasticity is 10% lower to allow for some cross-substitution	Reduction (to account for more cross substitution); down to –0.8
Market elasticity of demand for credit	–0.8	As suggested by the literature review	–0.6 to –1.0
Proportion of PPI profits passed through	80%	Updated to recent market conditions	Between 0 and 100% pass-through
Amount by which pre-remedy PPI price is in excess of competitive price	43%	From profitability analysis; using average 2005–2008	We checked the robustness of the results to lower and higher margins (between 35 and 47%)
Post-remedy competitive price	0.105	Increase in unit costs by 1% to allow for ongoing implementation costs; and advertising to sales ratio of 2% post-remedy	Sensitivities to allow one-off costs to be passed on in PPI prices (spread over 3 years)
Post-remedy PPI price	Equal to post remedy competitive price	Assumption that remedies are fully effective in driving the PPI price to the competitive level	We conducted sensitivities to allow for smaller reductions in PPI price after the remedies, so that between 50% and 100% of PPI excess profits are competed away with the remedies in place
Penetration rate	45%	Based on 2009 penetration rate	Between 35 and 55%
Cost/value of purchasing after the point of sale of credit	60% of consumers have a cost of 24% of pre-remedy PPI price; 30% of consumers associate positive gain of 41% of pre-remedy PPI price; 10% of consumers are indifferent	We use the Accent survey results for PLPPI, adjusting for possible double counting.	We ran sensitivities to allow lower valuations of the delay in buying PPI by consumers who prefer to buy later (0 to 60% of the pre-remedy PPI price). We also ran sensitivities to the magnitude of the costs and gains associated with the delay in the sales process (keeping relative values constant). Finally, we ran sensitivities of the results to the costs of loss of convenience to consumers who prefer to buy at the point of sale.
Amount of awareness of PPI prices prior to the credit point of sale	0% (all consumers are myopic)	Conservative assumption	We ran sensitivities to allow a proportion of credit consumers to be aware of PPI prices before purchasing credit; this proportion varying between 0 and 100%

Source: CC analysis.

TABLE 9 **CCPPI inputs and sensitivities**

Variable	*Input for the base case*	*Source/ comment*	*Sensitivities*
Price of CCPPI	8.35	APR with PPI—APR without PPI	
Price of credit	15.5	APR with PPI	We ran sensitivities to higher prices of credit (up to 20 per cent higher), because this may be a lower estimate of the price of credit
Market elasticity of demand for PPI	–1.1	Use the market elasticity for MPPI (lowest of the elasticities found)	Lower levels of market elasticity (to account for more cross substitution); down to –0.8
Market elasticity of demand for credit	–0.8	As suggested by literature review	–0.6 to –1.0
Proportion of PPI profits passed through	80%	Updated to recent market conditions	Between 0 and 100% pass-through
Amount by which pre-remedy PPI price is in excess of competitive price	59%	From profitability analysis; using average 2005–2009	We checked the robustness of the results to lower margins (between 35 and 59%)
Post-remedy competitive price	3.8	Increase in unit costs by 7% to allow for ongoing implementation costs; and advertising to sales ratio of 2% post-remedy	Sensitivities to allow one-off implementation costs to be passed on in PPI prices (spread over 3 years)
Post-remedy PPI price	Equal to post remedy competitive price	Assumption that remedies are fully effective in driving the PPI price to the competitive level	We conducted sensitivities to allow for smaller reductions in PPI price after the remedies, so that between 50% and 100% of PPI excess profits are competed away with the remedies in place
Penetration rate	20%	Based on 2009 penetration rate	Between 10 and 30 per cent
Cost/value of purchasing after the point of sale of credit	60% of consumers have a cost of 24% of pre-remedy PPI price; 30% of consumers associate positive gain of 41% of pre-remedy PPI price; 10% of consumers are indifferent	We use the Accent survey results for PLPPI, adjusting for possible double counting	We ran sensitivities to allow lower valuations of the delay in buying PPI by consumers who prefer to buy later (0 to 50% of the pre-remedy PPI price). We also ran sensitivities to the magnitude of the costs and gains associated with the delay in the sales process (keeping relative values constant). Finally, we ran sensitivities of the results to the costs of loss of convenience to consumers who prefer to buy at the point of sale.
Amount of awareness of PPI prices prior to the credit point of sale	0% (all consumers are myopic)	Conservative assumption	We ran sensitivities to allow a proportion of credit consumers to be aware of PPI prices before purchasing credit, this proportion varying between 0 and 100%

Source: CC analysis.

Modelling of static consumer benefits from the remedies: results

Introduction

1. In this appendix, we present the results of the modelling of the effects of the package of remedies on static consumer welfare, using the approach set out in Appendix I. We used Excel-based models to assess the impact of the package of remedies on consumer welfare, taking into account the impact of the removal of the waterbed effect after the remedies are in place, the impact of the delay between credit and PPI purchasing on consumer welfare, and the ongoing costs of implementing the package of remedies.

2. We construct a base case for which we model the impact of remedies on consumer welfare. In this base case, we use, as far as possible, the most reasonable values for the inputs (as set out in Tables 6 to 9 of Appendix I). We then vary the inputs, and the main assumptions underlying the model, to establish the sensitivity of the results to these changes.

PLPPI

3. Table 1 presents the results of the model for the base case, using the inputs set out in Table 6 of Appendix I. With the remedies in place, competition for PPI consumers is vigorous, and the price of PPI reduces to the level for which distributors no longer make excess profits on PPI sales. Total sales of PPI increase compared with pre-remedy PPI sales because of the reduction in the PPI price after the remedies, but this increase in sales is mitigated by two effects:

   (a) The price of credit increases after the remedies are in place, and this has the effect of reducing credit demand. Because we assume that all consumers are myopic in the base case, this has a knock-on effect on total demand for PPI, because fewer consumers now take out credit and therefore observe the price of PPI.

   (b) The other mitigating effect is the cost of convenience for consumers who prefer to buy PPI at the credit point of sale (Group 1 consumers). The PPI demand of these consumers increases compared with pre-remedy levels because the reduction in price is larger than the cost of convenience. But the increase in their demand is less than would be if this group did not care about convenience.

TABLE 1 **Predictions from the base model with myopic consumers: PLPPI**

Results	*Pre-remedy*	*After remedy*	*Change %*
Price of credit	0.69	0.8	15
Price of PPI	0.78	0.37	–52
Price of bundle	1.47	1.17	–21
Credit sales	1,000,000	881,143	–12
PPI sales, of which	300,000	402,834	34
Group 1 consumers	180,000	220,597	23
Group 2 consumers*	90,000	136,678	52
Group 3 consumers	30,000	45,559	52
Penetration rate (%)	30	46	
Consumer welfare credit	433,125	336,284	–22
Consumer welfare PPI	84,416	196,461	133
Total consumer welfare	517,541	532,745	3
Distributor profits PPI	128,700	0	
Distributor profits credit	–102,960	0	
Total profits	25,740	0	

Source: CC analysis.

*We assume that demand by group 2 consumers increases because of the lower price of PPI; however, the increase in surplus derived at constant prices does not result in additional quantities demanded.

4. Total consumer welfare increases by 3 per cent after the remedies are in place; the increase in consumer welfare amounts to 12 per cent of the total PPI excess profits. In monetary values, this means an increase in total consumer welfare of about £100 million a year,[1] before taking into account the time frame for the remedies to take effect and the one-off implementation costs for PLPPI of about £33 million.

5. In its response to the provisional decision, Barclays told us that, in the 2009 report, the base case for PLPPI predicted a fall in consumer welfare with remedies in place, whereas in the provisional decision on remedies we found an increase in welfare in the base model. Barclays queried the reason for this change. The reason is that our starting point for the modelling in the remittal was the modelling that was done to calculate the benefits to consumers from the package of remedies in the 2009 report. In order to calculate those benefits, we used likely values of the inputs wherever possible,[2] and found that the package of remedies would increase, not decrease, welfare.

6. We checked the sensitivity of our findings to the assumption that one-off implementation costs are not passed on to consumers in the form of higher PPI prices after the remedies are in place. If we include an allocation for one-off implementation costs after the remedies are in place (so that the one-off costs are spread over three years), the base model predicts that the increase in consumer welfare after the remedies are in place will amount to 10 per cent of PLPPI excess profits; that is, about £83 million a year net benefits to consumers.

7. We also checked the sensitivity of this finding to the assumption on the pre-remedy level of PPI sales. To test the sensitivity of the results to the level of PPI sales pre-remedy, we calculated the consumer welfare effects from the remedies assuming that the level of sales of PPI pre-remedy, and after remedy, was lower. If PPI sales

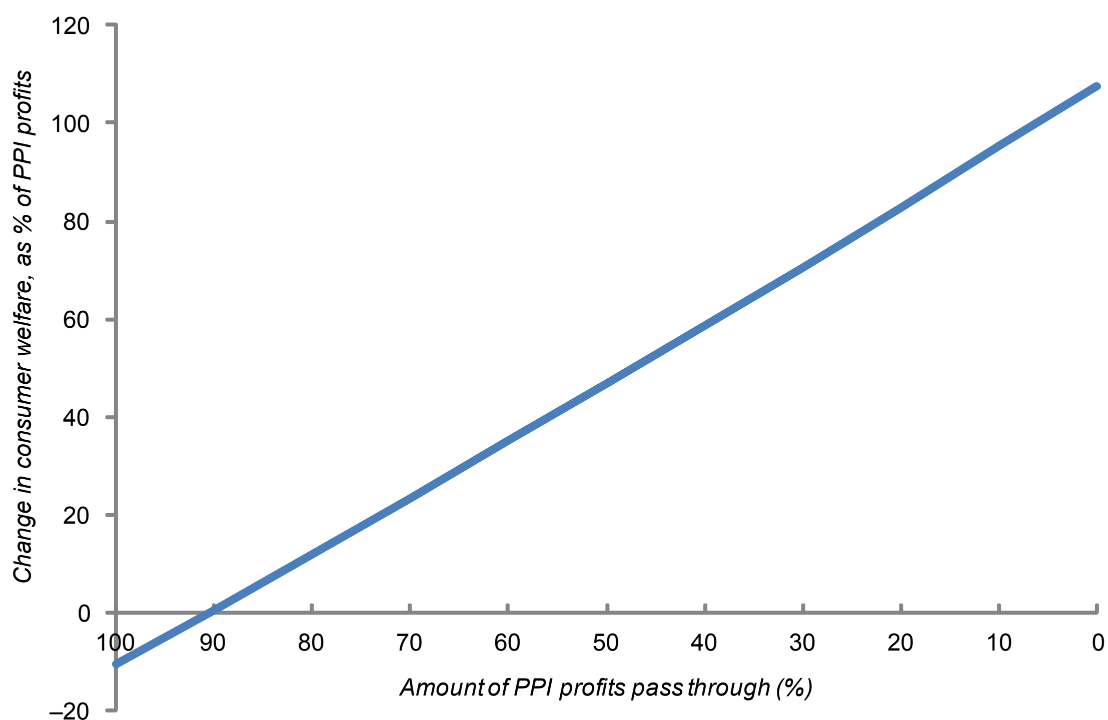
[1]This is obtained by multiplying the average pre-tax excess profits over 2005 to 2009 (£826 million for PLPPI) by 13 per cent.
[2]Main assumptions for calculation of the benefits in the 2009 report for PLPPI were: credit elasticity of –0.8; relative price of PPI to the bundle of 53 per cent; PPI elasticity of –1.54; pass-through of 100 per cent or of 80 per cent.

without remedies in place were only half of the level we used in the base case (which is based on average sales of PPI for 2005 to 2009), the benefits from the remedies to consumer halve to about £50 million a year. This remains high compared with the one-off costs of implementation of £33 million.

8. We tested the sensitivity of the results to changes in the inputs used in the model. Figure 1 shows the sensitivity of the results to the amount of pass-through (ie the extent of the waterbed effect). We find that, if the amount of pass-through is above 90 per cent, the base model predicts that the package of remedies may result in a small reduction in consumer welfare.

FIGURE 1

PLPPI: sensitivity of the results to the waterbed effect

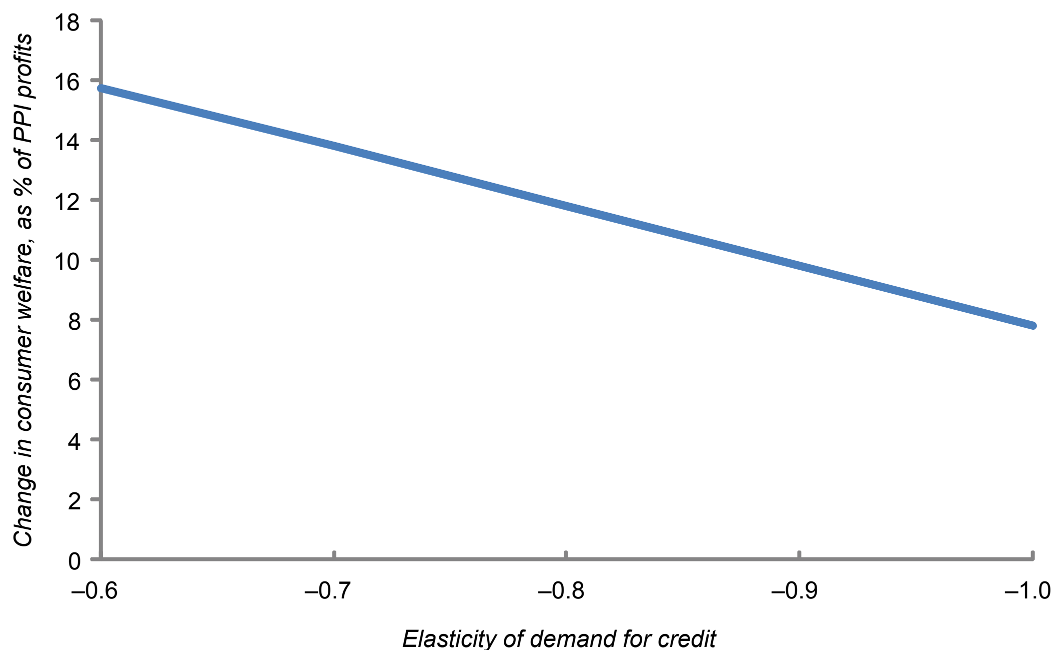


Source: CC analysis.

9. Figure 2 shows the sensitivity of the results to the market level elasticity of credit demand for the range of values that were reasonable. Figure 3 shows the sensitivity of the results to the pre-remedy PPI penetration rate for the range of values that were reasonable. In both cases, the model predicts that consumer welfare will increase after the remedies.

FIGURE 2

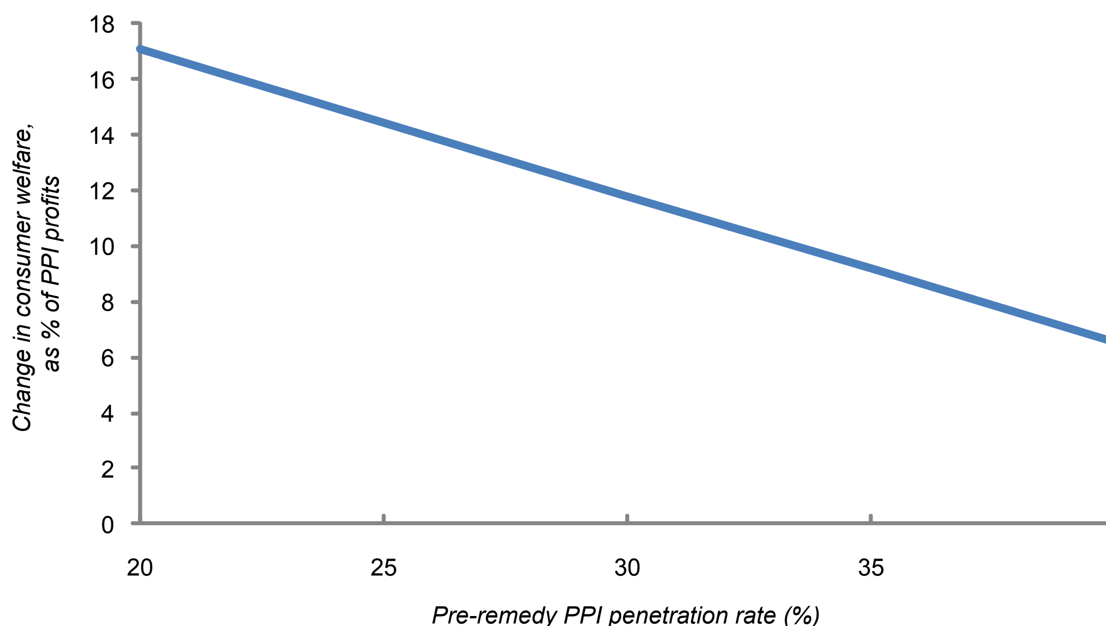
PLPPI: sensitivity of the results to the price elasticity of the market demand for credit



Source: CC analysis.

FIGURE 3

PLPPI: sensitivity of the results to the pre-remedy penetration rate



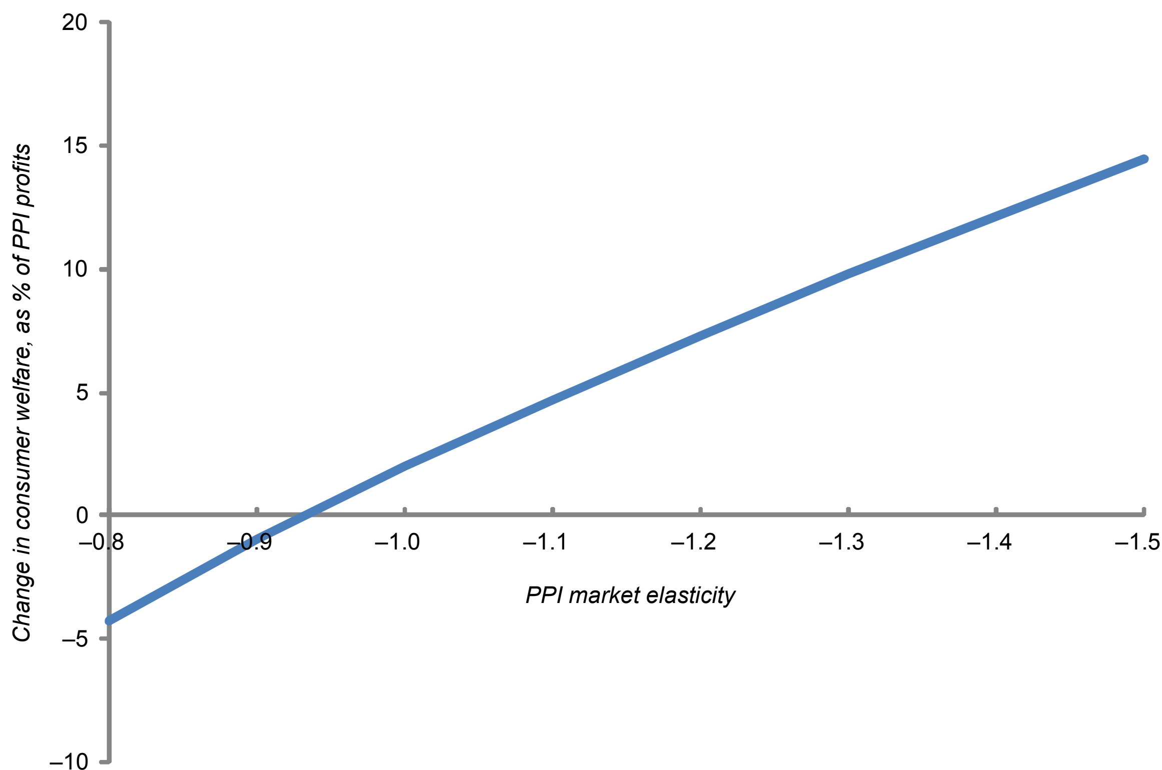
Source: CC analysis.

10. Figure 4 shows the sensitivity of the results to the market level elasticity of PPI demand. The model predicts that the increase in consumer welfare after the remedies is larger when PPI demand is more elastic. The model predicts that consumer welfare will increase if the market elasticity of PPI demand is –0.9 or higher. If

the PPI market elasticity of demand is –0.8, at the lower end of the range for the PPI market elasticity, the model predicts a small reduction in consumer welfare. However, this is assuming that all consumers are myopic: we relax the assumption of total myopic below and consider the implications for consumer welfare.

FIGURE 4

PLPPI: sensitivity of the results to the price elasticity of the market demand for PPI

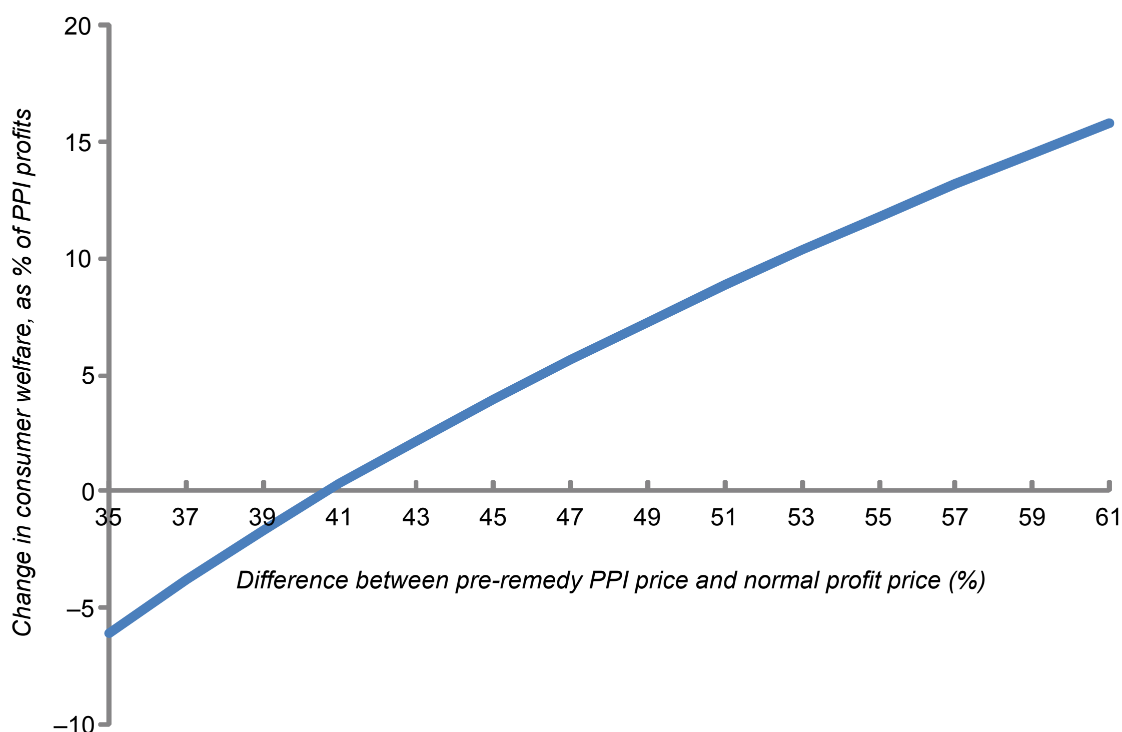


Source: CC analysis.

11. Figure 5 shows the sensitivity of the results to the pre-remedy excess profit margin, ie the amount by which the price of PPI prior to the remedies being imposed is in excess of the competitive PPI price. The model predicts that consumer welfare will increase if the pre-remedy excess profit margin is significantly lower than the 55 per cent value which we use in the base model and is derived from our profitability analysis. The base model predicts that consumer welfare will increase even if the excess profit margin were 41 per cent. We think that the excess profit margin is unlikely to be below that level. Indeed, we were conservative in our estimation of the excess profit margins, by allowing high costs of selling PPI in our estimation of the margins: we assumed the fully-allocated costs of selling a PPI policy at £100, which was between [1 and 5] times higher than the evidence on the fully-allocated cost of selling a PPI policy submitted by [✂]. Moreover, we used in our base case a value of 55 per cent, which is seven percentage points lower than the average excess profit margin for 2005 to 2008. For these reasons, we are confident that pre-remedy profit margins are higher than 41 per cent.

FIGURE 5

PLPPI: sensitivity of the results to the pre-remedy excess profit margin

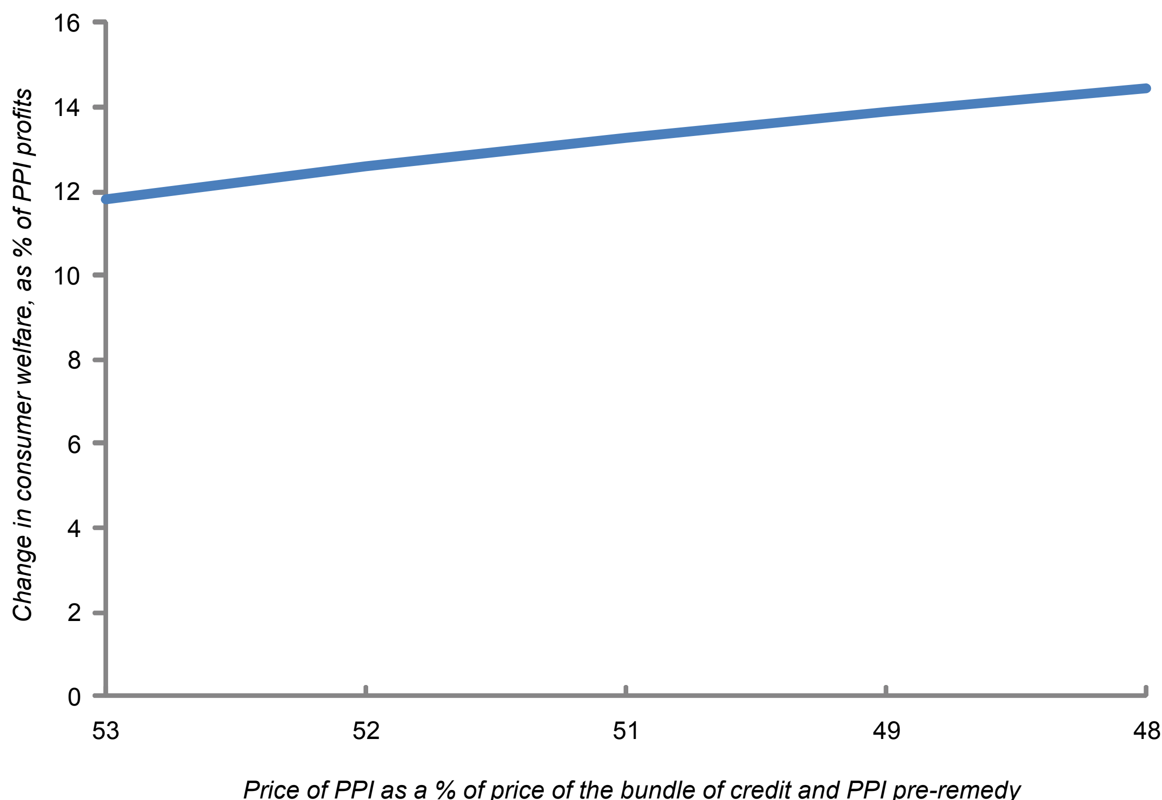


Source: CC analysis.

12. Figure 6 shows the sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit, pre-remedy. In our base case, which is based on 2006, the price of PPI represents about 53 per cent of the price of the bundle of credit and PPI. If we account for the fact that the price of credit has increased relative to PPI since 2006, so that the price of PPI has reduced relative to the price of the bundle, we find that the model predicts larger increases in consumer welfare after the remedies.

FIGURE 6

PLPPI: sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit



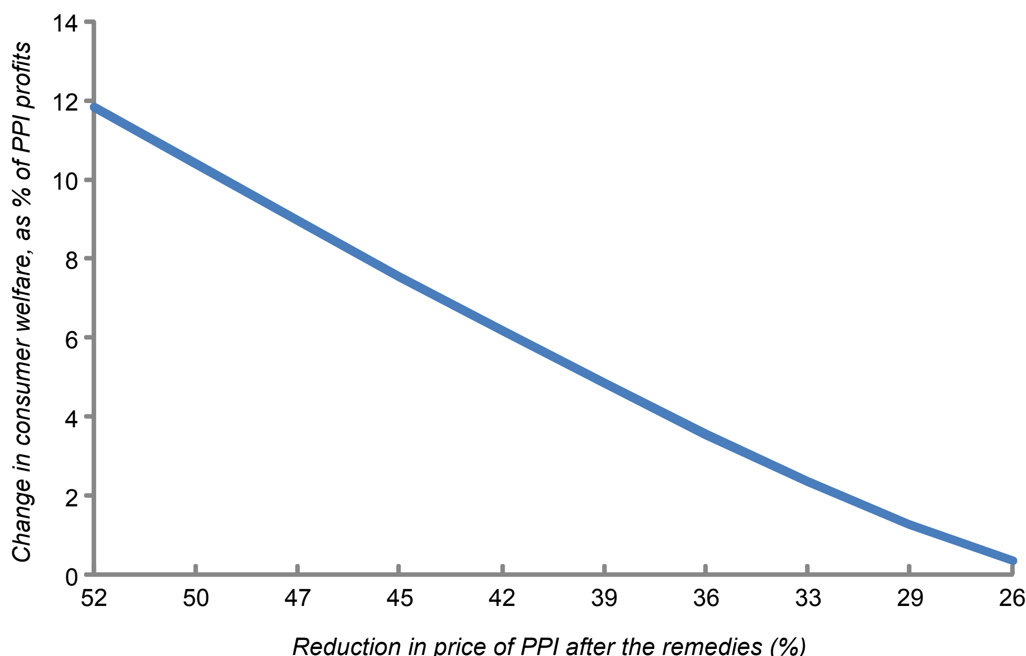
Source: CC analysis.

13. Figure 7 shows the sensitivity of the results to the assumption that all PPI excess profits are competed away in the PPI market with the remedies in place. In our base case, all PPI excess profits are competed away in the PPI market with the remedies in place, and the price of PLPPI reduces by 52 per cent. Indeed, we found that the remedies would be substantially effective, and therefore we expect prices to drop to levels close to the competitive price. We checked the sensitivity of our results to this assumption, by looking at the results of the model if we assumed that between 50 and 100 per cent of PPI excess profits are competed away in the PPI market after the remedies are in place, ie if the reduction in price after the remedies is between 26 and 52 per cent. We found that, even if only half of the excess profits are competed away in the PPI markets, so that the reduction in the price of PPI, after remedies, is 26 per cent, the model predicts that consumer welfare will increase after the remedies are in place.[3]

[3]If the price reduction after the remedy is such that distributors retain some excess profits are PPI, we would expect that the waterbed effect is not fully removed after the remedies are in place. Our modelling takes this effect into account: we assume that, if the price reduction is less than 52 per cent, some pass through of the remaining excess profits from PPI to credit persists.

FIGURE 7

PLPPI: sensitivity of the results to the amount by which prices reduce after the remedies

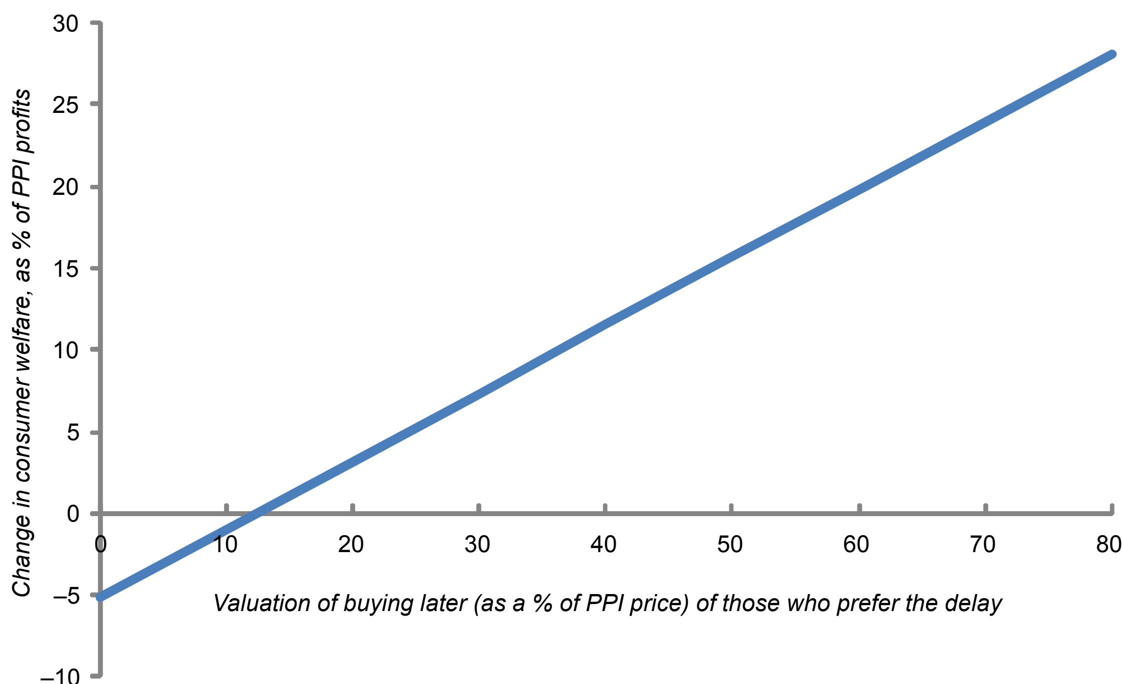


Source: CC analysis.

14. Figure 8 shows the sensitivity of the results to the Accent survey results on the positive willingness to pay for a delay in the sales process by consumers who prefer to buy PPI after the point of sale. In the base case, the 30 per cent consumers who prefer buying after the point of sale value this at 41 per cent of the price of PPI pre-remedy on average. We find that, if we ignore most or all of the positive valuations that these consumers associate with the delay in the process, the base model can predict that consumer welfare will decrease after the remedies are in place.

FIGURE 8

PLPPI: sensitivity of the results to the positive valuations of buying later by consumers who prefer the delay

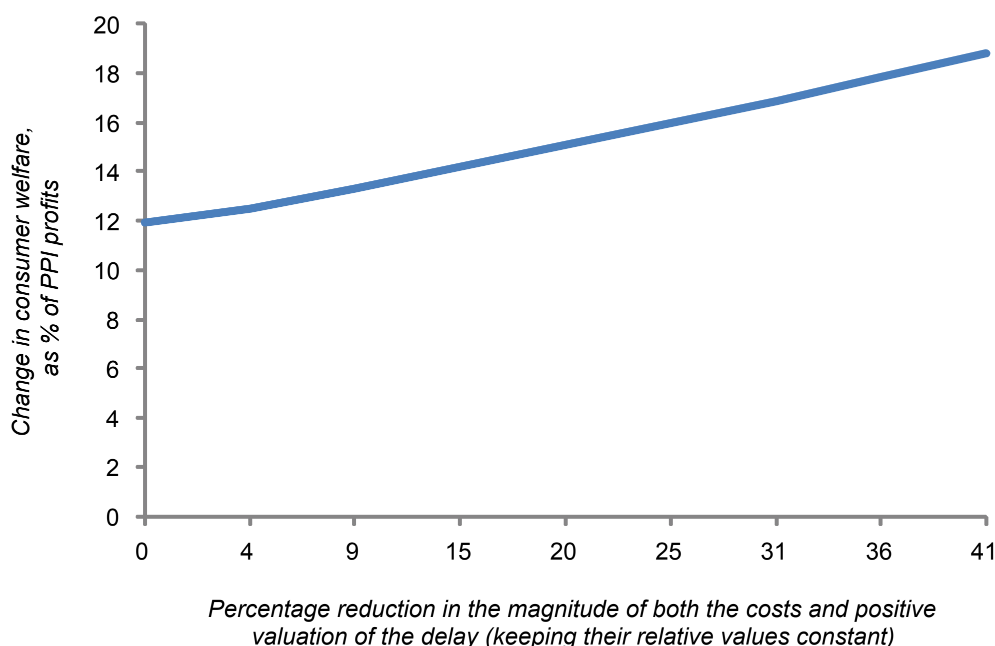


Source: CC analysis.

15. Figure 9 shows the sensitivity of the results to the magnitude of the willingness-to-pay results in the Accent survey. We concluded that the Accent survey results were robust in terms of the relative valuation of the costs of the loss of convenience of the different groups of consumers, but that the magnitudes may be too high (see Appendix F). In our base case, the costs of the loss of convenience of consumers who prefer to buy at the point of sale are valued at 24 per cent of the price of PPI, while the positive valuation of the delay of consumers who prefer the delay is 41 per cent of the price of PPI. If we reduce the magnitude of the costs/valuation of the delay of both groups of consumers (those who prefer to buy at the point of sale, and those who prefer to buy later), without changing the relative value of these costs, we find that the model predicts that consumer welfare will increase more than in our base case. This is shown in Figure 9, where we reduce the cost of convenience of the consumers who prefer to buy at the point of sale, and reduce the valuation of buying later of consumers who prefer to buy later, in the same proportions.

FIGURE 9

PLPPI: sensitivity of the results to the magnitude of the willingness-to-pay results of consumers' valuation of the delay (keeping the relative valuations constant)



Source: CC analysis.

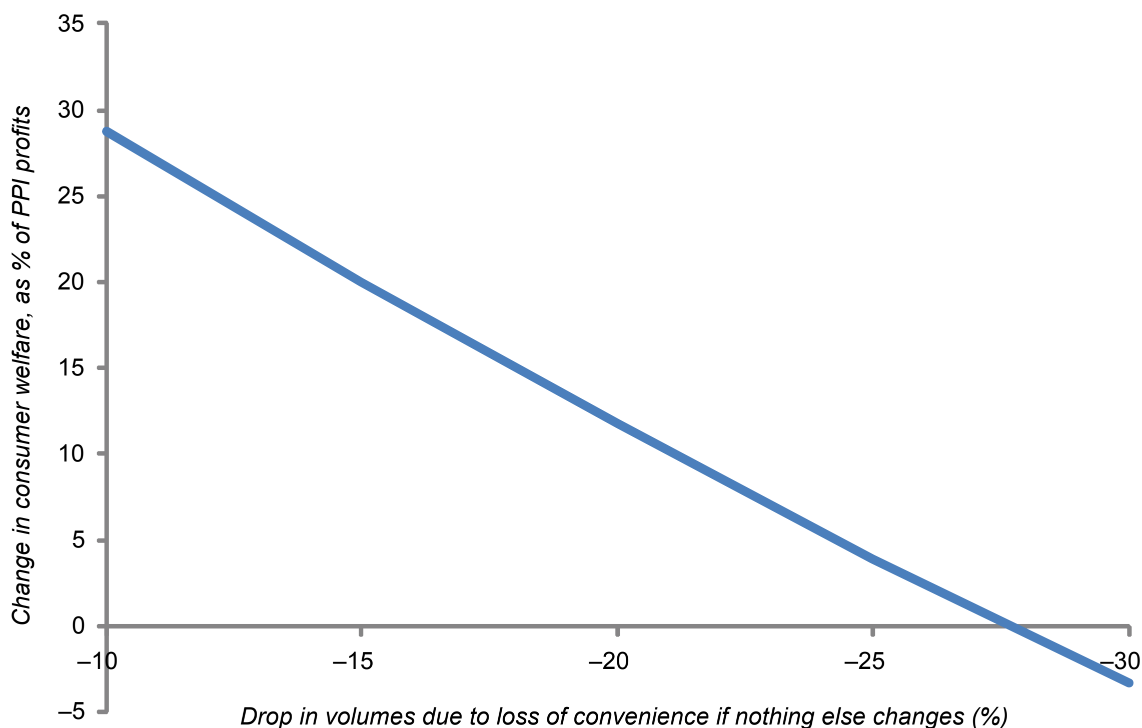
16. Figure 10 shows the sensitivity of the results to the costs of the loss of convenience. In our base case, the drop in volumes (at constant price) due to the costs of the loss of convenience is of 20 per cent. If the drop in volumes because of the loss of convenience were higher, this could either be because the costs of the loss of convenience to consumers who prefer to buy at the point of sale are higher than estimated in the Accent survey, or because the market demand for PPI is more elastic than in our base case estimate. We note that, if the demand for PPI were more elastic than in our base case, the model predicts larger increases in consumer welfare compared with the base case (see Figure 4). Therefore, if the drop in volumes due to loss of convenience was larger because the elasticity of PPI demand was larger (rather than because the costs of the loss of convenience were higher), the model predicts that consumer surplus increases more than in our base case. If the drop in volumes were larger because of larger costs of the loss of convenience, the model predicts that consumer welfare will be lower, as shown in Figure 10.[4] The model predicts that consumer welfare will decrease if the costs of the loss of convenience are such that, at constant prices, PPI volumes will reduce by 28 per cent. This is equivalent to a cost of convenience which amounts to 34 per cent of the monthly price of PPI (at constant elasticity)- that is about £10 per month on average. This would imply that the actual costs of the loss of convenience to consumers who prefer to buy at the point of sale are in fact 40 per cent higher than in our base case. We think it is unlikely that the results from the Accent survey have under-estimated the costs of the loss of convenience by such a large amount. In addition, given the concerns that the valuations of the costs of the loss of convenience are too high in our base case

[4] If the drop in volumes due to convenience were due to a combination of higher PPI elasticity and larger inconvenience costs, the effects from the remedies on consumer welfare would be more positive than in Figure 10.

(rather than too low), we think it is unlikely that the costs of the loss of convenience could be this high.

FIGURE 10

PLPPI: sensitivity of the results to the costs of the loss of convenience

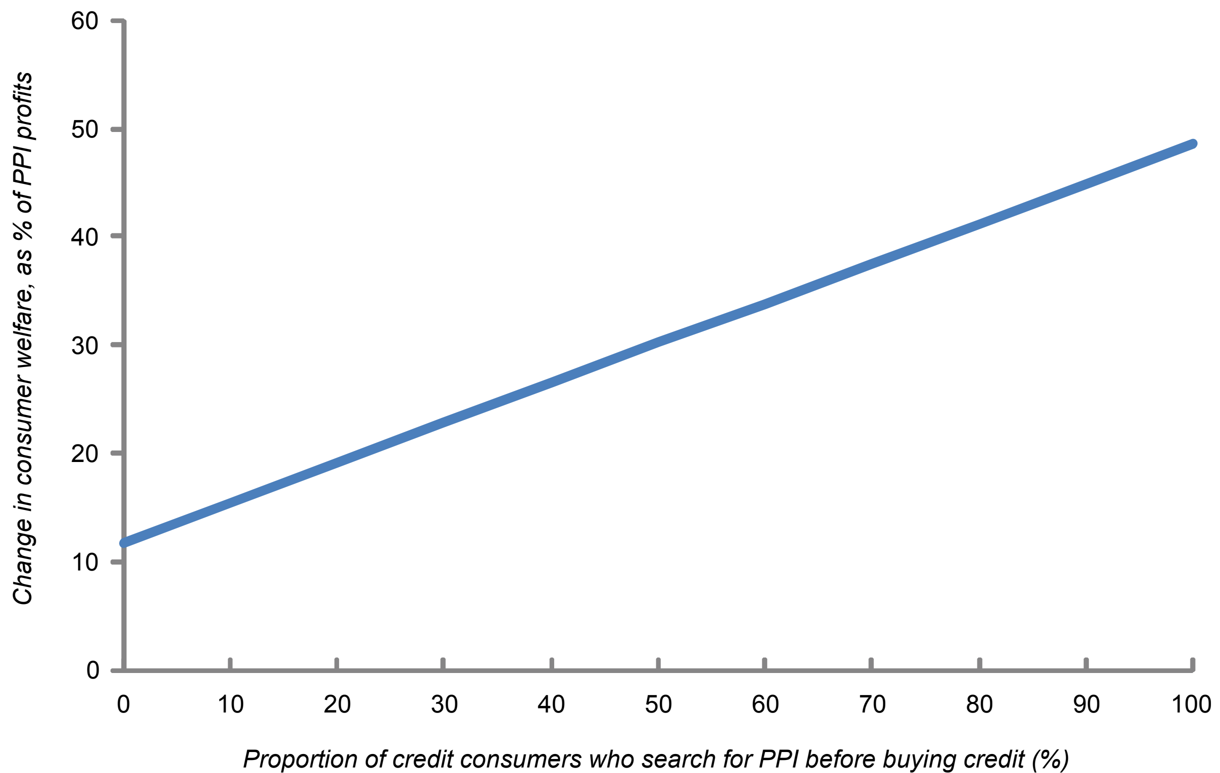


Source: CC analysis.

17. Figure 11 shows the sensitivity of the results to the removal of the assumption that all credit consumers are myopic. The larger the proportion of consumers who search for PPI prior to the credit purchase after the remedies, the larger the estimate of consumer welfare after the remedies. In the base case, we assumed that no consumers search.

FIGURE 11

PLPPI: sensitivity of the results to the assumption that all credit consumers are myopic



18. In conclusion, the sensitivity analysis for PLPPI shows that the model predicts that consumer welfare will increase after the remedies for most of the individual sensitivities we ran, but not all. There are a number of individual sensitivities where the model predicts that consumer welfare may reduce after the remedies are in place:

    (a) if the amount of pass-through is more than 90 per cent;

    (b) if the PPI elasticity is –0.9 or less;

    (c) if we ignore most or all of the positive valuations associated with buying PPI after the credit point of sale by consumers who prefer to buy with a delay; or

    (d) if the costs of the loss of convenience to consumers who prefer buying PPI at the point of sale are such that, if nothing else changes, PPI volumes would drop by 28 per cent or more.[5]

19. We therefore looked at the results of the model if we removed the assumption that all consumers were myopic, which we considered to be an extreme assumption, given that we know that in the present market structure about one-third of PLPPI consumers had thought of purchasing PPI before the credit purchase, and that we expect the remedies to have an impact on the ability of consumers to search for PPI prior to the credit point of sale as well as on the incentives for distributors to provide information to consumers prior to the credit point of sale.

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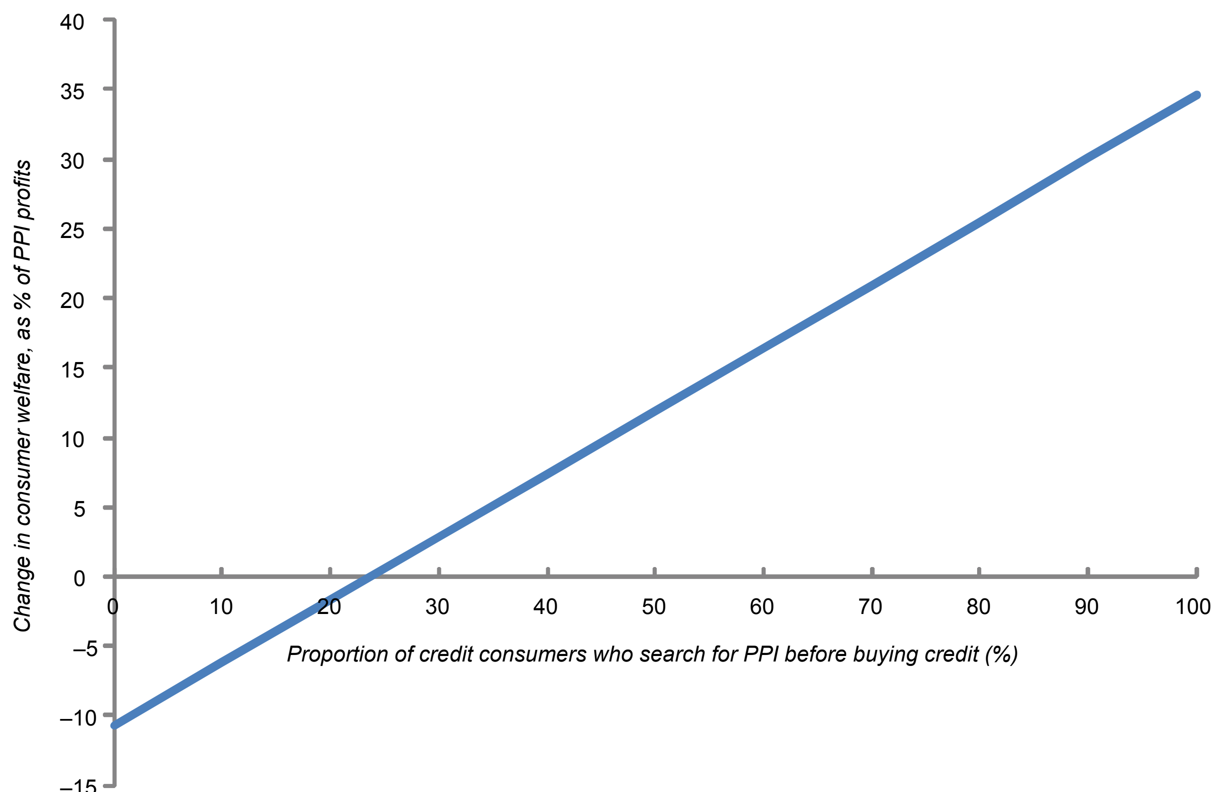
[5]The model also predicts that consumer welfare will decrease if the pre-remedy excess profit margins are less than 41 per cent. However, for the reasons set out in paragraph 11, this level of margins is very far from our base case assumption for the margins, and we therefore do not consider this possibility any further.

20. Figure 12 shows the results if we assume that a proportion of potential personal loan consumers are aware of the PLPPI price before the credit point of sale after the remedies are in place, and if we assume that the waterbed is 100 per cent. We find that, if 25 per cent or more credit consumers are aware of PPI prices before the credit point of sale (after the remedies), the model predicts that consumer welfare will increase even if we assume that there is full waterbed pre-remedy (ie 100 per cent pass-through of PPI profits).

FIGURE 12

PLPPI: sensitivity of results to consumer myopia, assuming 100 per cent waterbed effect

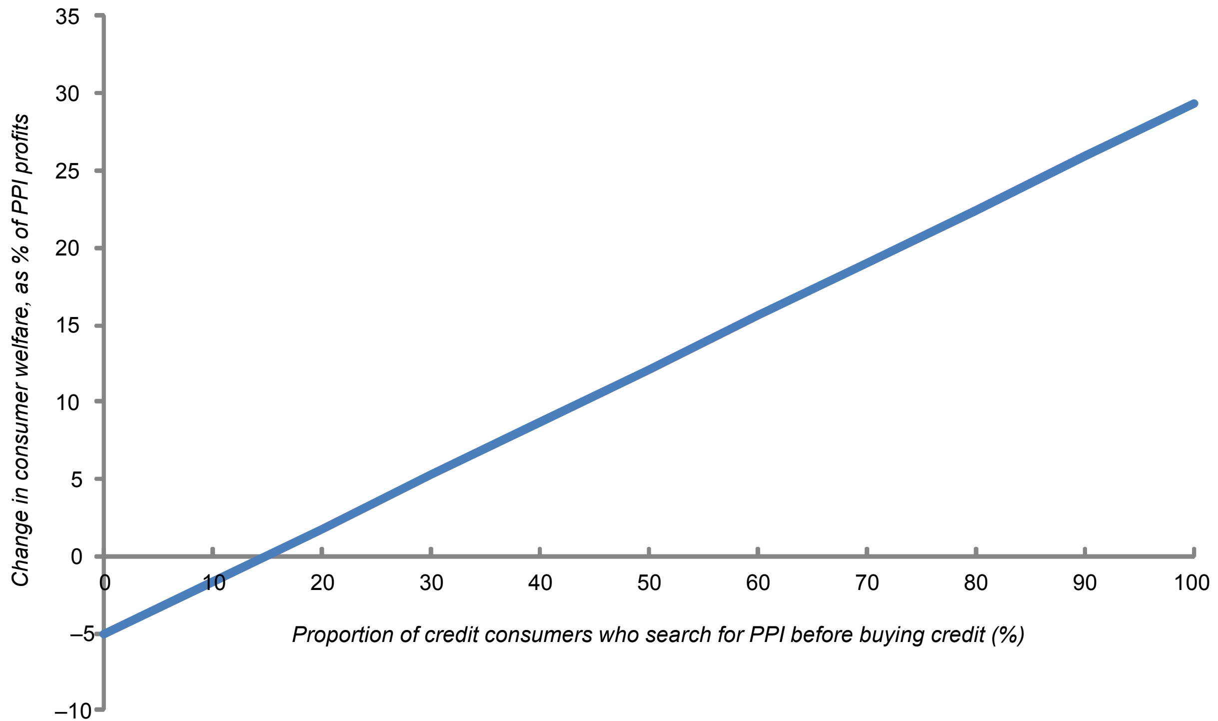


Source: CC analysis.

21. Figure 13 shows results if we assume that a proportion of potential credit consumers are aware of the PLPPI price before the credit point of sale after the remedies, but totally ignore the positive values associated with the POSP by consumers who prefer buying after the POSP. We find that, if 15 per cent or more of credit consumers are aware of PPI prices before the credit point of sale (after the remedies), the model predicts that consumer welfare will increase even ignoring the fact that some consumers prefer to buy after the point of sale.

FIGURE 13

PLPPI: sensitivity of results to consumer myopia, when we ignore the positive willingness to pay for the delay of consumers who prefer the delay



Source: CC analysis.

22. Figure 14 shows the results if we assume that a proportion of potential credit consumers are aware of the PLPPI price before the credit point of sale after the remedies, but assume that the market elasticity of PPI demand is at the lower end of our range (–0.8). We find that, if over 10 per cent of credit consumers are aware of PPI prices before the credit point of sale (after the remedies), the model predicts that consumer welfare will increase even ignoring the fact that some consumers prefer to buy after the point of sale.

FIGURE 14

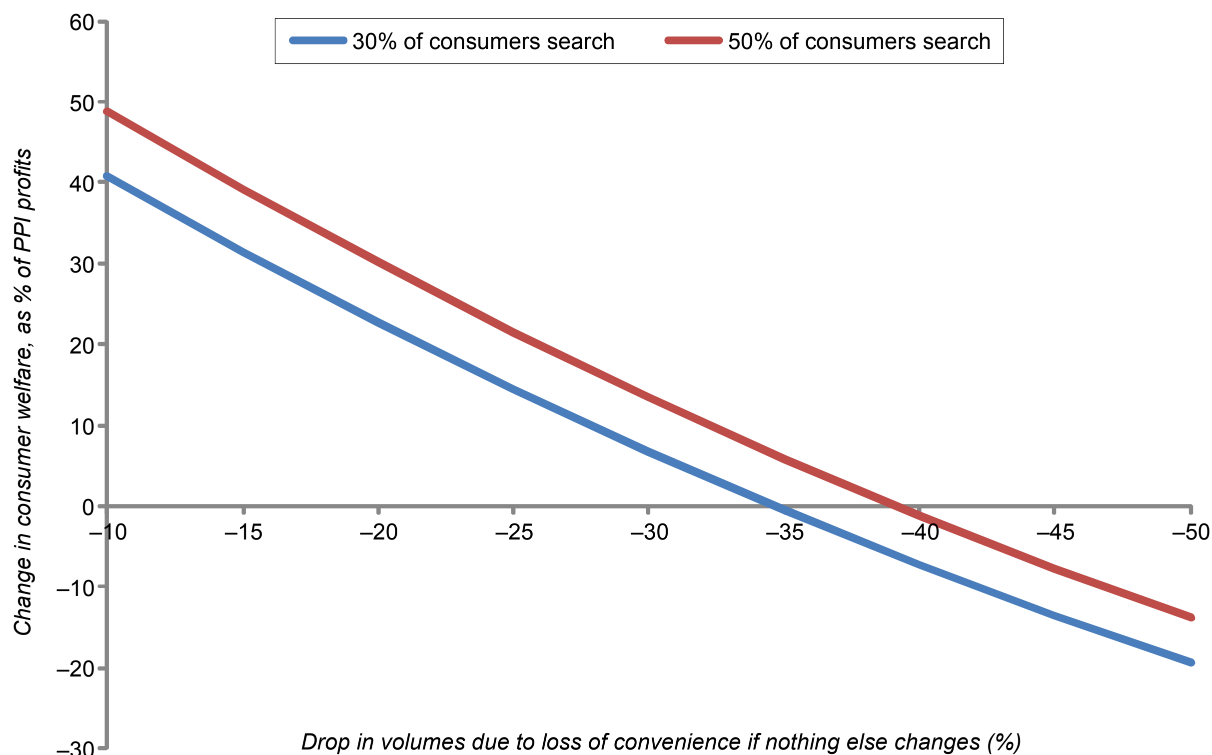
PLPPI: sensitivity of results to consumer myopia, when the PPI market elasticity is low (–0.8)

Source: CC analysis.

23. Figure 15 shows the sensitivity of the results to the costs of the loss convenience, when we remove the assumption that all consumers are myopic. If 30 per cent of consumers search for PPI, or are aware of the lower PPI price, before making decisions about credit, the model predicts that consumer welfare will increase if the drop in volumes due to the loss of convenience is 35 per cent or less. This would imply costs of the loss of convenience of 42 per cent of the monthly PPI price (ie £12.60 per month on average, or 70 per cent higher than in our base case). If 50 per cent of consumer search, the model predicts that consumer welfare will increase if the drop in volumes due to the loss of convenience is up to 40 per cent (which would be associated with a cost of the loss of convenience of 48 per cent of the PPI price, ie double the values found by the Accent survey).

FIGURE 15

PLPPI: sensitivity of results to the costs of the loss of convenience, when we remove the assumption of consumer myopia



Source: CC analysis.

24. Therefore, if more than 30 per cent of credit consumers search for PPI, or otherwise anticipate the fact that the price of PPI has decreased, after the remedies are in place, we found that the static model predicted an increase in consumer welfare after the remedies for almost every sensitivity we ran. This is the case even if the costs of the loss of convenience are 70 per cent higher than in our base case. As set out in paragraphs 41 to 45 of Appendix I, and paragraph 7.85, we think that the package of remedies will increase search for PPI prior to the credit point of sale, and therefore we are confident that more than 30 per cent of consumers will be aware of the lower PPI price prior to making decisions on credit when the remedies are in place.

MPPI

25. For MPPI, the base case (with the inputs and assumptions in Table 7 of Appendix I) predicts that consumer welfare will increase after the package of remedies is in place; the increase is equivalent to 43 per cent of MPPI excess profits. In monetary terms, this is equivalent to about £56 million benefits a year, before the time frame for the remedies to take effect and one-off costs of £8.5 million are taken into account.

26. We checked the sensitivity of this finding to the assumption that one-off implementation costs are not passed on to consumers in the form of higher PPI prices after the remedies are in place. If we include an allocation for one-off implementation costs after the remedies are in place (so that the one-off costs are spread over three years), the base model predicts that the increase in consumer welfare after the remedies are in place will amount to 39 per cent of MPPI excess profits; that is, about £51 million a year net benefits to consumers.

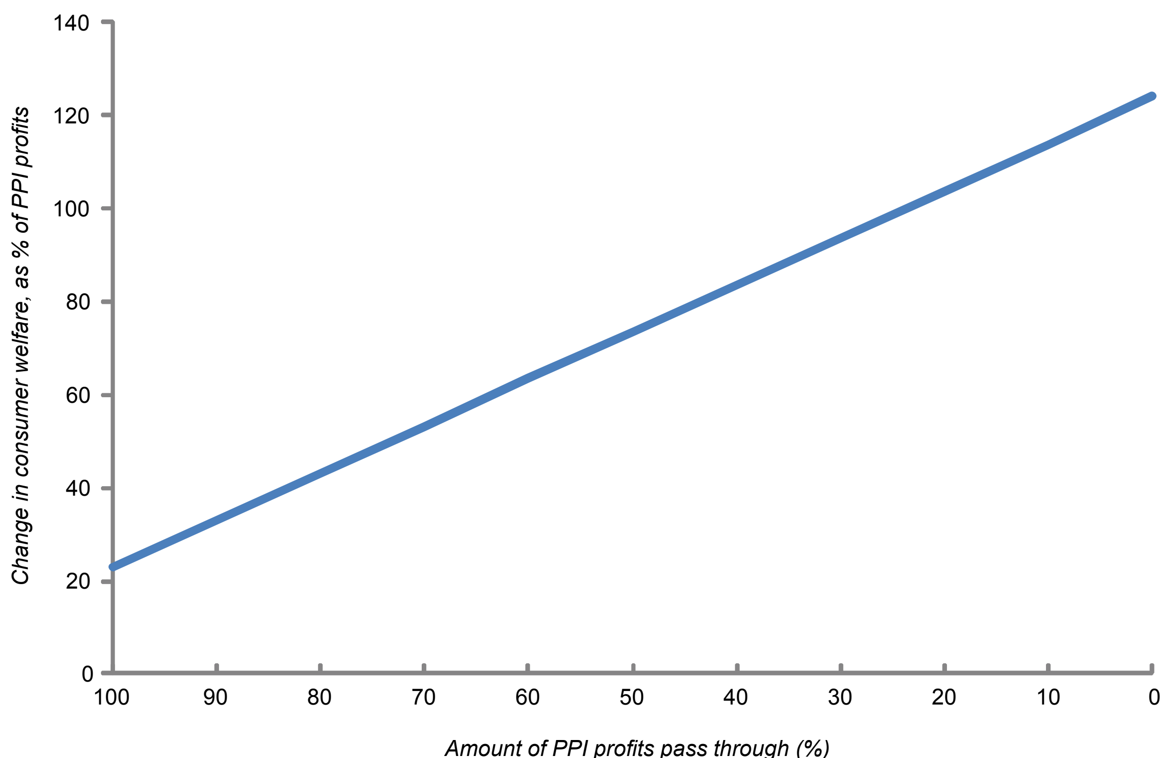
27. We also checked the sensitivity of the results to lower sales of MPPI because of significant amounts of unwanted sales prior to the remedies. If we assumed that half of the MPPI sales prior to the remedies being imposed were unwanted, and therefore did not take place after the remedies are in place, the benefits from the remedies for MPPI would halve to £28 million a year. This remains high compared with the one-off costs of implementation of the remedies.

28. We tested the sensitivity of the results to changes in the inputs used in the model. Figures 16 to 25 show the sensitivity of the results to changes in the inputs. We find that the model predicts an increase in consumer welfare from the remedies for almost all the individual sensitivities we ran. This is the case even if we completely ignore positive valuations from the delay for the consumers who prefer to buy later and continue to assume that all consumers are myopic (we then find an increase equivalent to 25 per cent of excess profits, or £33 million benefits a year). The only exception is if the costs of the loss of convenience to consumers who prefer to buy MPPI at the credit point of sale are very high: over 35 per cent of the current MPPI price. Given that Accent found these costs to be statistically insignificant, we are confident that this is not the case.

29. Figure 16 shows the sensitivity of the results to the amount of pass-through (ie the extent of the waterbed effect). We find that, if the waterbed effect is 100 per cent, the base model still predicts that the package of remedies will increase consumer welfare.

FIGURE 16

MPPI: sensitivity of results to the waterbed effect



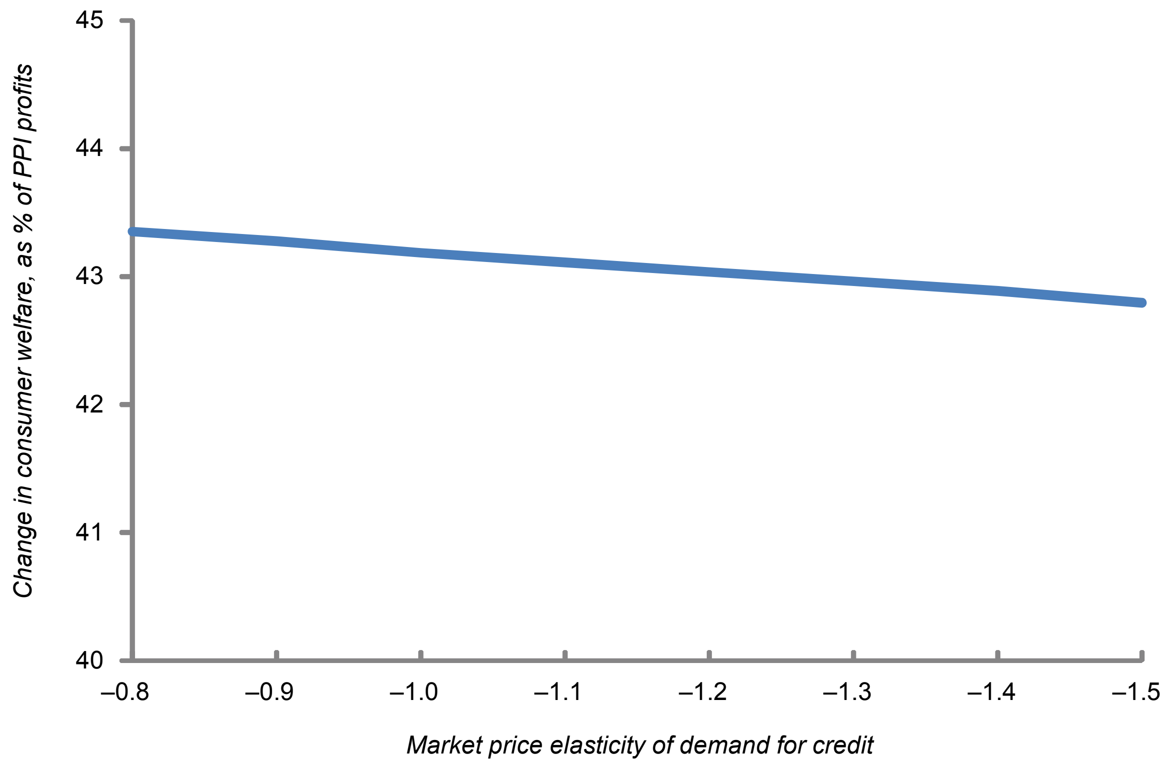
Source: CC analysis.

30. Figure 17 shows the sensitivity of the results to the market level elasticity of credit demand. Figure 18 shows the sensitivity of the results to the pre-remedy PPI penetration rate. Figure 19 shows the sensitivity of the results to the market level elasticity

of PPI demand. In all cases, the model predicts that consumer welfare will increase after the remedies.

FIGURE 17

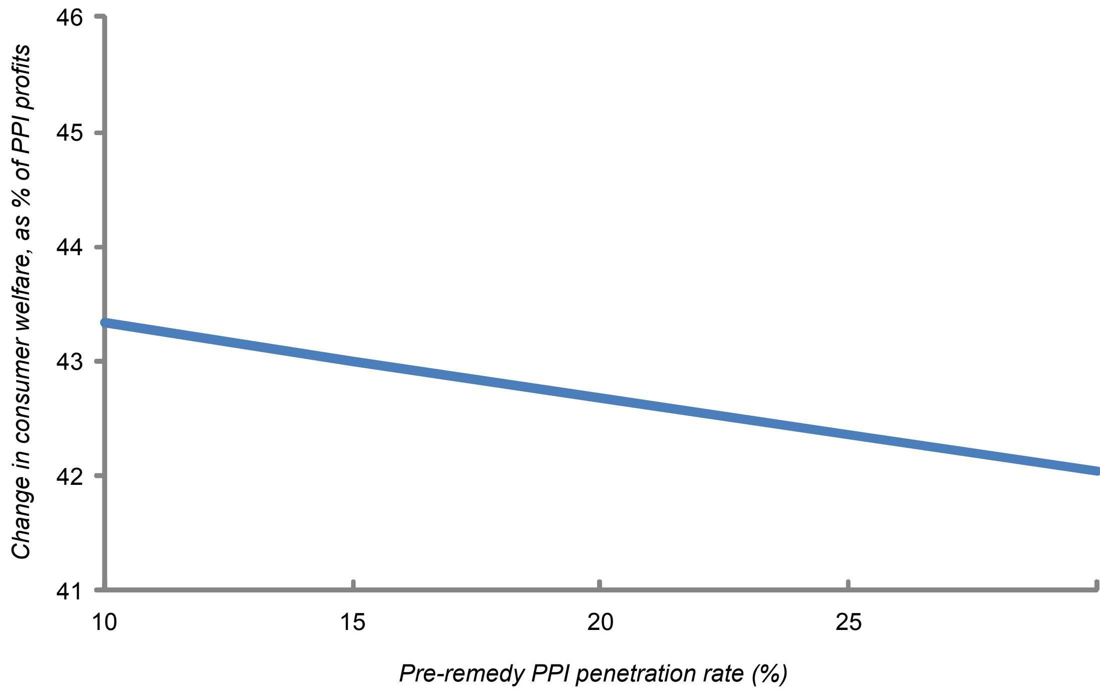
MPPI: sensitivity of results to credit elasticity



Source: CC analysis.

FIGURE 18

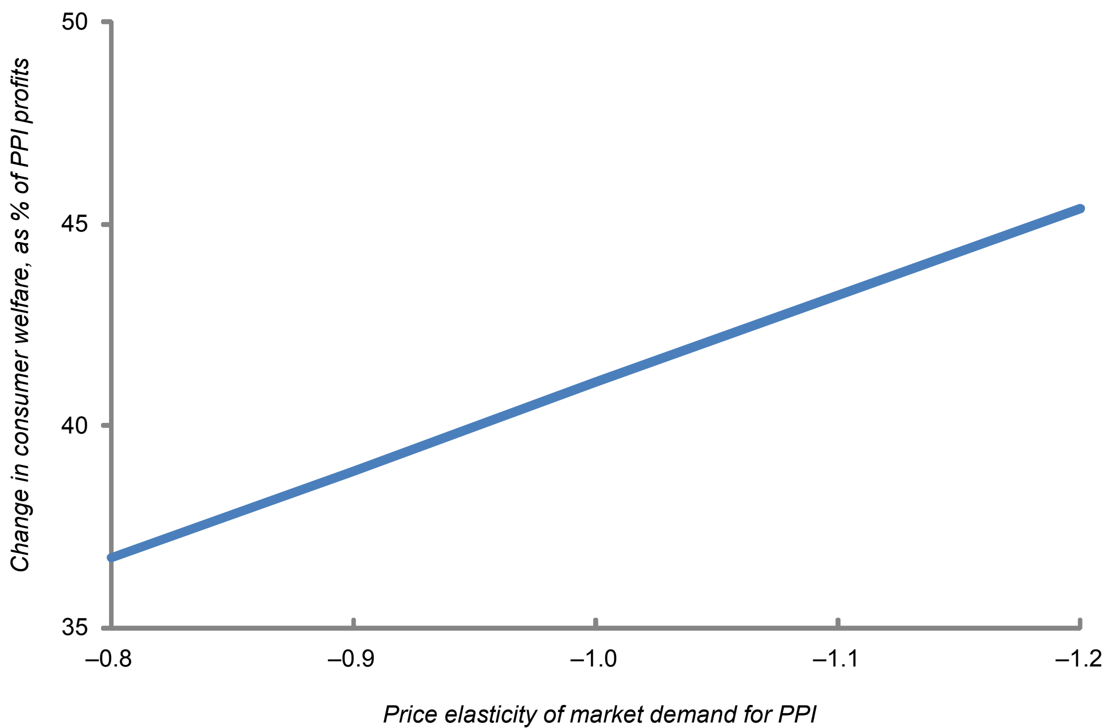
MPPI: sensitivity of the results to the pre-remedy penetration rate



Source: CC analysis.

FIGURE 19

MPPI: sensitivity of the results to the market elasticity of PPI demand

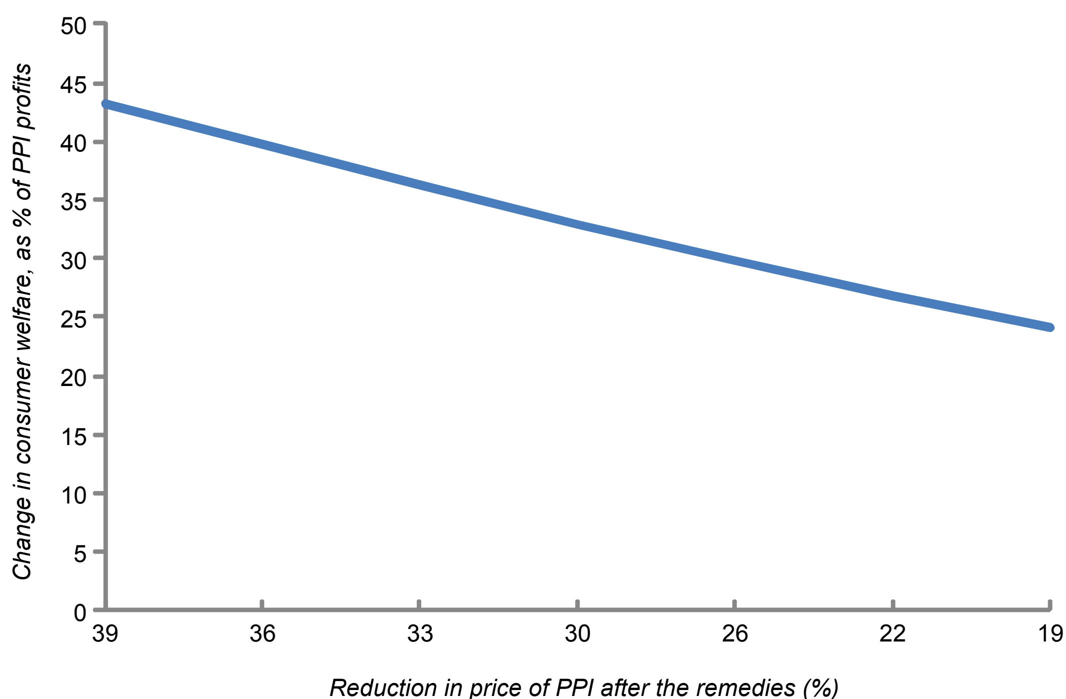


Source: CC analysis.

31. Figure 20 shows the sensitivity of the results to the assumption that all PPI excess profits are competed away in the PPI market with the remedies in place. In our base case, all PPI excess profits are competed away in the PPI market with the remedies in place, and the price of MPPI reduces by 40 per cent. Indeed, we found that the remedies would be substantially effective, and therefore we expect prices to drop to levels close to the competitive price. We checked the sensitivity of our results to this assumption, by looking at the results of the model if we assumed that between 50 and 100 per cent of PPI excess profits are competed away in the PPI market after the remedies are in place, ie if the reduction in price after the remedies is between 20 and 40 per cent. We found that, even if only half of the excess profits are competed away in the PPI markets, so that the reduction in the price of PPI, after remedies, is 20 per cent, the model predicts that consumer welfare will increase after the remedies are in place.

FIGURE 20

MPPI: sensitivity of results to the amount by which PPI prices reduce after the remedies

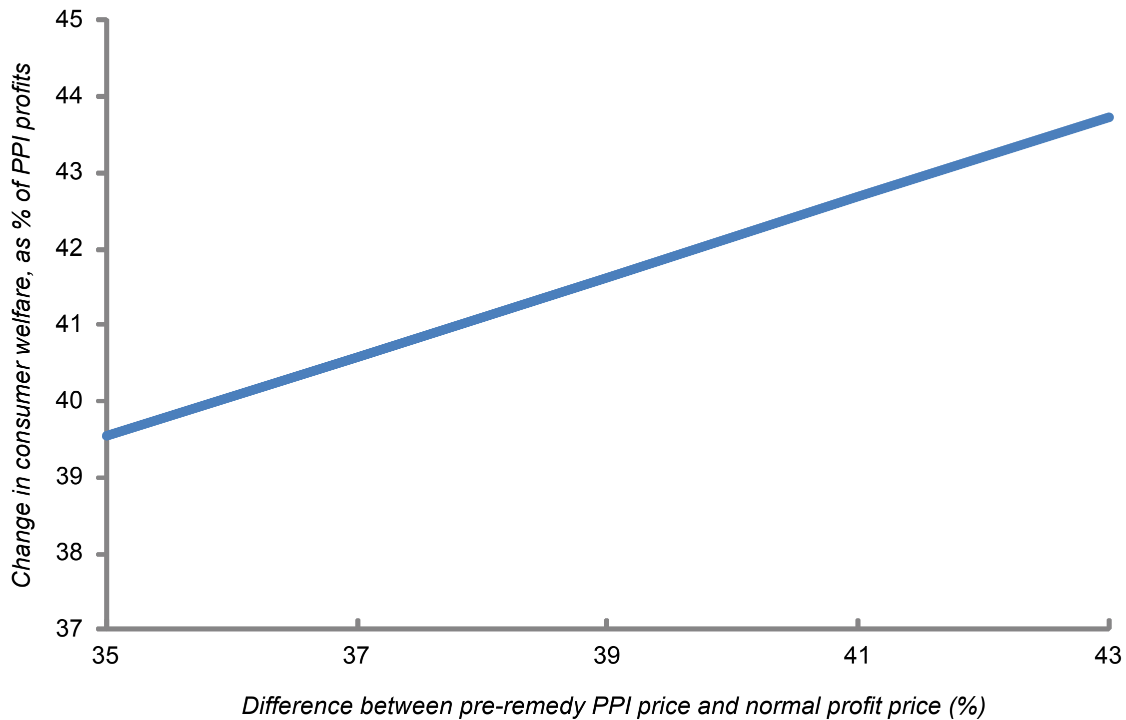


Source: CC analysis.

32. Figure 21 shows the sensitivity of the results to the pre-remedy excess profit margin, ie the amount by which the price of PPI prior to the remedies being imposed is in excess of the competitive PPI price. The model predicts that consumer welfare will increase even if the pre-remedy excess profit margin is lower than the 42 per cent value which we use in the base model, as derived from our profitability analysis.

FIGURE 21

MPPI: sensitivity of results to the pre-remedy excess profit margin

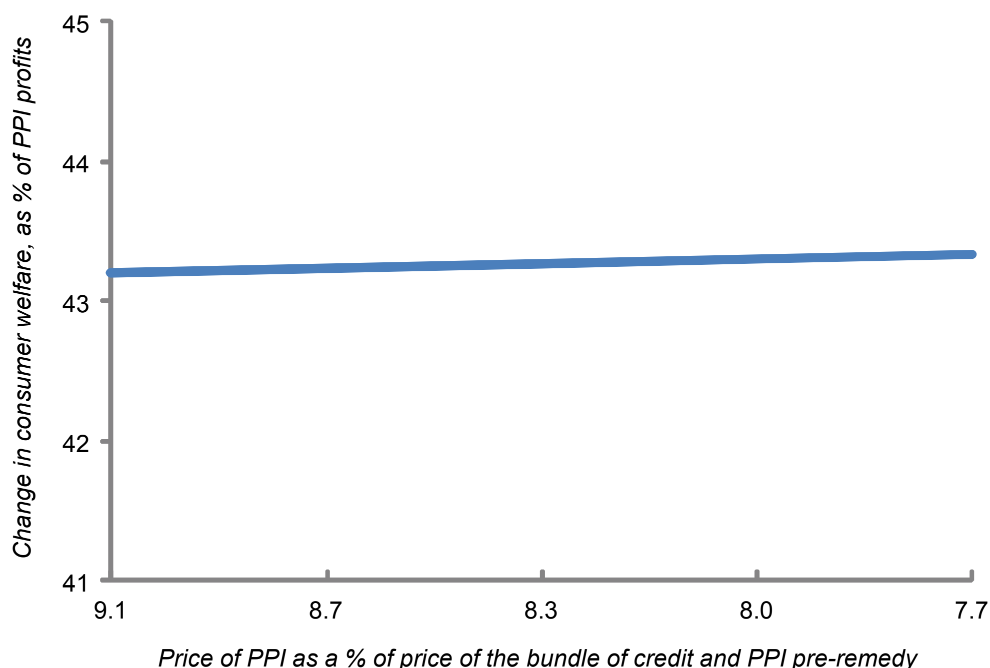


Source: CC analysis.

33. Figure 22 shows the sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit, pre-remedy. In our base case, which is based on 2006 data, the price of MPPI represents about 9 per cent of the price of the bundle of credit and PPI. If we account for the fact that the price of credit has increased relative to PPI since 2006 (by up to 20 per cent), so that the PPI element of the price of the bundle has reduced in relative terms, we find that the model predicts larger increases in consumer welfare after the remedies.

FIGURE 22

MPPI: sensitivity of results to price of PPI relative to the price of the bundle of PPI and credit

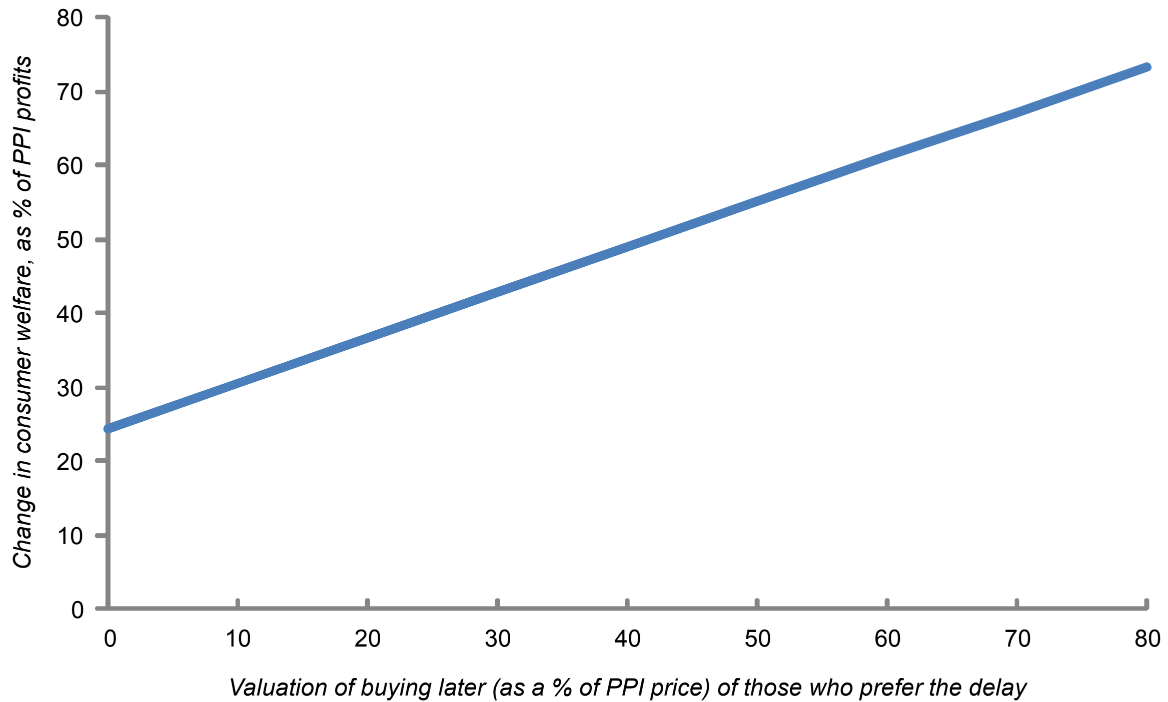


Source: CC analysis.

34. Figure 23 shows the sensitivity of the results to the Accent survey results on the positive willingness to pay for a delay in the sales process by consumers who prefer to buy PPI after the point of sale. In the base case, the 36 per cent of consumers who prefer to buy after a delay are willing to pay 31 per cent of the price of MPPI to do so. We find that, even if we ignore all of the positive valuations that these consumers associate with the delay in the process, the base model predicts that consumer welfare will increase after the remedies are in place. By extension, this also implies that the results from the model also hold if we change the relative values of the valuations of the loss of convenience by the different types of consumers: indeed, if the model predicts an increase in consumer welfare even if the positive valuations are ignored, this means that the model would also predict an increase in consumer welfare if the positive valuations are reduced (and the costs of the loss of convenience are reduced in proportion).

FIGURE 23

MPPI: sensitivity of the results to the positive valuations of buying later by consumers who prefer the delay

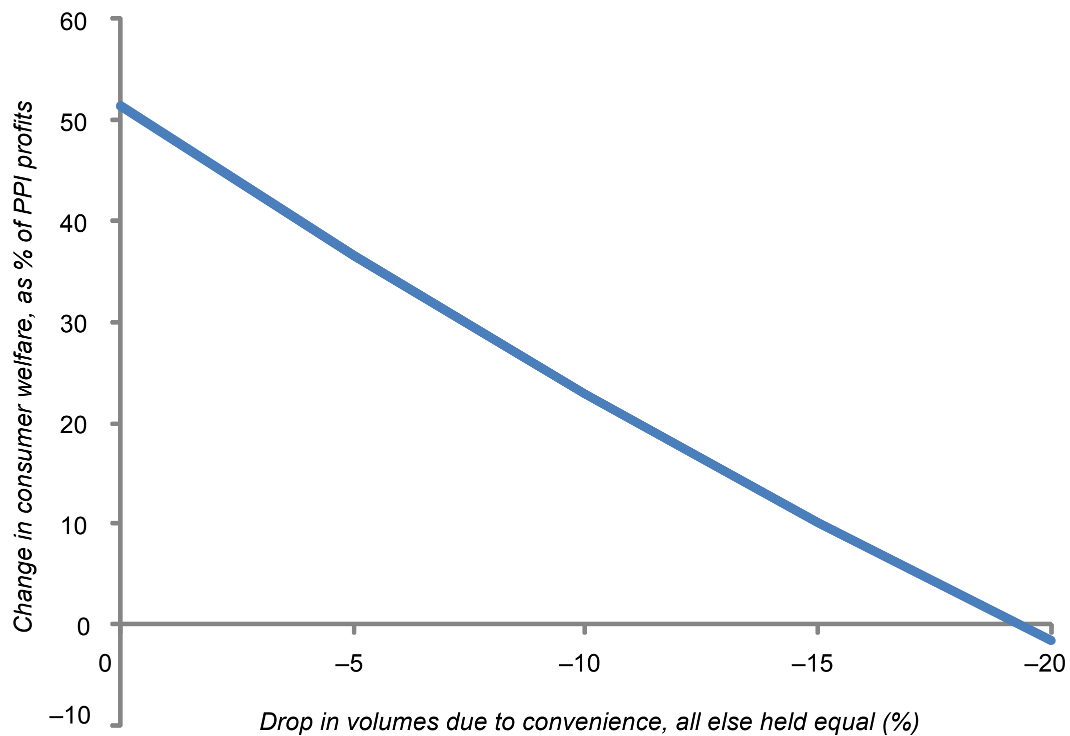


Source: CC analysis.

35. We checked the sensitivity of our results to the loss of convenience. Accent found that the costs of the loss of convenience to consumers who prefer to buy at the point of sale were not statistically significant. For the modelling, we assumed that the costs of the loss of convenience would be of 5 per cent for the base case. For an elasticity of –1.1, this would imply a loss of volumes of MPPI due to loss of convenience of less than 3 per cent if nothing else changed. Figure 24 shows the sensitivity of the results to the costs of the loss of convenience. The model predicts that consumer welfare may decrease if the costs of the loss of convenience are such that 20 per cent of sales would be lost if nothing else changes. This would happen if the costs of the loss of convenience to consumers who prefer to buy at the point of sale are 35 per cent of price of MPPI (ie, £12 per month on average). Given that Accent found that these costs were not significantly different from zero, it is unlikely that the costs of the loss of convenience could be this high.

FIGURE 24

MPPI: sensitivity of the results to the costs of the loss of convenience

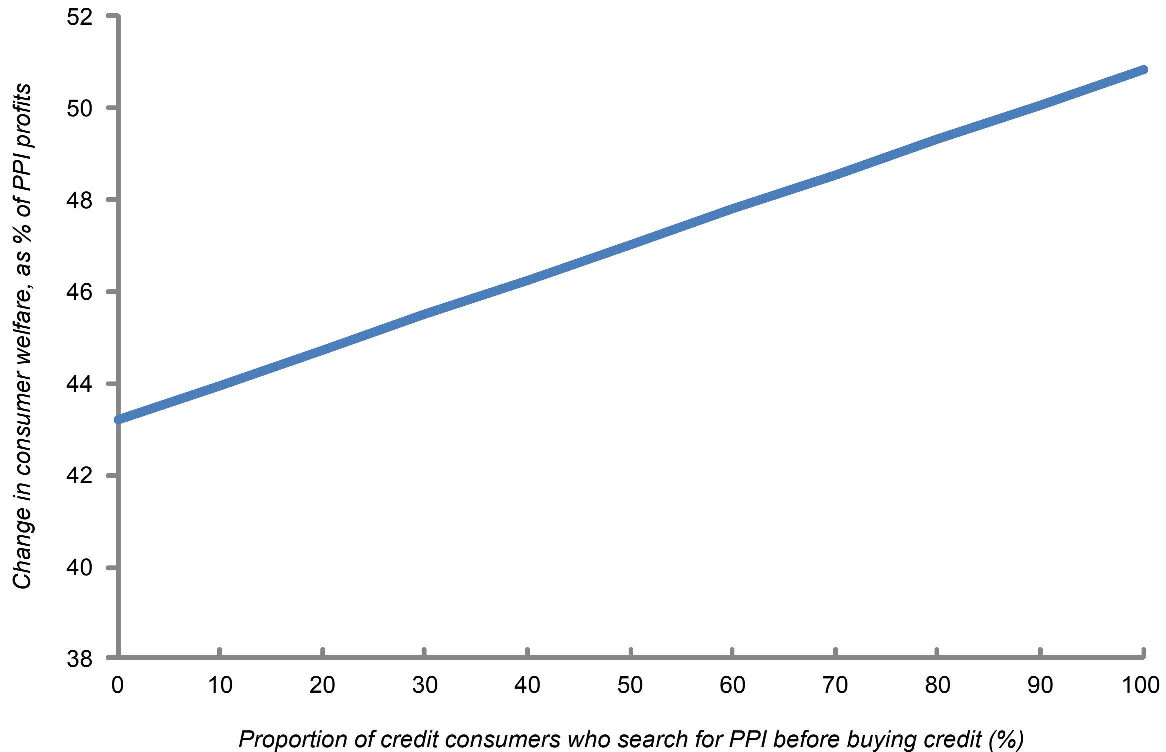


Source: CC analysis.

36. Figure 25 shows the sensitivity of the results to the removal of the assumption that all credit consumers are myopic. The larger the proportion of consumers who search for PPI prior to the credit purchase after the remedies, the larger the estimate of consumer welfare after the remedies. In the base case, we assumed that no consumers search.

FIGURE 25

MPPI: sensitivity of the results to the assumption that all credit consumers are myopic



Source: CC analysis.

CCPPI

37. For CCPPI, the base case (with the inputs and assumptions in Table 9 of Appendix I) predicts that consumer welfare will increase after the package of remedies is in place; the increase is equivalent to 18 per cent of CCPPI excess profits. In monetary terms, this represents about £77 million in benefits to consumers a year, before the time frame for the remedies to take effect and one-off costs of £26 million are taken into account.

38. We checked the sensitivity of this finding to the assumption that one-off implementation costs are not passed on to consumers in the form of higher PPI prices after the remedies are in place. If we include an allocation for one-off implementation costs after the remedies are in place (so that the one-off costs are spread over three years), the base model predicts that the increase in consumer welfare after the remedies are in place will amount to 14 per cent of CCPPI excess profits; that is, about £60 million a year net benefits to consumers.

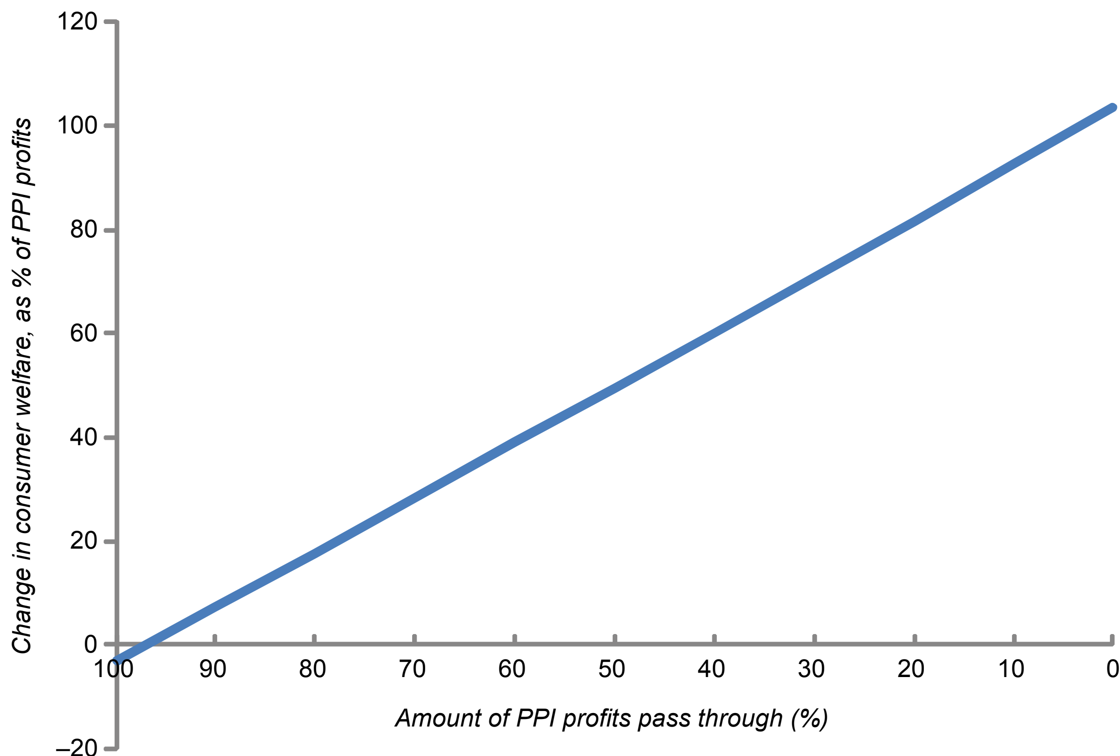
39. We also checked the sensitivity of the results to lower sales of CCPPI because of significant amounts of unwanted sales prior to the remedies. If we assumed that half of the CCPPI sales prior to the remedies being imposed were unwanted, and therefore did not take place after the remedies are in place, the benefits from the remedies for CCPPI would halve to about £38 million a year. This remains high compared with one-off costs of £26 million.

40. Figures 26 to 37 show the sensitivity of the results to changes in the inputs.

41. Figure 26 shows the sensitivity of the results to the amount of pass-through (ie the extent of the waterbed effect). We find that, if the waterbed effect is 100 per cent, the base model predicts that the package of remedies may result in a small reduction in consumer welfare. If the waterbed effect is less than 100 per cent, the model predicts an increase in consumer welfare with the remedies.

FIGURE 26

CCPPI: sensitivity of the results to the waterbed effect

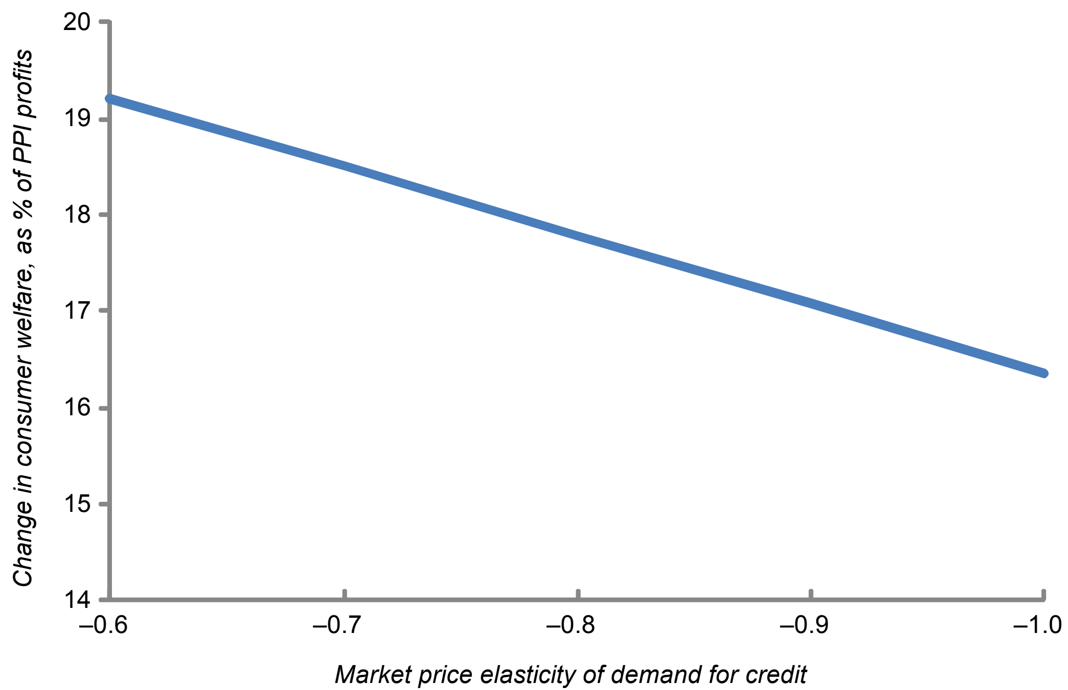


Source: CC analysis.

42. Figure 27 shows the sensitivity of the results to the market level elasticity of credit demand. Figure 28 shows the sensitivity of the results to the pre-remedy PPI penetration rate. Figure 29 shows the sensitivity of the results to the market level elasticity of PPI demand. In all cases, the model predicts that consumer welfare will increase after the remedies.

FIGURE 27

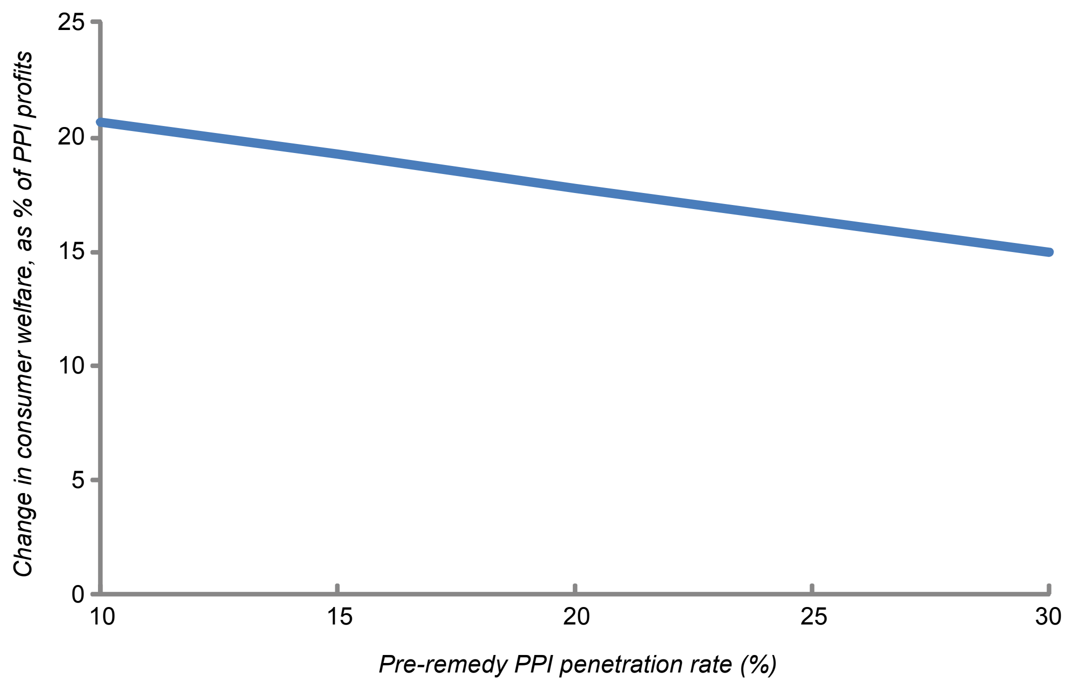
CCPPI: sensitivity of the results to credit elasticity



Source: CC analysis.

FIGURE 28

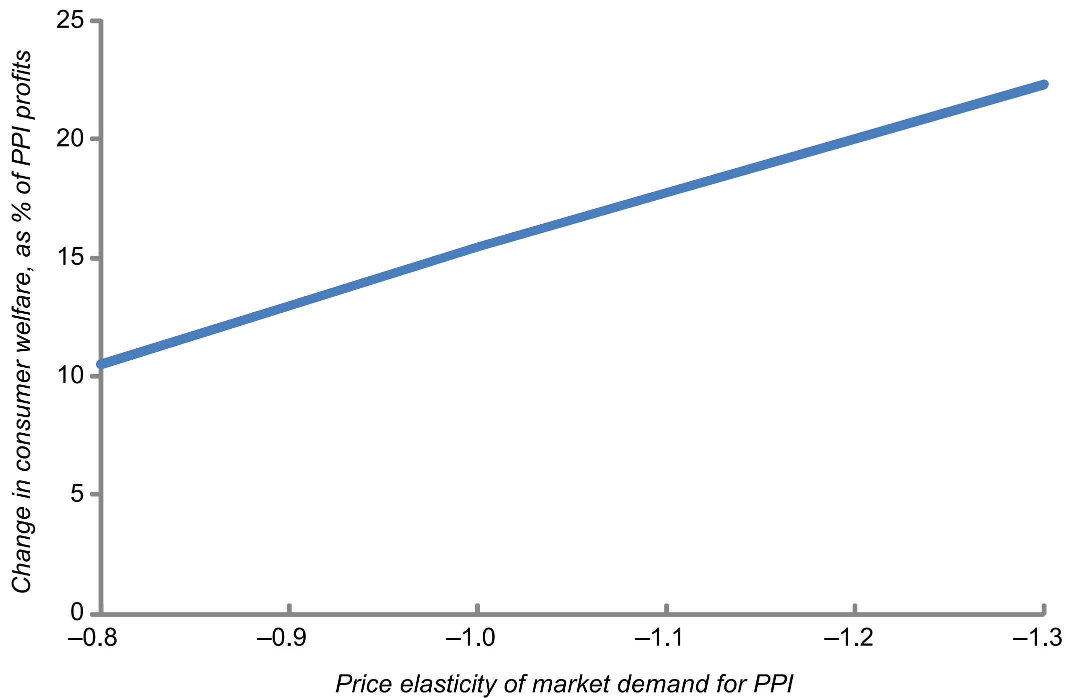
CCPPI: sensitivity of the results to the pre-remedy penetration rate



Source: CC analysis.

FIGURE 29

CCPPI: sensitivity of the results to the market elasticity of PPI demand

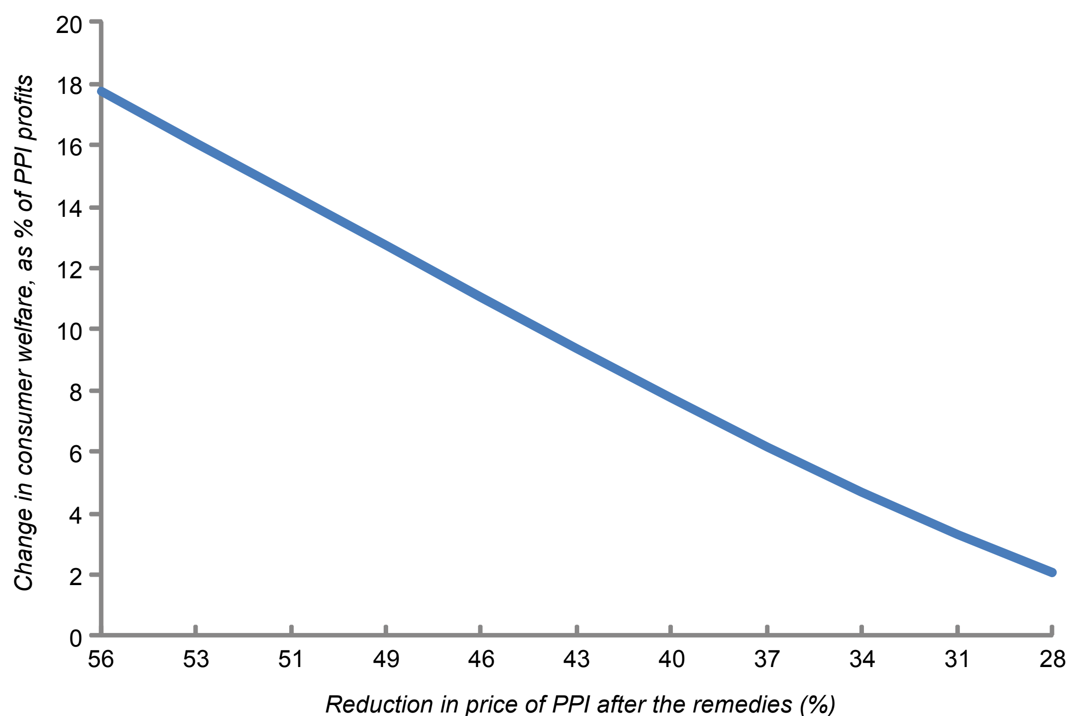


Source: CC analysis.

43. Figure 30 shows the sensitivity of the results to the assumption that all PPI excess profits are competed away in the PPI market with the remedies in place. In our base case, all PPI excess profits are competed away in the PPI market with the remedies in place, and the price of CCPPI reduces by 56 per cent. Indeed, we found that the remedies would be substantially effective, and therefore we expect prices to drop to levels close to the competitive price. We checked the sensitivity of our results to this assumption, by looking at the results of the model if we assumed that between 50 and 100 per cent of PPI excess profits are competed away in the PPI market after the remedies are in place, ie if the reduction in price after the remedies is between 28 and 56 per cent. We found that, even if only half of the excess profits are competed away in the PPI markets, so that the reduction in the price of PPI, after remedies, is 28 per cent, the model predicts that consumer welfare will increase after the remedies are in place.

FIGURE 30

CCPPI: sensitivity of the results to the amount by which PPI prices reduce after the remedies

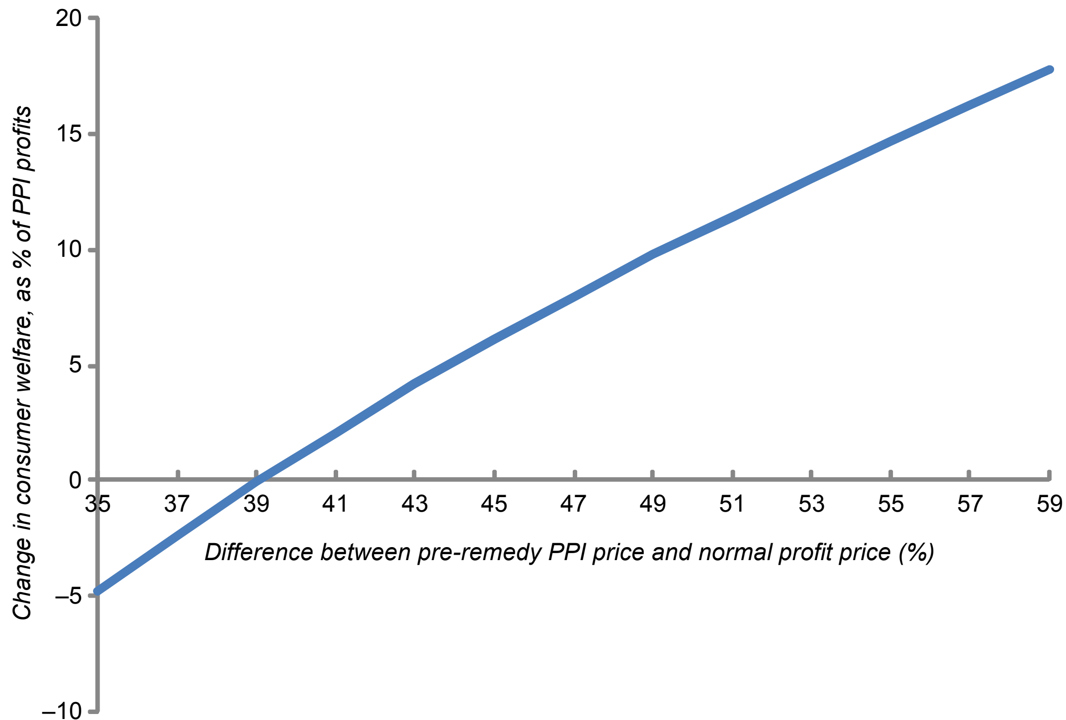


Source: CC analysis.

44. Figure 31 shows the sensitivity of the results to the pre-remedy excess profit margin, ie the amount by which the price of PPI prior to the remedies being imposed is in excess of the competitive PPI price. For our base case, we estimated that the pre-remedy excess profit margin was 59 per cent. This was based on average margins for 2005 to 2009. We find that the model predicts that consumer welfare will increase if the pre-remedy excess profit margin is higher than 39 per cent. This is considerably lower than the value we used in the base case; given the conservative assumptions for our profitability analysis (as set out in paragraph 11 above), we consider that it is unlikely that pre-remedy excess profit margins are below 39 per cent.

FIGURE 31

CCPPI: sensitivity of the results to the pre-remedy excess profit margin

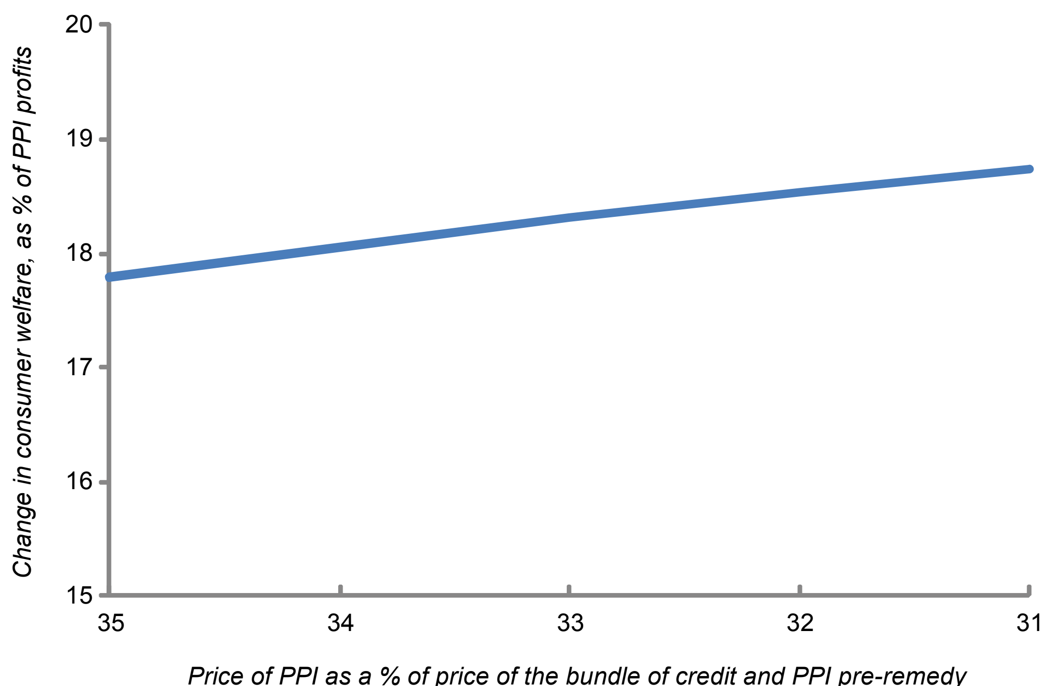


Source: CC analysis.

45. Figure 32 shows the sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit, pre-remedy. In our base case, the price of CCPPI represents about 35 per cent of the price of the bundle of credit and PPI. These figures assume a credit card APR of 15.5 per cent, and price of CCPPI of £0.79 per £100 of outstanding balance (which gives a bundled APR of 23.85 per cent). However, the 15.5 per cent value for the credit card APR may be a lower estimate: there are indications that the credit card APR is higher (at least for certain credit groups). If we account for the fact that the average credit card APR may be higher than 15.5 per cent, the model predicts larger increases in consumer welfare after the remedies.

FIGURE 32

CCPPI: sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit

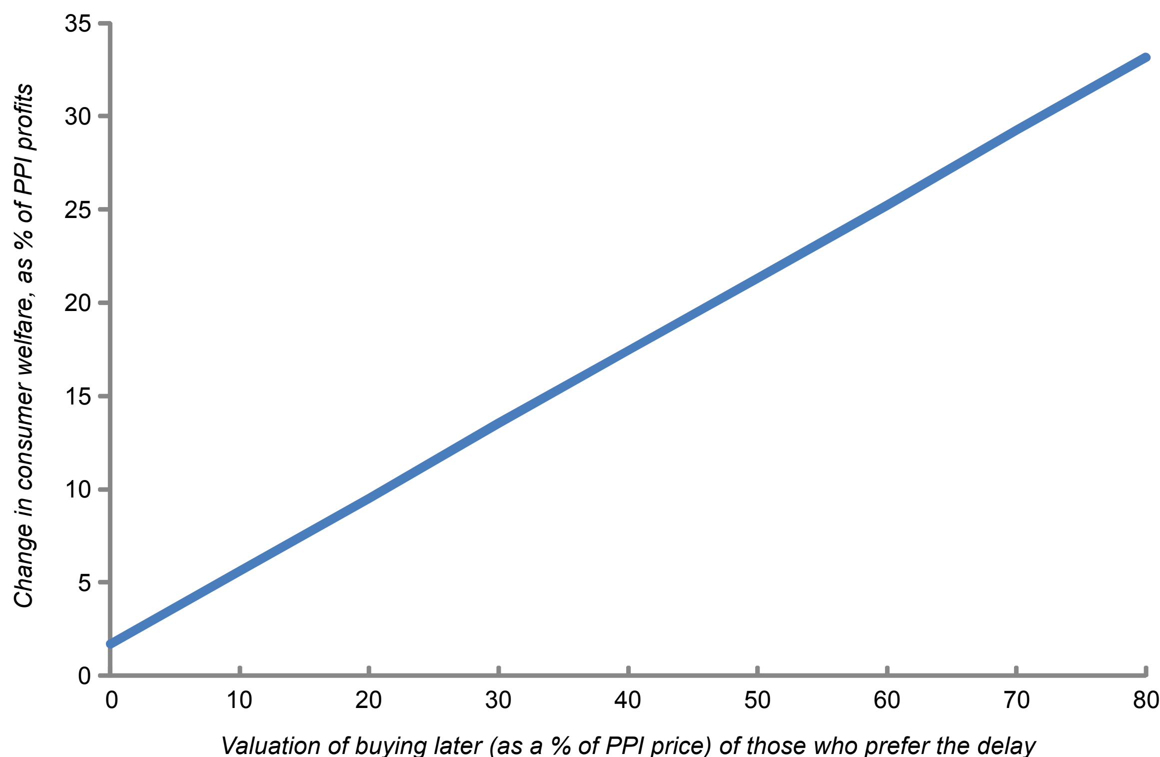


Source: CC analysis.

46. Figure 33 shows the sensitivity of the results to the Accent survey results on the positive willingness to pay for a delay in the sales process by consumers who prefer to buy PPI after the point of sale. We assumed, for CCPPI, that consumers' preferences regarding the delay in purchasing PPI were similar to those of PLPPI consumers. Therefore, in the base case, we assume that 30 per cent of consumers prefer buying after the point of sale and value this at 41 per cent of the pre-remedy PPI price. We find that, even if we ignore all of the positive valuations that these consumers associate with the delay in the process, the base model predicts that consumer welfare will increase after the remedies are in place.

FIGURE 33

CCPPI: sensitivity of the results to the positive valuations of buying later by consumers who prefer the delay

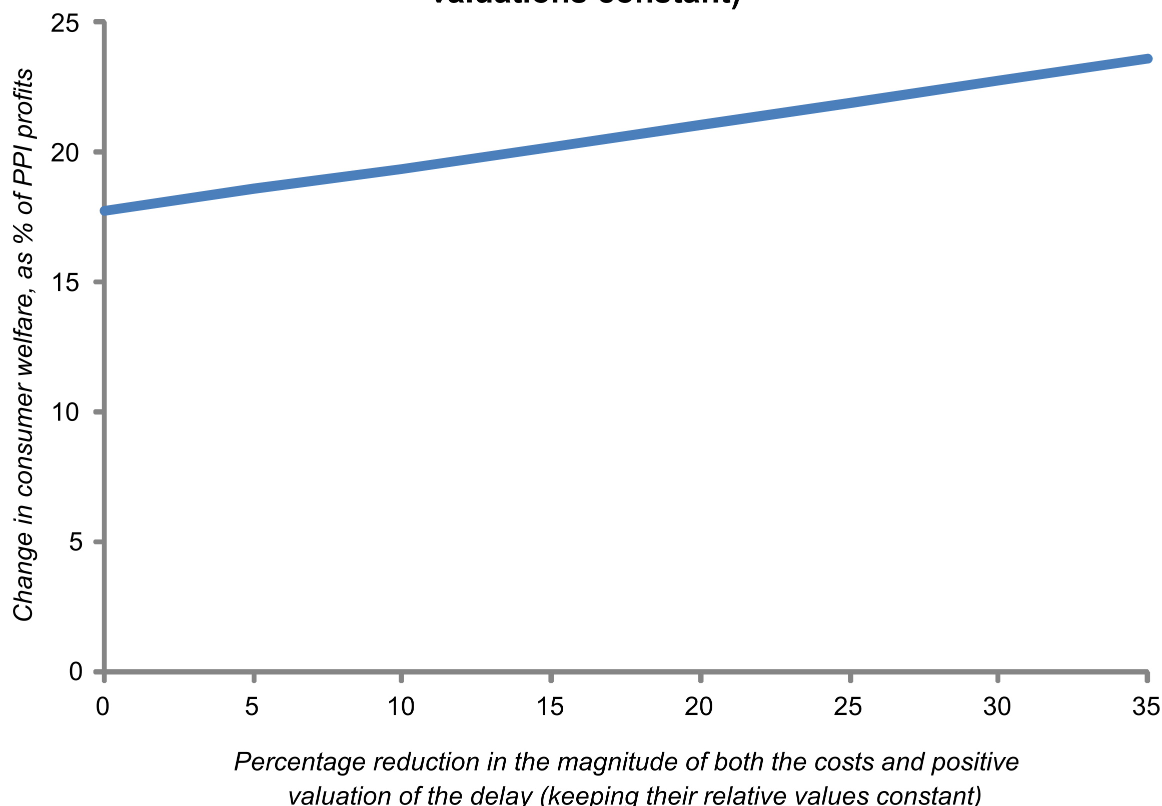


Source: CC analysis.

47. Figure 34 shows the sensitivity of the results to the magnitude of the willingness-to-pay results in the Accent survey. We concluded that the Accent survey results were robust in terms of the relative valuation of the costs of the loss of convenience of the different groups of consumers, but that the magnitudes may be too high. In our base case, the costs of the loss of convenience of consumers who prefer to buy at the point of sale are valued at 24 per cent of the price of PPI, while the positive valuation of the delay of consumers who prefer the delay is 41 per cent of the price of PPI. If we reduce the magnitude of the costs/valuation of the delay of both groups of consumers (those who prefer to buy at the point of sale, and those who prefer to buy later), without changing the relative value of these costs, we find that the model predicts that consumer welfare will increase more than in our base case. This is shown in Figure 34, where we reduce the cost of convenience of the consumers who prefer to buy at the point of sale, and reduce the valuation of buying later of consumers who prefer to buy later, in the same proportions.

FIGURE 34

CCPPI: sensitivity of the results to the magnitude of the willingness-to-pay results of consumers' valuation of the delay (keeping the relative valuations constant)



Source: CC analysis.

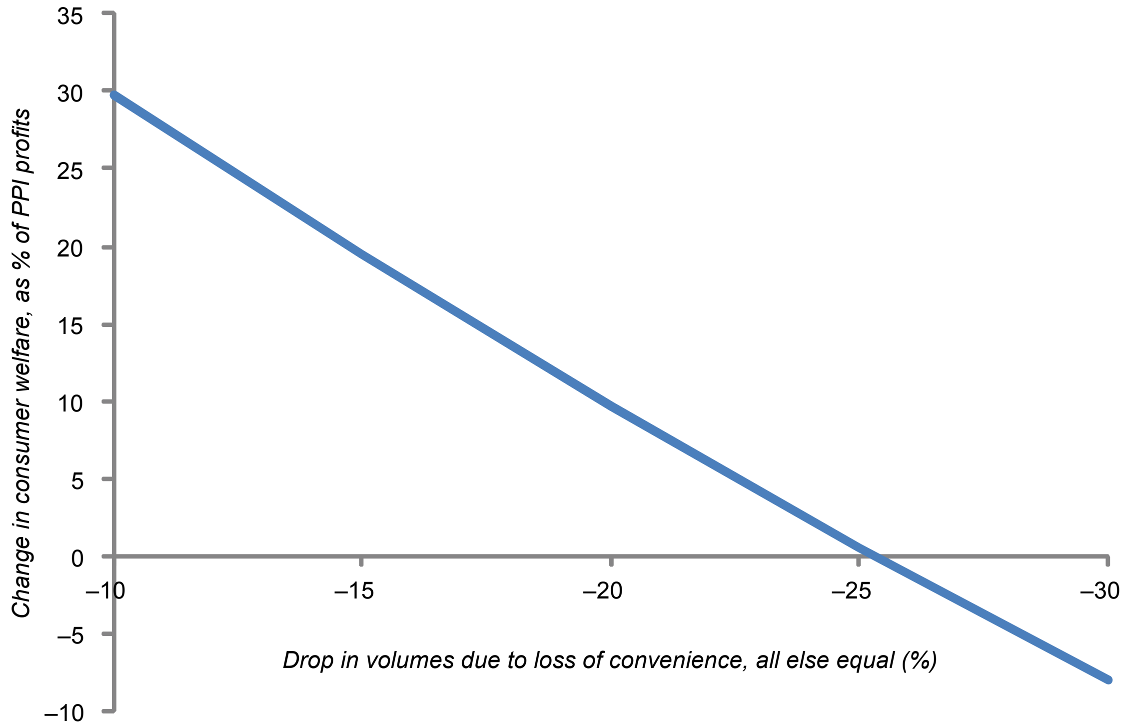
48. Figure 35 shows the sensitivity of the results to the costs of the loss of convenience. In our base case, the drop in volumes (at constant price) due to the costs of the loss of convenience is 15 per cent.[6] If the drop in volumes because of the loss of convenience were higher, this could either be because the costs of the loss of convenience to consumers who prefer to buy at the point of sale are higher than estimated in the Accent survey, or because the market demand for PPI is more elastic than in our base case estimate. We note that, if the demand for PPI were more elastic than in our base case, the model predicts larger increases in consumer welfare compared with the base case (see Figure 29). If the costs of the loss of convenience were larger, the model predicts that consumer welfare will be lower, as shown in Figure 35. The model predicts that consumer welfare will decrease if the costs of the loss of convenience are such that, at constant prices, PPI volumes will reduce by more than 25 per cent. This is equivalent to a cost of convenience which amounts to 40 per cent of the monthly price of CCPPI (at constant elasticity). This would imply that the actual costs of the loss of convenience to consumers who prefer to buy at the point of sale are 60 per cent higher than in our base case. We think it is unlikely that the results from the Accent survey have under-estimated the costs of the loss of convenience by such a large amount. Moreover, for CCPPI, although we used the results from the Accent survey on costs of convenience for PLPPI, we think that the costs of the loss of convenience are likely to be much lower and more similar to MPPI. The use of the

[6]The drop in volumes due to convenience (all else being equal) is less than for PLPPI, even though the costs of the loss of convenience are the same. This is because we were conservative for CCPPI and assumed that the elasticity of CCPPI demand was –1.1.

PLPPI estimates reflected a cautious approach, as explained in paragraph 5.86. For these reasons, we think it is unlikely that the costs of the loss of convenience could be this high for CCPPI.

FIGURE 35

CCPPI: sensitivity of the results to the costs of the loss of convenience

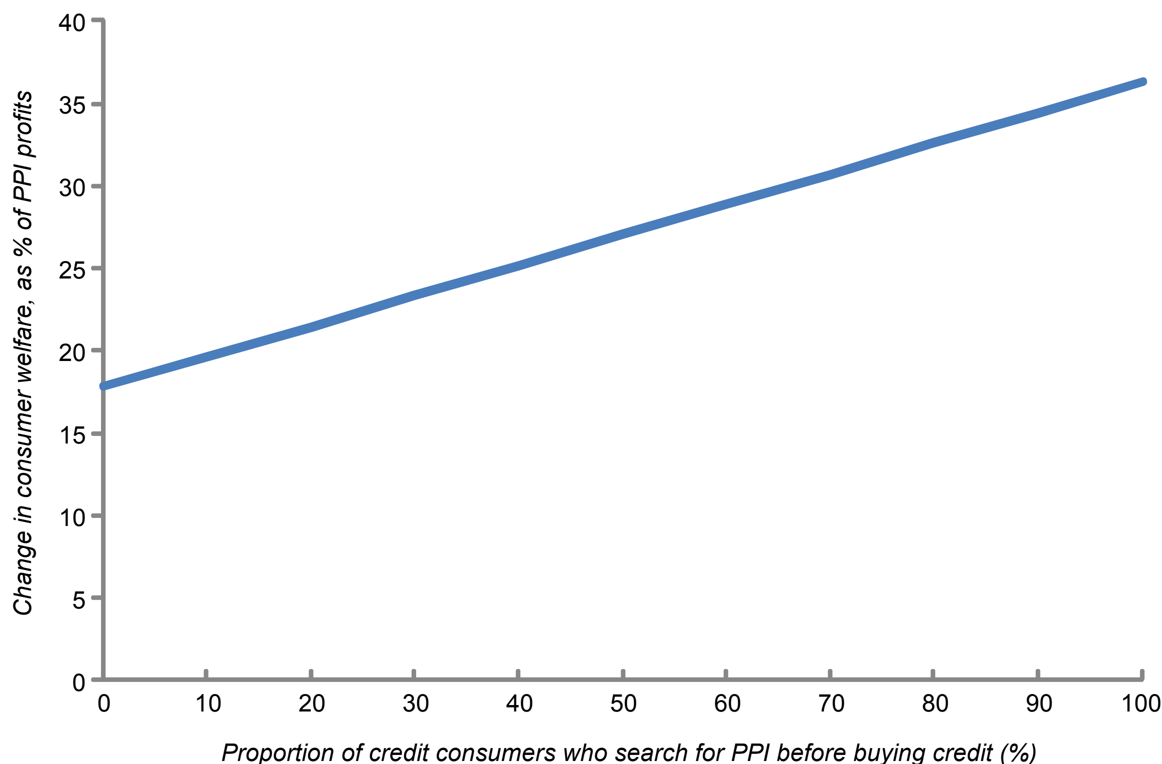


Source: CC analysis.

49. Figure 36 shows the sensitivity of the results to the removal of the assumption that all credit consumers are myopic. The larger the proportion of consumers who search for PPI prior to the credit purchase after the remedies, the larger the estimate of consumer welfare after the remedies. In the base case we assumed no consumers search.

FIGURE 36

CCPPI: sensitivity of the results to the assumption that all credit consumers are myopic



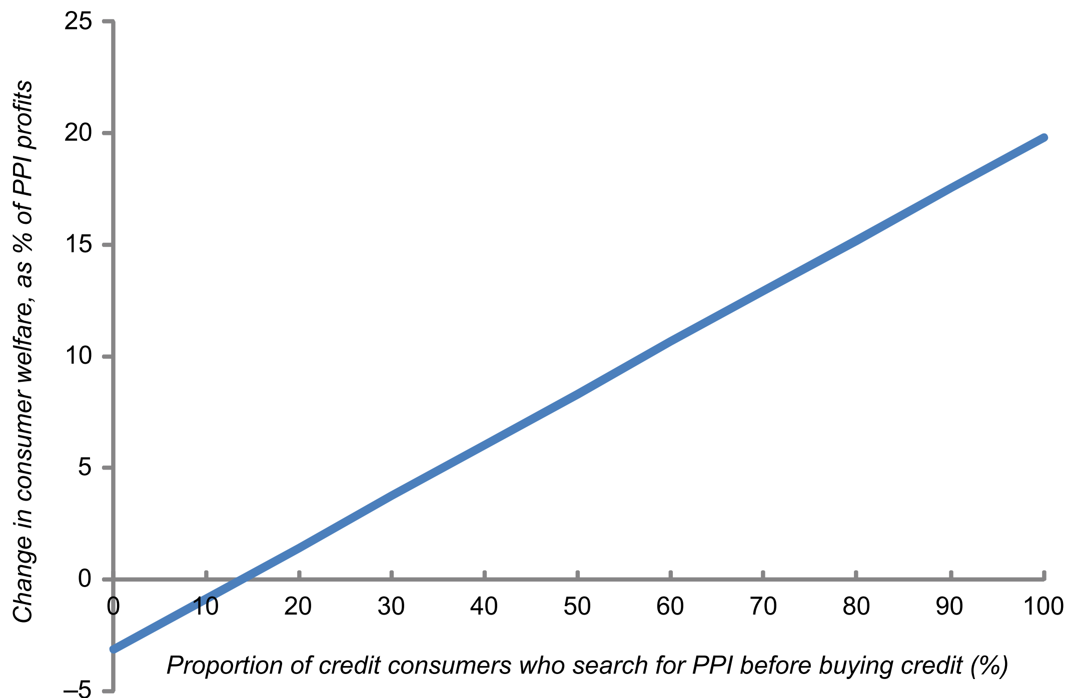
Source: CC analysis.

50. We found that the base model predicts a reduction in consumer welfare if there is full waterbed (100 per cent pass-through).[7] We therefore looked at the sensitivity of the finding when we relax the assumption that all consumers are myopic and there is 100 per cent pass-through. Figure 37 shows the results: the model predicts an increase in consumer welfare when there is 100 per cent pass-through if the proportion of consumers who search prior to the credit point of sale is 12 per cent or more.

[7]The model also predicts that consumer welfare will decrease if the pre-remedy excess profit margins are lower than 39 per cent. However, for the reasons presented in paragraph 44, this level of margins is very far from our base case assumption for the margins, and we therefore do not consider this possibility any further. Similarly, the model predicts that consumer welfare will decrease if the costs of the loss of convenience to consumers who prefer the delay are 40 per cent or more of the current CCPPI price. For the reasons set out in paragraph 16, we were cautious and used the PLPPI survey results for the estimate of the costs of the loss of convenience for CCPPI, even though we expect that the costs of the loss of convenience for CCPPI are lower than for PLPPI. Therefore, we think it is unlikely that the costs of the loss of convenience could be this high for CCPPI.

FIGURE 37

CCPPI: sensitivity of results to consumer myopia, with 100 per cent waterbed assumption



Source: CC analysis.

SMPPI

51. For SMPPI, the base case (with the inputs and assumptions in Table 8 of Appendix I) predicts that consumer welfare will increase after the package of remedies is in place; the increase is equivalent to 15 per cent of SMPPI excess profits. In monetary terms, this is equivalent to about £17 million of benefits a year, before the time frame for the remedies to take effect and one-off costs of £1–£2 million are taken into account.

52. We checked the sensitivity of this finding to the assumption that one-off implementation costs are not passed on to consumers in the form of higher PPI prices after the remedies are in place. If we include an allocation for one-off implementation costs after the remedies are in place (so that the one-off costs are spread over three years), the base model predicts that the increase in consumer welfare after the remedies are in place will amount to 13 per cent of SMPPI excess profits; that is, about £15 million a year net benefits to consumers.

53. We also checked the sensitivity of the results to lower sales of SMPPI because of significant amounts of unwanted sales prior to the remedies. If we assumed that half of the SMPPI sales prior to the remedies being imposed were unwanted, and therefore did not take place after the remedies are in place, the benefits from the remedies for SMPPI would halve to £8 million a year.

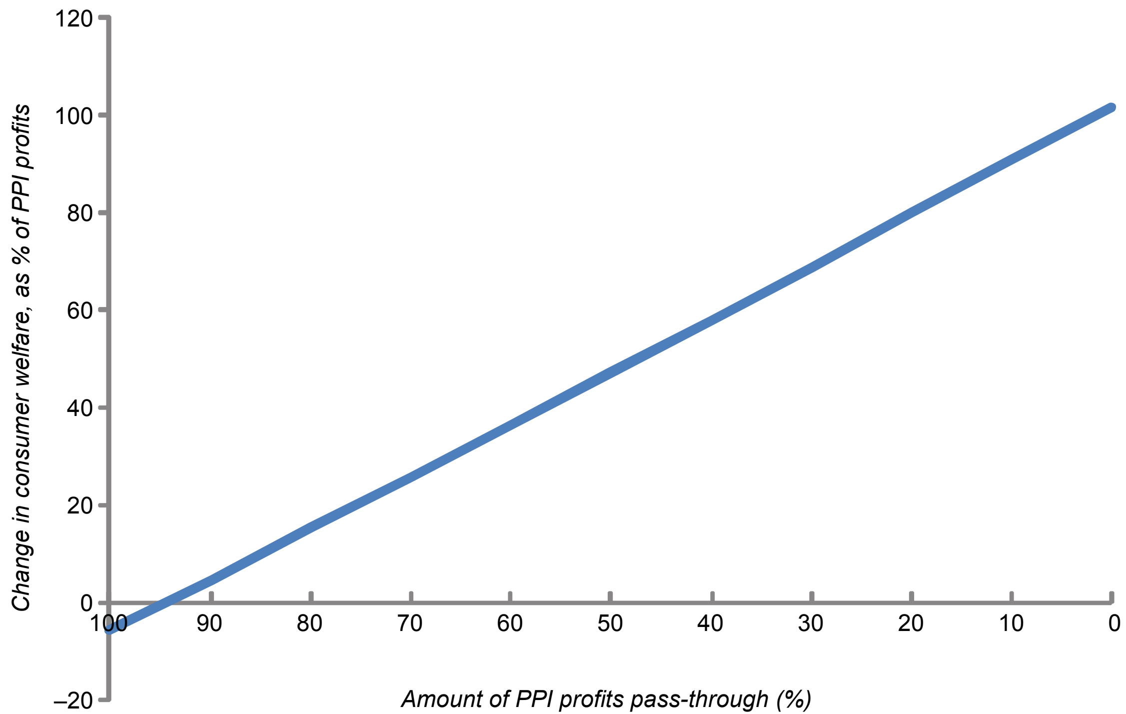
54. Figures 38 to 47 show the sensitivity of the results to changes in the inputs.

55. Figure 38 shows the sensitivity of the results to the amount of pass-through (ie the extent of the waterbed effect). We find that, if the waterbed effect is 100 per cent, the

base model predicts a small reduction in consumer. For any pass-through of less than 95 per cent, the base model predicts that consumer welfare will increase after the remedies.

FIGURE 38

SMPPI: sensitivity of the results to the waterbed effect

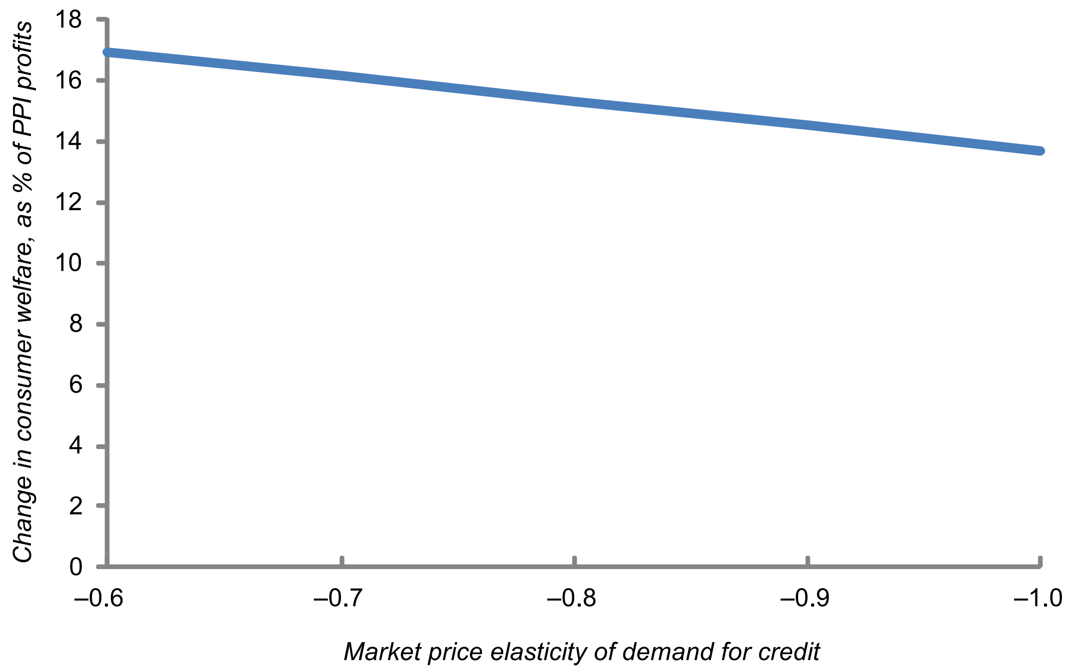


Source: CC analysis.

56. Figure 39 shows the sensitivity of the results to the market level elasticity of credit demand. Figure 40 shows the sensitivity of the results to the market level elasticity of PPI demand. Figure 41 shows the sensitivity of the results to the pre-remedy PPI penetration rate. In all cases, the model predicts that consumer welfare will increase after the remedies.

FIGURE 39

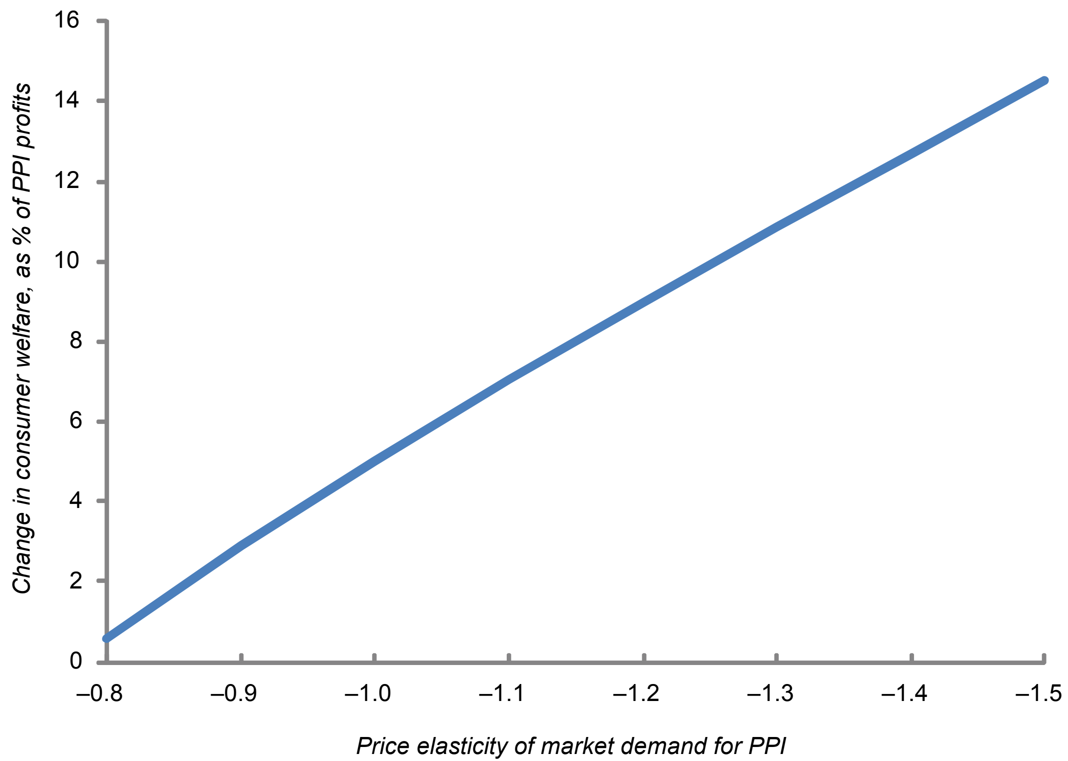
SMPPI: sensitivity of the results to credit elasticity



Source: CC analysis.

FIGURE 40

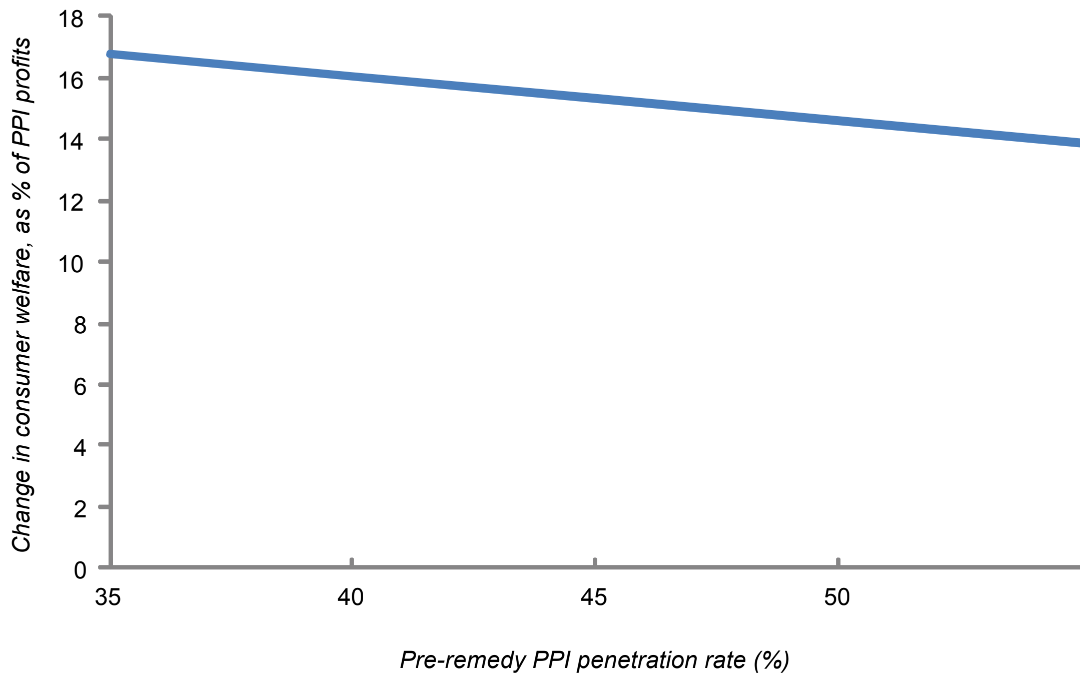
SMPPI: sensitivity of the results to the market elasticity of PPI demand



Source: CC analysis.

FIGURE 41

SMPPI: sensitivity of the results to the pre-remedy penetration rate

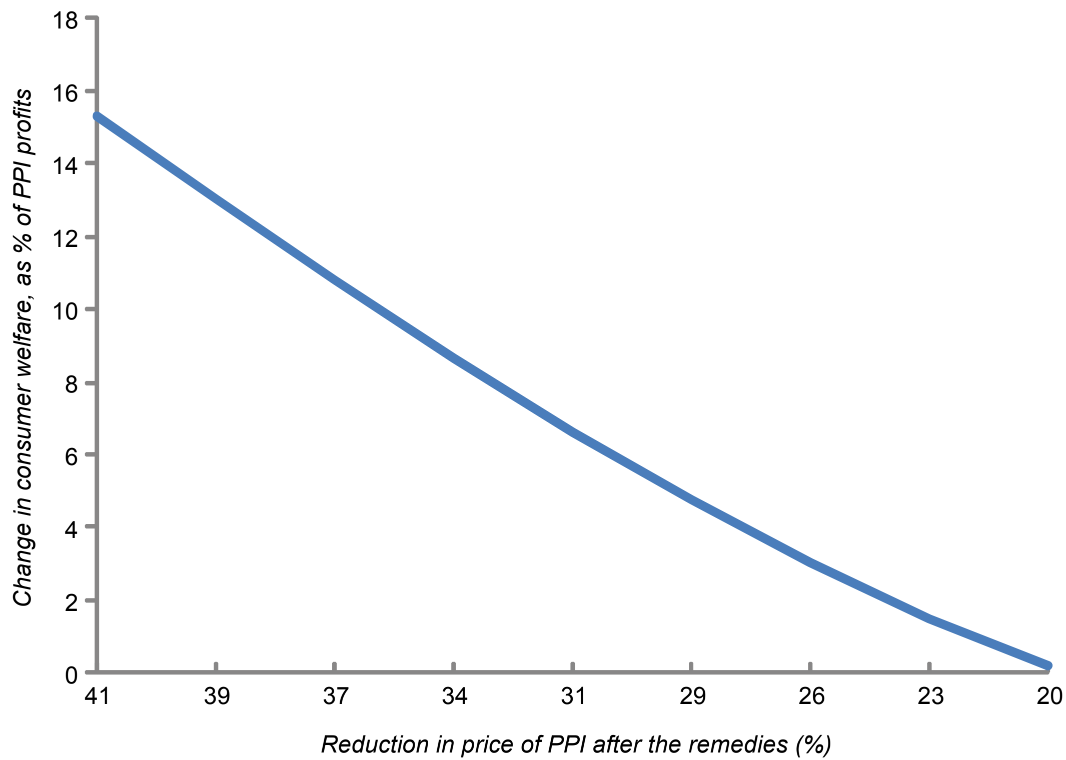


Source: CC analysis.

57. Figure 42 shows the sensitivity of the results to the assumption that all PPI excess profits are competed away in the PPI market with the remedies in place. In our base case, all PPI excess profits are competed away in the PPI market with the remedies in place, and the price of SMPPI reduces by 41 per cent. Indeed, we found that the remedies would be substantially effective, and therefore we expect prices to drop to levels close to the competitive price. We checked the sensitivity of our results to this assumption, by looking at the results of the model if we assumed that between 50 and 100 per cent of PPI excess profits are competed away in the PPI market after the remedies are in place, ie if the reduction in price after the remedies is between 20 and 41 per cent. We found that, even if only half of the excess profits are competed away in the PPI markets, so that the reduction in the price of PPI, after remedies, is 20 per cent, the model predicts that consumer welfare will increase after the remedies are in place.

FIGURE 42

SMPPI: sensitivity of the results to the amount by which PPI prices reduce after the remedies

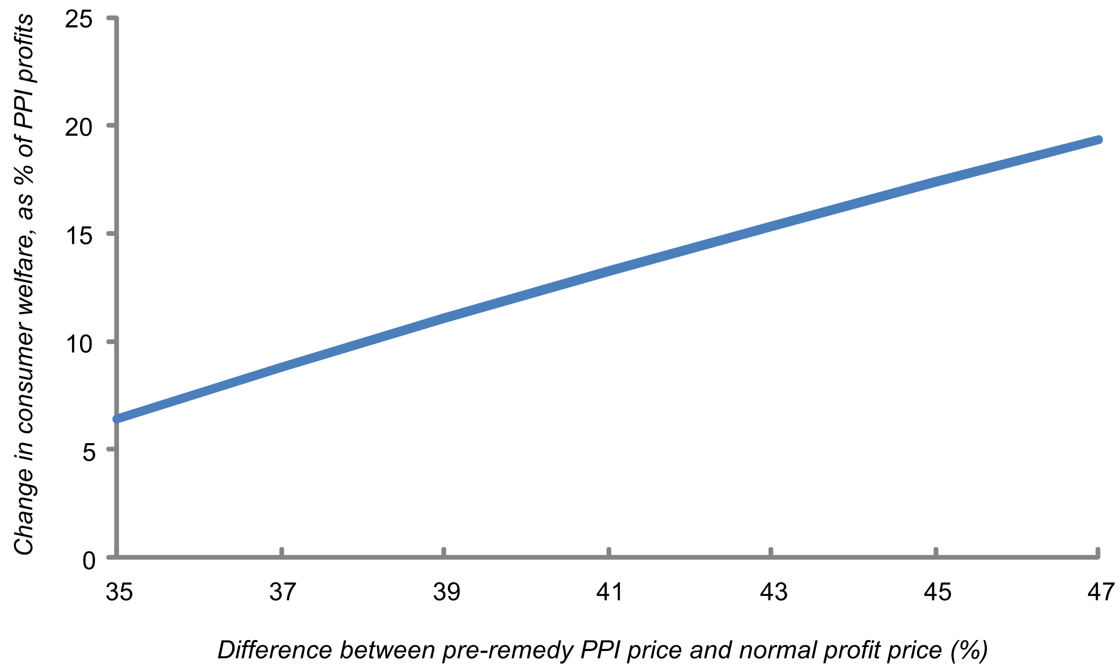


Source: CC analysis.

58. Figure 43 shows the sensitivity of the results to the pre-remedy excess profit margin, ie the amount by which the price of PPI prior to the remedies being imposed is in excess of the competitive PPI price. We find that the model predicts that consumer welfare will increase even if the pre-remedy excess profit margin is significantly lower than the 43 per cent value which we use in the base model, as derived from our profitability analysis: even if the margin were only 35 per cent, the model predicts an increase in consumer welfare.

FIGURE 43

SMPPI: sensitivity of the results to the pre-remedy excess profit margin

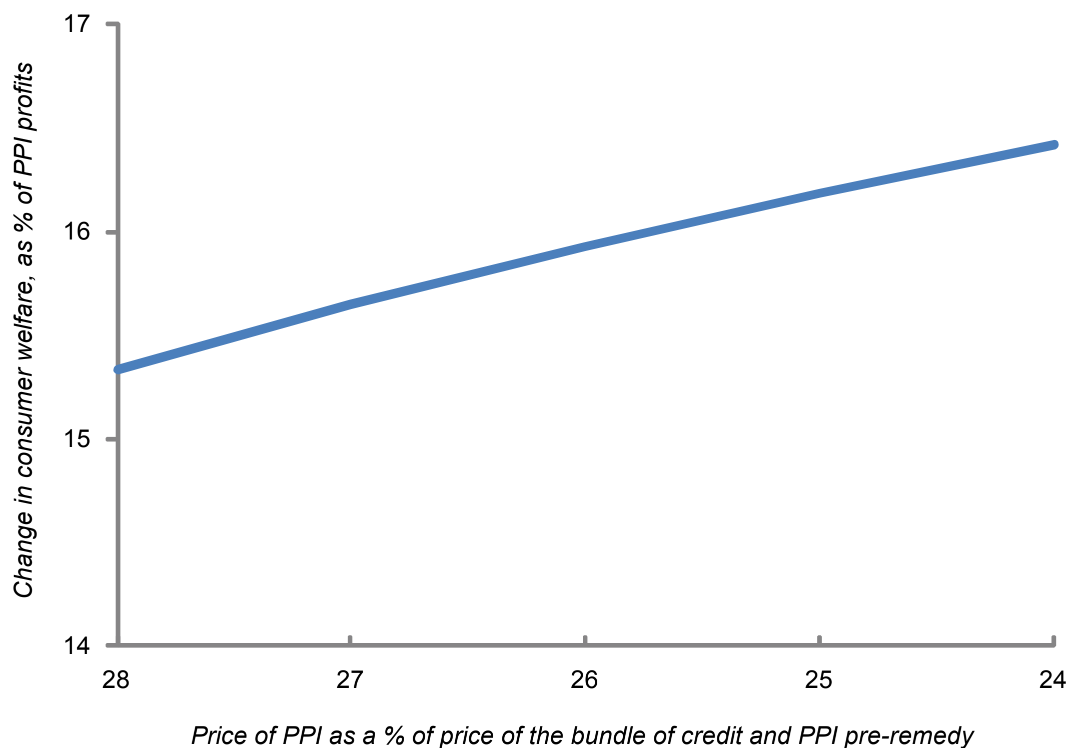


Source: CC analysis.

59. Figure 44 shows the sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit, pre-remedy. In our base case, which is based on data for 2006, the price of SMPPI represents about 28 per cent of the price of the bundle of credit and PPI. However, there are indications that the price of credit may have increased since 2006. If we account for the fact that the price of credit has increased in the modelling (by up to 20 per cent, so that the PPI price relative to the bundle price decreased to up to 24 per cent), the model predicts larger increases in consumer welfare after the remedies.

FIGURE 44

SMPPI: sensitivity of the results to the price of PPI relative to the price of the bundle of PPI and credit



Source: CC analysis.

60. Figure 45 shows the sensitivity of the results to the Accent survey results on the positive willingness to pay for a delay in the sales process by consumers who prefer to buy PPI after the point of sale. We assumed, for SMPPI, that consumers' preferences regarding the delay in purchasing PPI were similar to those of PLPPI consumers. Therefore, in the base case, we assume that 30 per cent of consumers prefer buying after the point of sale and value this at 41 per cent of the pre-remedy PPI price. We find that, if we ignore most or all of the positive valuations that these consumers associate with the delay in the process, the base model can predict that consumer welfare will decrease after the remedies are in place. This is the case if the positive valuations associated with the delay by those who prefer the delay amount to 10 per cent of the pre-remedy PPI price or less.

FIGURE 45

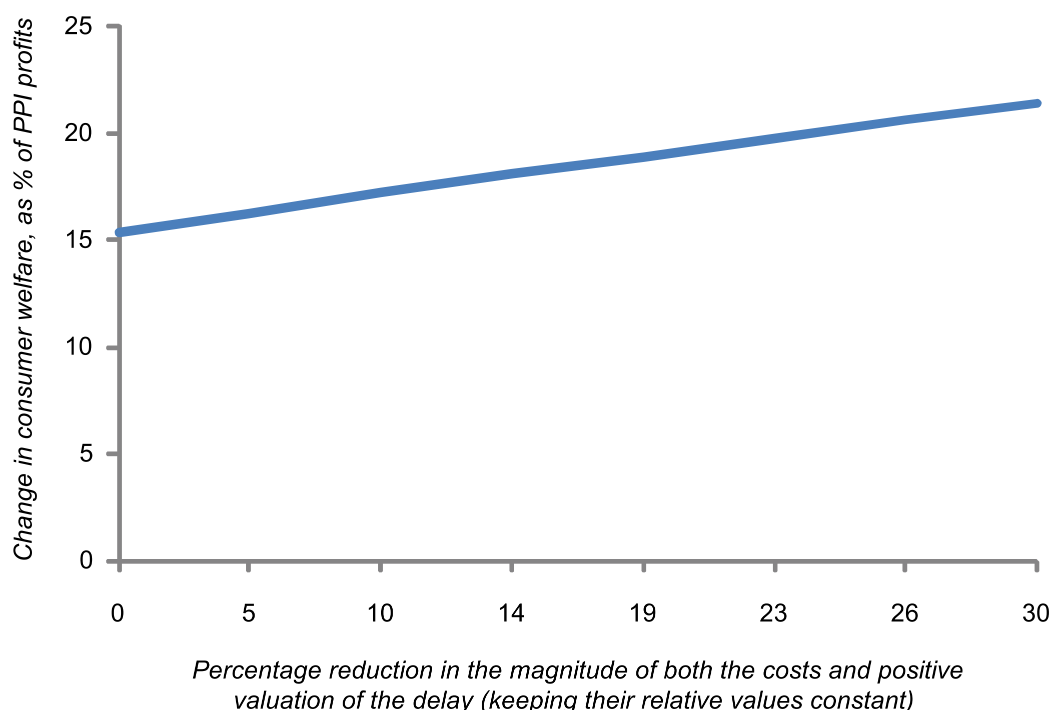
SMPPI: sensitivity of the results to the positive valuations of buying later by consumers who prefer the delay

Source: CC analysis.

61. Figure 46 shows the sensitivity of the results to the magnitude of the willingness-to-pay results in the Accent survey. We concluded that the Accent survey results were robust in terms of the relative valuation of the costs of the loss of convenience of the different groups of consumers, but that the magnitudes may be too high. In our base case, the costs of the loss of convenience of consumers who prefer to buy at the point of sale are valued at 24 per cent of the price of PPI, while the positive valuation of the delay of consumers who prefer the delay is 41 per cent of the price of PPI. If we reduce the magnitude of the costs/valuation of the delay of both groups of consumers (those who prefer to buy at the point of sale, and those who prefer to buy later), without changing the relative value of these costs, we find that the model predicts that consumer welfare will increase more than in our base case. This is shown in Figure 46, where we reduce the cost of convenience of the consumers who prefer to buy at the point of sale, and reduce the valuation of buying later of consumers who prefer to buy later, in the same proportions.

FIGURE 46

SMPPI: sensitivity of the results to the magnitude of the willingness-to-pay results of consumers' valuation of the delay (keeping the relative valuations constant)

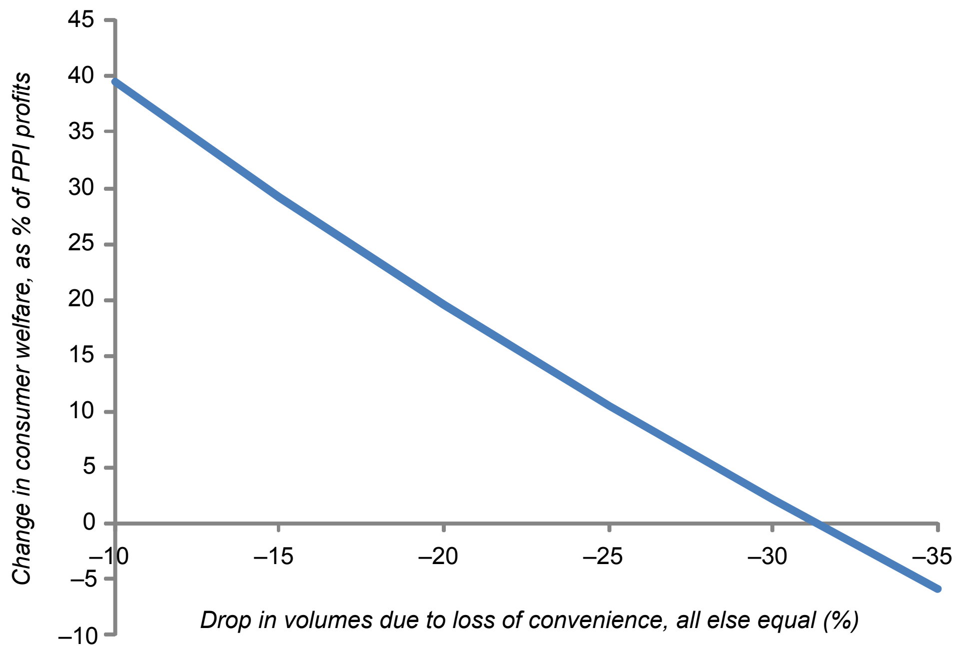


Source: CC analysis.

62. Figure 47 shows the sensitivity to the costs of the loss of convenience. In our base case, the drop in volumes (at constant price) due to the costs of the loss of convenience is of 20 per cent. If the drop in volumes because of the loss of convenience were higher, this could either be because the costs of the loss of convenience to consumers who prefer to buy at the point of sale are higher than estimated in the Accent survey, or because the market demand for PPI is more elastic than in our base case estimate. We note that, if the demand for PPI were more elastic than in our base case, the model predicts larger increases in consumer welfare compared with the base case (see Figure 39). If the costs of the loss of convenience were larger, the model predicts that consumer welfare will be lower, as shown in Figure 47. The model predicts that consumer welfare will decrease if the costs of the loss of convenience are such that, at constant prices, PPI volumes will reduce by more than 30 per cent. This is equivalent to a cost of convenience which amounts to over 32 per cent of the monthly price of PPI (at constant elasticity). This would imply that the actual costs of the loss of convenience to consumers who prefer to buy at the point of sale are in fact 40 per cent higher than in our base case. We think it is unlikely that the results from the Accent survey have under-estimated the costs of the loss of convenience by such a large amount. In addition, given the concerns that the valuations of the costs of the loss of convenience are too high in our base case (rather than too low), we think it is unlikely that the costs of the loss of convenience could be this high.

FIGURE 47

SMPPI: sensitivity of the results to the costs of loss of convenience

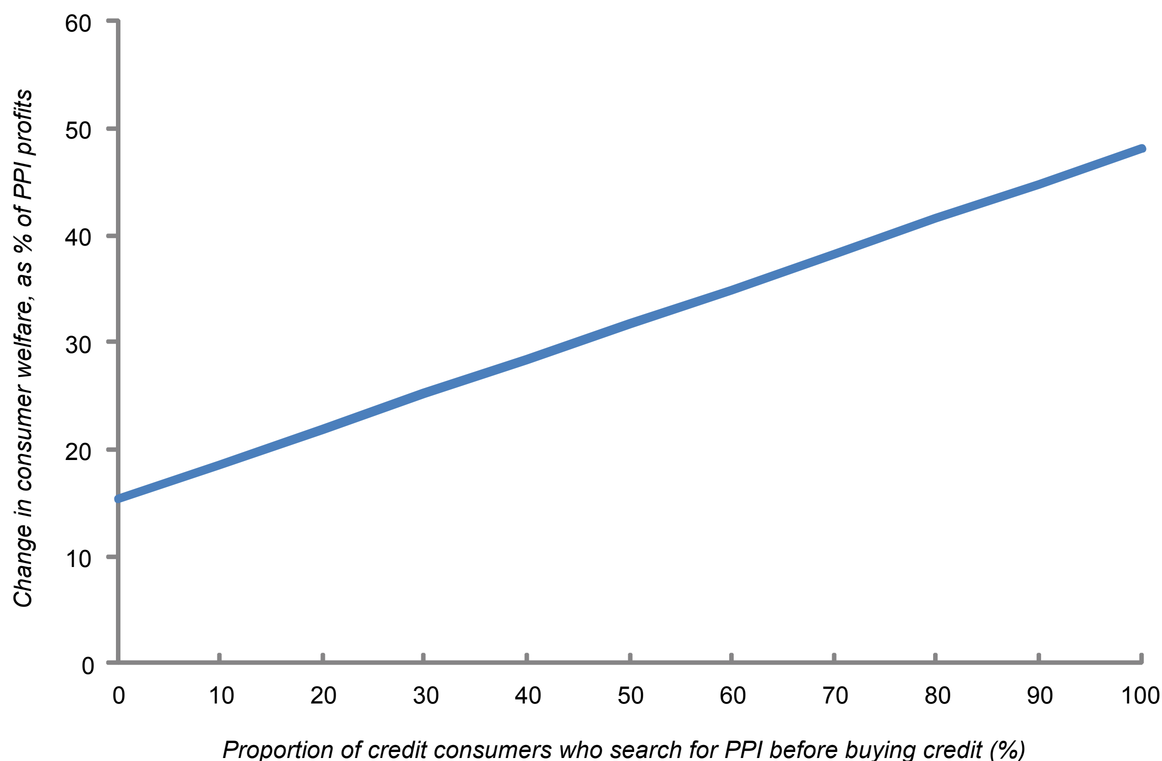


Source: CC analysis.

63. Figure 48 shows the sensitivity of the results to the removal of the assumption that all credit consumers are myopic. The larger the proportion of consumers who search for PPI prior to the credit purchase after the remedies, the larger the estimate of consumer welfare after the remedies. In the base case we assumed no consumers search.

FIGURE 48

SMPPI: sensitivity of the results to the assumption that all credit consumers are myopic



Source: CC analysis.

64. The sensitivity analysis shows that the model predicts that consumer welfare will increase after the remedies for most individual sensitivities, but not all. The model predicts that static consumer welfare will fall after the remedies if either:

(a) there is full waterbed (95 per cent pass-through of PPI profits or more);

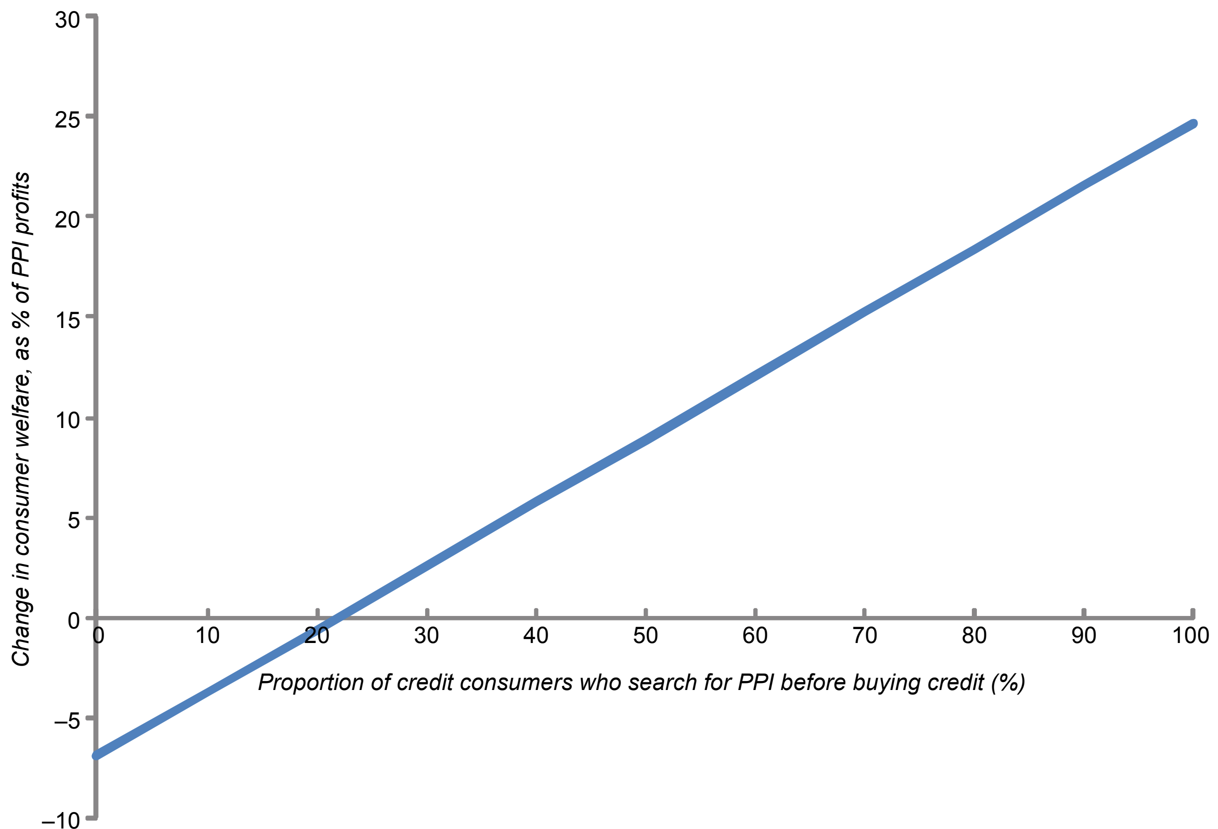
(b) we ignore most of the positive valuations associated with buying after the point of sale by consumers who prefer delaying the purchase. If the gain in surplus that these consumers associate with delaying the purchase is 10 per cent of the price they pay or less, the base model predicts a reduction in consumer welfare after the remedies; or

(c) the costs of the loss of convenience are such that, at constant price and PPI elasticity, the reduction in volumes due to the loss of convenience would be more than 30 per cent.

65. As for PLPPI, we analysed the results of the model if we removed the assumption that all consumers were myopic. Figure 49 shows results from the model if we assume that a proportion of second-mortgage potential consumers are aware of the price of SMPPI before the credit point of sale after the remedies in place, and if we ignore the positive values associated with the POSP by consumers who prefer buying after the credit point of sale. We find that, if 22 per cent or more of consumers are aware of SMPPI prices before the credit point of sale (after the remedies are in place), the model predicts that consumer welfare will increase even if we do not take into account in the modelling of the fact that some consumers prefer to buy after the point of sale.

FIGURE 49

SMPPI: sensitivity of results to consumer myopia, when we ignore the positive willingness to pay of consumers who prefer the delay

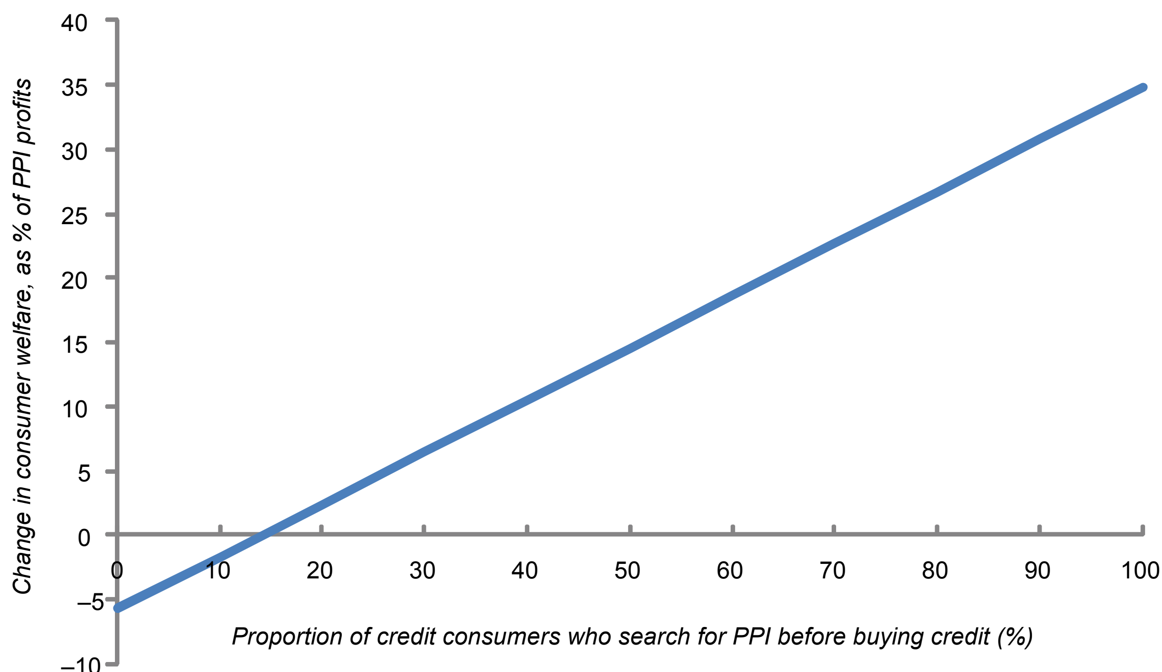


Source: CC analysis.

66. Figure 50 shows the results from the model if we assume that a proportion of second-mortgage potential consumers are aware of the price of SMPPI before the credit point of sale after the remedies are in place, and if we assume full waterbed (100 per cent pass-through). We find that, if 15 per cent or more consumers are aware of SMPPI prices before the credit point of sale (after the remedies are in place), the model predicts that consumer welfare will increase even if there is 100 per cent waterbed.

FIGURE 50

SMPPI: sensitivity of results to consumer myopia, assuming 100 per cent waterbed

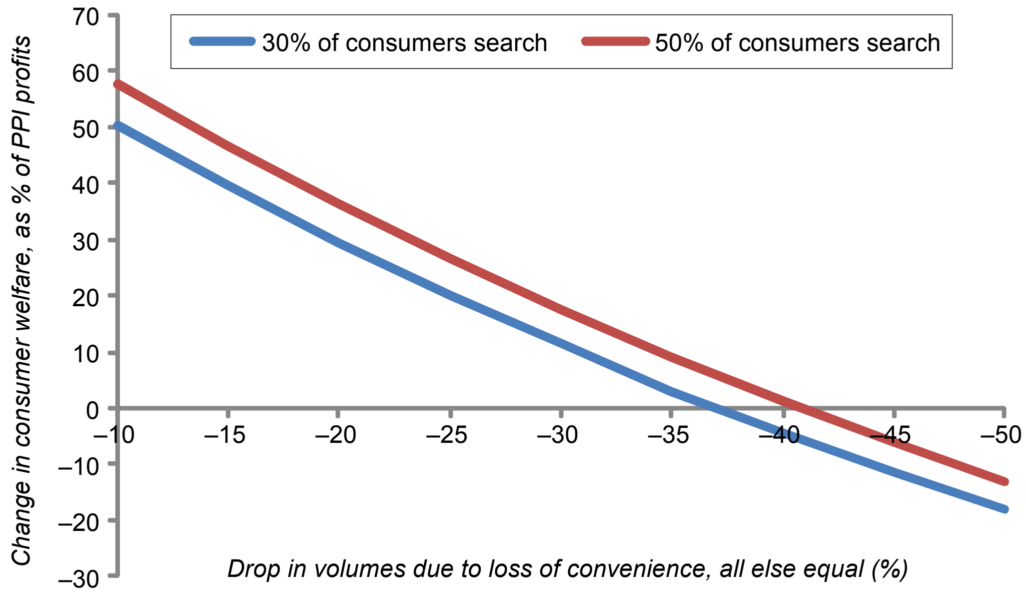


Source: CC analysis.

67. Figure 51 shows the sensitivity of the results to the costs of the loss convenience, when we remove the assumption that all consumers are myopic. If 30 per cent of consumers search for PPI, or are aware of the lower PPI price, before making decisions about credit, the model predicts that consumer welfare will increase if the drop in volumes due to the loss of convenience is less than 37 per cent. This would imply costs of the loss of convenience of 40 per cent of the monthly SMPPI price (ie almost 70 per cent larger than in our base case). If 50 per cent of consumer search, the model predicts that consumer welfare will increase if the drop in volumes due to the loss of convenience is up to 40 per cent (which would be associated with a cost of the loss of convenience of 43 per cent of the PPI price, ie almost double the values in our base case).

FIGURE 51

SMPPI: sensitivity of results to the costs of the loss of convenience, when we remove the assumption of consumer myopia



Source: CC analysis.

The cost of implementation of remedies

Introduction

1. This appendix sets out the evidence we received during the original investigation on costs of implementing the remedies, and the evidence we received during the remittal on the estimates of implementing the remedies.

The cost of implementing remedies as set out in the 2009 report

2. During the original investigation we asked main parties to the inquiry to provide us with estimates of the cost of implementing remedies, in terms of one-off costs and ongoing implementation costs. We published estimates of costs in Appendix 10.12 of the 2009 report. These are set out in Tables 1 and 2 below.

TABLE 1 **Implementation cost estimates by party**

£

	Unbundling retail PPI from merchandise cover	*Information provision in marketing material*	*Provision of information to third parties*	*POSP including provision of personal PPI quote*	*Annual statement*	*Single-premium prohibition*	*Monitoring*	*Overall cost*
[✂]	N/A	580,000	10,000	1,940,000	5,325,000	0	10,000	7,907,000
[✂]	N/P	N/P	N/P	N/P	N/P	N/P	N/P	N/P
[✂]	N/A	299,000	76,000	2,099,000	386,000	584,000	0	3,444,000
[✂]	N/A	N/P	N/P	N/P	N/P	N/P	N/P	N/P
[✂]	N/A	0	75,000	1,750,000	150,000	1,700,000	N/P	3,575,000
[✂]	N/A	3,772,000–5,574,000	624,650–1,197,300	33,675,000–51,160,000	1,901,000–2,564,000	2,303,000–2,861,000	485,000–1,630,000	42,760,150–64,981,300
[✂]	N/A	1,700,000–3,000,000	500–1,000	4,300,000–6,300,000	1,200,000–2,300,000	N/A	125,000–200,000	5,000,000–9,000,000
[✂]	N/A	24,000	5,000	247,000	132,000	251,000	175,000	414,286
[✂]	N/A	700,000	0	1,995,000–6,095,000	1,925,000–2,525,000	1,050,000–5,050,000	90,000	4,760,000–9,460,000
[✂]	N/A	49,870	698,958	1,186,700	621,854	440,073	53,805	3,051,259
[✂]	N/P	N/P	N/P	N/P	N/P	N/A	N/P	N/P
[✂]	N/A	175,000–700,000	1,100,000	26,150,000–26,600,000	1,060,000	25,000,000	N/P	28,485,000–29,460,000
[✂]	N/A	360,000	0	14,000,000	3,550,000	4,000,000	30,000	21,940,000
[✂]	114,620	37,817	0	116,833	115,840	N/A	0	389,450
[✂]	242,350	0	0	0	177,000	N/A	0	419,350
Total	356,970	7,697,687–11,324,687	2,590,108–3,163,258	87,459,533–111,494,533	16,543,694–18,906,694	35,328,073–39,886,073	968,805–2,188,805	122,145,495–154,041,645

Source: CC based on data provided by the parties.

Notes:
1. N/A = not applicable.
2. N/P = not provided.
3. [✂] estimated total annual costs of £1.9 million that related to the changes to the business structure that would be required as a result of the package of remedies as a whole, and the costs of operating this new business structure. [✂] said that it was not able to apportion the costs of implementation to each of the individual remedies as the costs of each remedy depended largely on the other remedies being imposed.
4. The cost estimates provided by HBOS take no account of the merger of Lloyds TSB and HBOS and are presented separately. HBOS told us it assumed that it would fall to the existing HBOS business to implement the CC's proposed remedies, having regard to existing business models and IT systems.

TABLE 2 **Ongoing cost estimates by party**

£

	Unbundling retail PPI from merchandise cover	*Information provision in marketing material*	*Provision of information to third parties*	*POSP including provision of personal PPI quote*	*Annual statement*	*Single-premium prohibition*	*Monitoring*	*Overall cost*
[✂]	15,250	0	1,500	0	136,139	N/A	30,000	182,889
[✂]	N/A	0	10,000	859,000	136,200	351,000	50,000	1,406,200
[✂]	N/A	0	385,000	2,430,000	16,000–1,600,000	100,000–120,000	N/P	2,931,000–4,535,000
[✂]	N/A	18,260	25,135	141,141	241,691	87,886	53,970	568,083
[✂]	N/A	127,000	125,000	1,485,000	565,000	90,000	27,800	2,420,000
[✂]	N/A	125,000	45,000	1,440,000	2,540,000	0	26,000	4,176,000
[✂]	N/A	N/P	N/P	N/P	N/P	N/P	N/P	N/P
[✂]	N/A	0	1,260,000	1,420,000	287,000	660,000	N/P	3,627,000
[✂]	N/A	590,000	50,000	3,787,300	504,600–804,600	N/A	291,000	5,222,900–5,522,900
[✂]	N/A	650,000–930,000	200,500–251,000	11,650,000–12,325,000	850,000–1,000,000	N/A	200,000–400,000	12,600,000–15,400,000
[✂]	N/P	N/P	N/P	N/P	N/P	N/P	N/P	N/P
[✂]	N/P	N/P	N/P	N/P	N/P	N/A	N/P	N/P
[✂]	N/A	4,090,000–8,180,000	320,000–535,000	10,808,000–14,622,000	3,800,000–4,305,000	1,474,000–1,723,000	460,000–1,530,000	20,952,000–30,890,000
[✂]	425,460	95,260	2,520	1,093,700	3,389,833	N/A	87,700	5,076,933
[✂]	N/A	0	0	9,450,000	1,730,000	0	380,000	11,560,000
Total	440,710	5,695,520–10,065,520	2,424,655–2,690,155	44,564,141–49,053,141	14,196,463–16,735,463	2,762,886–3,031,886	1,606,670–2,876,670	70,723,005–85,365,005

Source: CC based on data provided by the parties.

Notes:
1. N/A = not applicable.
2. N/P = not provided.
3. [✂] estimated total annual costs of £1.9 million that relate to the changes to the business structure that would be required as a result of the package of remedies as a whole, and the costs of operating this new business structure. [✂] said that it was not able to apportion the costs of implementation to each of the individual remedies as the costs of each remedy depended largely on the other remedies being imposed.
4. The cost estimates provided by HBOS take no account of the merger of Lloyds TSB and HBOS and are presented separately. HBOS told us it assumed that it would fall to the existing HBOS business to implement the CC's proposed remedies, having regard to existing business models and IT systems.

3. It can be seen from Tables 1 and 2 that three banks provided the largest estimates of implementation costs: [✂], [✂] and [✂]. Their estimates were £43–£65 million, £22 million and £28–£29 million respectively (£93–£116 million in total). Their estimates of ongoing costs were £21–£31 million, £12 million and £3–£5 million respectively (£35–£48 million in total). These are among the highest ongoing costs, but those put forward by [✂], for the POSP, and [✂], for the annual statement, were also particularly significant.

4. In Appendix 10.13 of the 2009 report we set out our analysis of this data.

5. In the 2009 report, we noted various reasons why the cost estimates submitted by the parties—£122–£154 million implementation costs and £71–£85 million ongoing costs—were likely to overstate the costs to the main suppliers of the remedies. We concluded (in paragraph 10.507) that the one-off costs of implementing the remedy package could be around £100 million and the range of ongoing compliance costs could be in the region of £50–£60 million.

New evidence on the cost of implementing remedies

6. During the remittal we asked parties to provide us with internal documents relating to their actions in response to the Notices of Possible Remedies, the provisional decision on remedies and the 2009 report. We received many documents from those parties which provided the largest estimates of costs of implementation ([✂]). We reviewed these for more up-to-date estimates of costs.

[✂]

7. The earliest relevant document we identified was a [✂] full business case for moving from single-premium PLPPI to a regular-premium product dated November 2008. The spend sanctioned in this document was £1.6 million. This related to a minimal change solution that could be implemented quickly. [✂] estimate for the implementation of a full solution including some costs not included in the Full Business Case (eg some necessary IT changes) which we included in the 2009 report was £2.3–£2.8 million.

8. In [✂] presentation dated 12 March 2009, it was noted that:

> The high level figures provided in the formal [✂] response to the Competition Commission estimated compliance with the Remedies as £20.9m, of which £17.7m was IT costs.
>
> Whilst there was a degree of positioning in the formal response, there is a significant Risk that the funding required for CoCo Remedies will exceed the estimates currently in plan.

9. [✂]. All work came within the scope of [✂].

10. The scope of [✂] included compliance with all parts of the CC remedy package set out in the 2009 report, including considering the creation of new products for launch should the POSP come into force. It also appeared to go beyond what was needed for compliance with the CC remedy package, in that it considered developing a product which can be sold to non-credit customers.

11. The most recent (November 2009) estimate of the budget to completion of [✂] was £16.7 million.

12. [✂] told us in March 2010 that its most up-to-date estimate of one-off costs of implementation of the CC remedies was £17.4 million (comprising £15.8 million for implementation in the loans, cards and mortgages business and a further £1.6 million for [✂]).

13. In March 2010, [✂] told us that its most up-to-date estimate of ongoing implementation costs for 2011 (only) was £4.148 million.

14. In terms of the split between products, an August 2009 document showed that the split of one-off costs was estimated to be: PLPPI £6.0 million, CCPPI £5.8 million and MPPI £3.3 million (and some money unallocated between products)—equating to a split of about 39 per cent of costs each for PLPPI and CCPPI, and 22 per cent for MPPI. For ongoing costs of implementation, the estimates were: PLPPI £2.3 million, CCPPI £1.9 million and no known ongoing costs for MPPI—equating to a 55/45 split of ongoing costs between PLPPI and CCPPI.

[✄]

15. During the original investigation, [✄] told us that it expected it would cost about £25 million to implement the POSP. This was based on the cost of developing [✄].

16. [✄] main project to deal with the various regulatory and competition-related developments in relation to PLPPI was [✄]. That product became known as [✄]. This is a product aimed at both credit and non-credit customers, and as such the product goes beyond what was needed for compliance with the remedy package set out in the 2009 report.

17. Costs of [✄] were regularly reported. In the most recent report of costs we saw (October 2009), the estimated costs were £4.5 million.

18. In relation to CCPPI, [✄] main project was [✄]. The project to develop this product, [✄], had three main elements—the first element was the tactical cessation of new sales of the existing CCPPI policy; the second element was to launch the new product initially scheduled for [✄] for online sales [✄] and the third element was aimed at preparing for the POSP in October 2010 and to develop the product for stand-alone sales. In December 2009, the total development costs were estimated at £3.7 million.

19. We found no evidence on the costs of making any changes needed to [✄] MPPI products.

20. [✄] told us that to use these internal documents as the basis for estimating the cost of compliance with the remedies would be to underestimate costs. It said:

    (a) The cost figures provided to the Commission included a significant spend on IT to deliver specific changes to systems, for example to deliver annual statements and POS PPI quotations. [✄] has not yet been able to fully develop the systems needed to implement these changes (and therefore cost them) partly due to the fact that the Commission's final order (with the necessary detail) has not yet been published.

    (b) [✄].

    (c) The IT costs quoted within [✄] 2010 budget (and therefore within the £4.5m for 2009/2010) do not include IT Infrastructure de-commissioning costs which will be incurred once the new products are fully integrated. These costs could amount to an additional £1.5m.

    (d) As the Commission is aware, [✄] and therefore spending during this period would have been lower than that estimated at the Commission stage.

    (e) The £3.7m refers to the IT capability build, delivery and implementation of [✄]. This was the agreed budget for the project in Q2 2009 and includes £1.3m in relation to delivery of Phase 2. It also includes the budget expected to prepare the capability required to meet some of the Commission's remedies based on the remedies as known in early 2009, such as the ability to have parameter-driven quote and buy functionality for a POSP. Implementation of the

remedies would have been part of Phase 2, but the costs associated have not been scoped.

21. In essence, reasons *(a)* to *(c)* and *(e)* were that it regarded £8.2 million as an under-estimate as its budget had not included all IT costs, bearing in mind that we had not specified in detail all our remedies and it could not therefore programme some of the IT work needed to develop compliant solutions. We noted that there might be some additional IT costs, but it only quantified the IT cost of decommissioning, which it said was £1.5 million. We saw no reason for *(d)* to have an impact on the budget. We put this to [✂]; it said that it did not believe this was a reasonable conclusion for us to reach, but as it did not say why this was the case we saw no reason to change our view.

22. We considered [✂] responses and concluded that £8.2 million would probably underestimate its cost of implementing the remedies. However, [✂] did not quantify most of the extra costs it envisaged (save for £1.5 million for decommissioning). We were not well placed to calculate these individual additional costs. We therefore decided to include an allowance for them, by taking the total estimates [✂] provided (£9.7 million) and adding an extra 50 per cent, leading to an estimated cost of £14.6 million. We noted that our final decision on proportionality was not affected by the assumption of an extra 50 per cent; we could equally have assumed that [✂] costs would be the same as its [✂] and it would not have changed our results.

Costs of implementation

23. We replaced the costs of implementation provided by [✂], [✂] and [✂] during the original investigation with the costs of £17.4 million ([✂]) and £14.6 million ([✂]). This reduced the costs of implementation of remedies estimated by the main parties from the range £122–£145 million to £61–£69 million for PLPPI, MPPI, CCPPI and SMPPI. We decided to use these figures for our estimates of one-off costs of imple-mentation; though we had not had the opportunity to check the internal costs of other parties in developing their new products, by addressing the cost estimates of [✂], [✂] and [✂] we had dealt with by far the largest cost estimates.

24. For ongoing costs, we were able only to revise the estimates provided by [✂] and this reduced the ongoing implementation costs estimated by parties to the range £37–£42 million for PLPPI, MPPI, CCPPI and SMPPI. Unlike the one-off costs of implementation, this did not enable us to test all of the largest estimates provided by main parties. On balance, we thought that £37–£42 million was probably still an overestimate of the costs of ongoing implementation, but we decided to retain these figures for our calculations.

The effectiveness of the POSP for PPI products where the premium tracks the credit balance

1. In this appendix we consider the issue raised by the Tribunal with respect to retail PPI, regarding how effective the POSP could be for PPI products where the premium tracks the credit balance.

2. This was raised by the Tribunal as an issue we might wish to explore in our remittal in relation to retail PPI. The Tribunal explained the issue in paragraph 178 of its judgment:

> The point which caused us concern was this. The Commission's decision that the proposed remedies package would be substantially effective to remedy the AEC in relation to all types of PPI, including retail PPI, involved a judgment that stand alone providers would be able to offer real competition to distributors. Yet its findings included recognition that, in relation to retail PPI, competition by stand alone providers was adversely affected by their inability to know the level of credit being extended by the retailer, on a constantly fluctuating credit account, so that they could not tailor a stand-alone PPI policy to the amount owed from time to time by the consumer. Shop Direct's submission was that the Commission's remedies package contained no solution to this conundrum, so that it could not therefore rationally be expected effectively to remedy the AEC in relation to retail PPI.

3. The issue was raised by SDGFS in the remittal. SDGFS said that there was no substitute for retail PPI—as there was no alternative policy its customers could take out which would insure exactly the outstanding balance—and therefore imposing remedies, such as the POSP, which were predicated on customers being able to find alternative policies, would be ineffective and therefore disproportionate.

4. We considered the issue first for retail PPI (paragraphs 5 to 11). Then we considered it for CCPPI (paragraphs 12 to 13), as some parties (eg MBNA) told us during the remittal that the same issues arose for CCPPI as for retail PPI. Finally, we considered it for other PPI products (paragraphs 14 and 15), as LBG said that the difficulty which the Tribunal identified with the CC's reasoning in respect of retail PPI applies not only to retail PPI and CCPPI, but also to MPPI and PLPPI, where monthly payments may vary with changes to interest rates and rescheduling of the underlying credit.

Retail PPI

5. In paragraph 6.170*(a)* of the 2009 report, we identified one of three barriers to switching to be:

> the inability of stand-alone providers to offer insurance which tracks the outstanding balance on a credit account, or to offer merchandise cover, means that retail PPI policy-holders cannot find a perfect substitute for their policy; instead they can only find a policy which insures a set amount, leading them to be over- or under-insured in any given month and which does not include merchandise cover.

6. In paragraph 6.183 of the 2009 report, we found that the ability to tailor premiums to the changing balance was one of three substantial advantages from ‘selling retail PPI at the initial point of sale and subsequently, by virtue of supplying the credit to which the retail PPI relates’ and consequently that, in paragraph 6.184 of the 2009 report:

> the sale of retail PPI at the initial point of sale and continued exclusive access to customer accounts restricts the extent to which other PPI providers can compete effectively and is therefore a feature of relevant markets which prevents, restricts and distorts competition in the supply of retail PPI.

7. In effect, we concluded that the tailoring of the PPI premium to the outstanding credit balance gave the retail PPI distributor an incumbency advantage. We did consider and reject in the 2009 report one remedy option that was directly aimed at this particular issue: namely a requirement on credit card and retail credit providers to share information about current consumer balances with other PPI providers (the ‘information sharing remedy’—see paragraphs 10.366 to 10.370 of the 2009 report). We also considered and rejected price caps for these sectors on the grounds that the package of remedies would be substantially effective in addressing the AEC and would do so in a timely manner (paragraph 10.373 of the 2009 report).

8. We commissioned qualitative research in January 2010 from GfK into retail PPI customers’ attitudes to searching for alternative policies. The results of this survey gave a clear steer that many customers (most in this survey, although we recognized that this was a qualitative survey) actually preferred fixed-balance policies. The reasons cited for this included that they knew their exact monthly outgoing, which would help them to budget their finances, and they liked the flexibility to choose how the payout was used.

9. In addition, we have observed that several large distributors of CCPPI[1] have been developing, in response to the 2009 report, short-term IP policies which do not track outstanding balances, for sale to their credit customers including their credit card customers (and ultimately other companies’ credit customers).

10. These pieces of new evidence convinced us that the advantage held by retail PPI providers by their ability to tailor insurance premiums to outstanding credit balance was not significant—in effect, there is no significant incumbency advantage associated with knowing the outstanding balance on the credit product, as in practice consumers do not appear to attach significant value to policies tracking the outstanding balance.

11. In response to our provisional decision, SDGFS said that we had found ‘that Retail PPI providers no longer have an effective monopoly over their customers’.[2] We did not agree with SDGFS’s interpretation of our report. Our finding places retail PPI in the same situation as other PPI products, such as PLPPI and MPPI, where there are some stand-alone products available away from the point of sale but distributors hold an effective monopoly over PPI customers at the point of sale of credit.

[1] [✂]
[2] SDGFS response to provisional decision, paragraph 33.

CCPPI

12. Having found that the ability to track customer balances was not a significant issue for retail PPI, we considered whether it would nevertheless be a significant issue for CCPPI customers.

13. We saw no reason to expect that CCPPI customers would value tracking of balances significantly more than retail PPI customers. Moreover, as noted in paragraph 9, several distributors of CCPPI have been developing, in response to the 2009 report, short-term IP policies which do not track outstanding balances, for sale to their credit customers, including their credit card customers. We thought that distributors would not do this if they did not expect to be able to attract credit card customers with such an offer.

PLPPI and MPPI

14. In its response to the CC's consultation document, LBG told us that the difficulty for stand-alone providers to ascertain the amount of credit requiring to be insured from month to month also applied to MPPI and PLPPI where monthly payments might vary with changes in interest rates and rescheduling on the underlying credit. LBG told us that it would expect the CC to take account of this issue in respect of these PPI product types.

15. We did not think that this was a strong argument. As with CCPPI and retail PPI, credit providers have a potential advantage over other PPI providers in so far as their access to ongoing information about the credit means that they are able to offer products which would automatically adjust the level of cover provided if the underlying credit repayments were to change. However, this is unlikely to be a significant form of incumbency advantage for the following reasons:

    - We would normally expect changes to credit repayments on personal loans or mortgages to take place at discrete intervals, triggered by a specific event—for example, moving house or, if for variable rate loans, a change in base rates. Given the nature of the credit obligation, there is unlikely to be the same level of month-by-month variation in monthly repayments, as would be the case for some credit card accounts.

    - To the extent that consumers value products which provide cover that is aligned with consumers' obligations under specific credit agreements, stand-alone providers are able to approximate this product feature by offering periodic reviews of the level of cover provided.

    - Stand-alone providers may choose to market products to cover a range of obligations, rather than tailoring cover closely to individual credit products.

    - We did not identify this element of incumbency advantage as a feature that restricts, prevents or distorts competition in MPPI or PLPPI (or indeed SMPPI) markets. It has not been raised with us by any of the parties whose interests might be adversely affected if it were a material consideration—for example, stand-alone providers or consumer groups.

Conclusions on the effectiveness of the POSP for PPI products where the premium tracks the credit balance

16. We concluded that there was limited preference for PPI products where the premium tracks the credit balance and that, as a result, stand-alone products which do not track balance could be effective substitutes for these policies.

Timescale over which remedies will have effect

Introduction

1. This appendix sets out our analysis of the likely timescales over which the various elements of the remedy package would have effect.

Background

Discussion of timescales in the 2009 report

2. In the 2009 report, we concluded in paragraph 10.510 that our package of remedies would address the AEC in a 'timely manner' and that this was a reason for not imposing price caps to deal directly with the consumer detriment of high prices. Our reasoning in relation to price caps was set out in paragraph 10.373:

> We believe that price caps could address the customer detriment of higher prices and we have not been persuaded by the evidence that price caps would have negative impacts on competition. However, we consider that the packages of remedies we have decided to implement will address the AEC that we have identified in a timely manner and we do not have to address the customer detriment shown in higher prices resulting from the AEC. We consider that by addressing the AEC with the package of remedies which we have decided on, this aspect of the customer detriment will also be addressed.

The Tribunal's findings in relation to timescale

3. Our assessment of the timescale within which the remedies would be effective formed part of Barclays' first ground of appeal, namely that the CC 'failed to take account of considerations which are relevant to the proportionality of the POSP'. The Tribunal's main findings on this point are repeated below.

> 115. In our view the Commission should have addressed the issue of time-scale in the Report in more detail than is encapsulated in its use of the word "timely". While it sufficiently conveys an opinion that the time-table would be short enough to mean that the accumulation of costs in advance of the accruing of the benefits would not lead to the cost being disproportionate, it describes no measurement of time in any objective sense. While there may be cases in which a remedy package is of sufficiently low cost to make any quantification of time before full effectiveness unnecessary, the costs element in the present case is not of that low order and, as will appear, other disadvantages of the remedies package needed to be weighed in the balance in addition to pure cost.
>
> 116. We would not have regarded this failing, on its own, as justifying the quashing of the decision to impose the POSP. This is because we regard it as having occurred more in the expression of the Commission's reasoning in the Report, than in any deeper failure to take the question of timescale into account. We consider that the Commission's reason for not imposing a price cap, in (paragraph

10.373 of the 2009 report), shows that it did conduct a sufficient review of the timing issue, but then failed to spell it out in the Report. In other words, we are satisfied that if this failing had been the only reviewable error in the Report, the correction of it could not have led the Commission to a decision not to impose the POSP. Since however we have for reasons arising under Grounds 2 and 3 decided that the decision to impose the POSP must be quashed and remitted for further consideration, the Commission should address the timescale question in any reconsideration of the issue whether to impose a POSP, or similar remedy.

Reconsideration of timeliness for the remittal

4. In light of the Tribunal's judgment, we are therefore setting out our thinking in greater depth on this issue as we undertook to do in paragraph 34 of our consultation document of 11 December 2009, as follows:

> As part of our assessment of whether the remedies package including the POSP would be an effective and proportionate solution to the AEC, we will set out our reasoning as to how quickly the remedies package, including a POSP, would take effect …. In doing so we will have regard to any new submissions put to us.

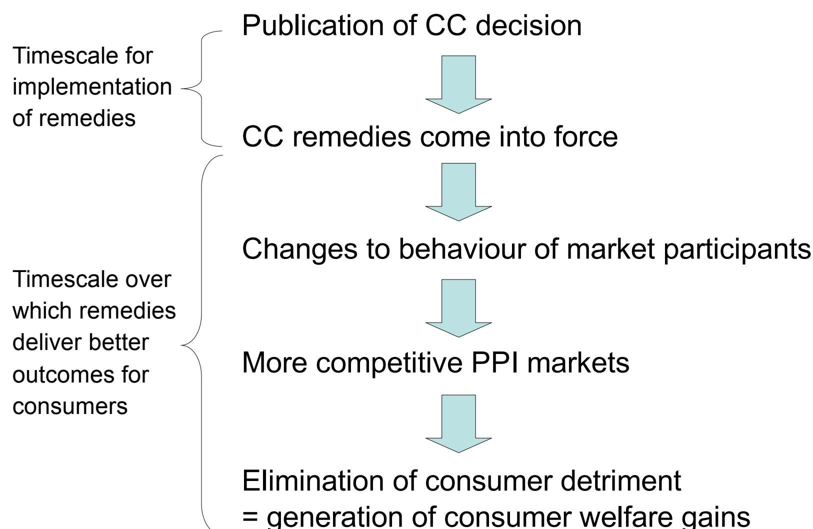
5. This appendix sets out what we consider to be the main elements of a fuller consideration of this issue. This draws on the evidence and argumentation in the 2009 report and also, where relevant, on the submissions made by the CC to the Tribunal. This assessment also draws on evidence provided to us during the remittal process—for example, from consumer research and internal documents.

High-level framework for consideration of remedies timescales

6. Figure 1 sets the scene by illustrating, at a high level, the process through which the remedy package is expected to generate benefits for consumers.

FIGURE 1

Process by which remedies generate consumer benefits



Source: CC.

7. The timescale over which the remedy package may be expected to generate consumer benefits can be broken into the following two stages:

   (a) *The timescale for the implementation of the remedies.* This includes the time that is needed to finalize the Order giving legal force to the remedies and the time that is allowed to providers to prepare for the various provisions of the Order coming into force.

   (b) *The timescale over which the remedies, once in force, may be expected to deliver benefits to consumers.* The measures in the remedy package are aimed at increasing competitive pressure in PPI markets resulting in changes to consumer and provider behaviour and, as a result, the elimination of the consumer harm associated with the AEC.

8. These are shown as consecutive steps in Figure 1, though it is possible that some consumer benefits may be generated before the remedies come into force. This may happen if, for example, providers or consumers anticipate the remedies and/or implement elements of the remedy package before they are obliged by the Order to do so. An example of this occurring in practice is the introduction by SDGFS of an unbundled retail PPI product during 2009.

9. In the remainder of this appendix we consider these two components of the timescale over which our remedies may be expected to generate benefits to consumers.

Timescale for the implementation of remedies

10. In the 2009 report—and as set out in the draft Order published for consultation on 7 July 2009—we proposed that the remedies should come into force in two tranches:[1]

    (a) The following obligations come into force within six months of making the Order: to include material in marketing materials, to provide data for the FSA[2] to use in the comparative tables on the moneymadeclear website and to publish claims ratios on request.

    (b) The other remedies all come into force within 12 months of making the Order. These are the POSP, the single-premium prohibition, the obligations to provide personal PPI quotes and annual reviews to consumers and the obligation to unbundle retail PPI from merchandise cover.

11. If we made an Order at around the end of the first quarter of 2011 and the above timescales do not change, all elements of the remedies package would be in force by the second quarter of 2012.

12. The obligations will have immediate effect from the date on which they come into force. For example, all PPI sales by credit arrangers that are made a year or more after making the Order must comply with the POSP. Similarly, all marketing materials produced from six months after making the Order must contain the key messages specified in the 2009 report. There is one partial exception to this, which is that some flexibility is allowed as to the timing of the first annual review (see paragraphs 42 to 47 below).

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[1]Paragraph 10.521 of the 2009 report.
[2]Responsibility for operating the moneymadeclear website and for publishing the comparative tables, including those in relation to PPI, transferred in April 2010 from the FSA to the CFEB.

The timescale for remedies to deliver benefits to consumers

13. This is the area in which our reasoning on timeliness as set out in the 2009 report was found to be inadequately expressed by the Tribunal and is therefore the main focus of this element of the remittal. In the rest of this appendix, we consider:

(a) the types of consumer harm associated with the AEC and the corresponding benefits that we expect to result from increased competition;

(b) the mechanisms and the timescale over which the remedies might be expected to increase competitive pressure in relation to new PPI sales;

(c) the mechanisms and the timescale over which the remedies might be expected to increase competitive pressure in relation to existing PPI consumers; and

(d) the mechanisms and the timescale over which the remedies might be expected to impact on the reputation of PPI and other dynamic benefits.

Consumer harm arising from the AEC and benefits from increased competition

14. The package of measures set out in the 2009 report is expected to remedy the AEC and as a result also to address the consumer detriment that is associated with the absence of competition that we found. We identified various categories of consumer detriment that would be addressed through our remedies package:

(a) By increasing competition, the remedies were expected to generate dynamic benefits, which we expected to be on a very large scale, although we were unable to estimate them with any precision. In the 2009 report, we highlighted three sources of such benefits:[3]

(i) arresting any decline in the size of the PPI sector that resulted from the current lack of competition, for example negative publicity associated with high prices;

(ii) increased advertising and far more interest in (and awareness of) the sector, such that the demand for PPI should increase once it was sold at competitive prices; and

(iii) selection pressure, encouraging companies that developed products which benefited consumers and punishing those that developed poor products.

(b) By increasing competitive pressure on PPI prices, the remedies were expected also to generate substantial static consumer welfare benefits through:

(i) eliminating the economic inefficiency and consumer detriment associated with high PPI prices and, where relevant, low credit prices (we were able to estimate this element of the consumer detriment, after allowing for any 'waterbed effects' for all sectors other than CCPPI);[4] and

(ii) reducing adverse selection costs as a result of selling PPI at lower prices (we were not able to estimate this element of the consumer detriment).[5]

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[3]Paragraph 10.493 of the 2009 report.
[4]Paragraphs 10.494 & 10.496 of the 2009 report.
[5]Paragraph 10.495 of the 2009 report.

15. In paragraphs 16 to 50 we consider the timescale issue in relation to the static welfare effects (and particularly the pricing effects) arising from increased competition for new PPI sales and from switching by existing PPI customers. We consider the timescale over which we expect dynamic benefits to be realized in paragraphs 51 to 55.

Mechanism and timescale of remedies effects in relation to new sales

16. We consider first the impact of the remedy package in relation to new PPI sales. We have separated out the impact in relation to new sales and existing PPI policies because the mechanism by which the remedies are likely to take effect will differ between the two situations.

17. Table 1 shows the ratio of new PPI policies to the total number of policies in force in 2007.[6] For PLPPI and SMPPI, new policies accounted for slightly more than one-third of all PPI policies in force. For MPPI and CCPPI, which generally relate to longer-lasting credit arrangements, this proportion is lower (between 10 and 20 per cent).

TABLE 1 **Ratio of new PPI policies to policies in force at start and end of year**

*New PPI policies issued during 2007 as percentage of policies in place at start and end of year**

	Percentage of policies at start of year	*Percentage of policies at end of year*
MPPI	13.1	14.2
CCPPI	16.9	18.3
PLPPI	35.5	39.3
SMPPI	34.7	38.8

Source: CC analysis of data provided by the 12 largest distributors.

*New policies exclude policies cancelled during cooling-off period.

18. Another way of illustrating the relative significance of new and existing customers is to look at the proportion of policies in place at the start of a year that were terminated during the same year. In 2007, around one-fifth of CCPPI policies in place at the start of the year were terminated during the year. For MPPI, this figure was around one-quarter and for PLPPI and SMPPI it was a little under half.

Mechanism for remedies to take effect

19. The POSP is central to the impact of the remedies package in relation to new PPI sales. It has been designed to work together with the information remedies to transform the context within which consumers make decisions about PPI.

20. The POSP is aimed at reducing the incumbency advantage enjoyed by credit arrangers over other PPI providers, so that more consumers are in a position to exercise choice about which PPI provider to use. The informational remedies—in particular, the personal PPI quote, the provision of information in marketing materials and on the moneymadeclear website—complement the POSP by providing consumers with tools to help them search the market and compare PPI products in order to choose the best product for them.[7] By changing the process for buying and selling

[6]In 2007, the number of active policies provided by the 12 largest distributors fell between 2.4 per cent (PLPPI) and 12.4 per cent (SMPPI)—see Table 2.2 of the 2009 report. All else being equal, the ratio of new policies to the total number of policies in force will tend to be higher when the market is expanding and lower when the market is contracting.
[7]See paragraphs 10.36 and 10.37 of the 2009 report.

PPI in this way, we expect the POSP to change the behaviour both of suppliers and consumers.

21. The main mechanisms by which we would expect the POSP and other remedies to feed through to increased competition for new sales and thereby better outcomes for consumers are summarized in paragraphs 10.43 to 10.45 of the 2009 report:

(a) 'By creating a clear break between the sale of credit and the sale of PPI, and providing consumers with the tools that they require to compare PPI policies (personal PPI quote, information provision in marketing materials and provision of information to the FSA for use in its comparative tables), we expect this aspect of the remedies package significantly to increase incentives for, and ability of, consumers to search for the best-value PPI policy that meets their needs' (paragraph 10.43).

(b) '… this element of the remedies package is also likely to increase marketing spend on PPI, as distributors seek to increase the profile of their PPI products to increase the likelihood of achieving a subsequent sale, and from stand-alone providers seeking to take advantage of the prohibition. … An increase in marketing is also likely to generate additional consumer search, intensifying competitive pressure' (paragraph 10.44).

(c) 'By encouraging consumers to shop around after the credit sale, we considered that a point-of-sale prohibition will open up the possibility for substantially greater sales to be made on a stand-alone basis and would provide a stronger incentive than currently exists for distributors to offer PPI at keener prices to achieve PPI sales at the end of the prohibition period' (paragraph 10.45).

Timescale over which remedies will have effect

22. Given the importance of the POSP to the effectiveness of the remedies package,[8] we would not expect the first tranche of measures[9] to be substantially effective by themselves in generating competition in relation to new sales. This means that, assuming we make an Order at around the end of the first quarter of 2011, the second quarter of 2012 is the earliest point at which we might expect the remedies to be substantially or fully effective in increasing competition for new sales.

23. We expect the remedies to have a substantial immediate effect in relation to competition for new PPI sales for the following reasons:

(a) First, the POSP in combination with the informational remedies will immediately change the context in which consumer decisions about PPI are made. By removing the main barriers to search and providing all consumers with the opportunity to search the market away from the credit point of sale, we would expect consumer search activity to increase substantially from the date on which the POSP comes into effect.

(b) Second, by changing the context in which consumer decisions about PPI are made, the POSP in combination with the information remedies generates an immediate change to the incentives facing PPI distributors and intermediaries arranging credit (collectively 'credit arrangers'). The lead-in period to the introduction of the POSP provides an opportunity for credit arrangers to develop their

[8]See, for example, paragraphs 10.67 to 10.71 of the 2009 report.
[9]Disclosure of claims ratios, and provision of information in marketing materials and on the moneymadeclear website.

product offering in ways that make their products attractive to consumers in this new environment.

(c) Third, the POSP in combination with the information remedies generates immediate new opportunities for stand-alone providers, including credit providers offering PPI on a stand-alone basis. As in *(b)* above, the lead-in period provides an opportunity for stand-alone providers to develop new products and propositions that will be attractive to PPI consumers that can be in place as soon as the remedies have come fully into force.

24. We discuss each of these points further below.

Change to context in which consumer decisions are made

25. From the date on which the POSP comes into force, there will be a clear break between the sale of credit and the sale of PPI.[10] Where a credit arranger discusses PPI with a consumer at the credit point of sale, they will not be able to conclude a PPI sale until a period of time[11] has elapsed after the end of the credit sale and the consumer has been provided with a PPI quote.

26. By the time the POSP comes into force, some complementary remedies will already have been put in place (see paragraph 10*(a)* above), and the others will come into force on the same date (see paragraph 10*(b)*). In particular:

(a) The obligations to include information about the price of PPI and key messages in marketing materials and to provide price and other information for use on the moneymadeclear website will have been up and running for six months (see paragraphs 10.521 and 10.522 of the 2009 report).

(b) The prohibition on single premiums comes in on the same date (paragraph 10.522 of the 2009 report) and will have immediate effect (paragraph 10.263 of the 2009 report). In practice, we expect that many providers—and all providers of single-premium PLPPI—will have moved away from single-premium PPI by that date (paragraph 10.260 of the 2009 report). The single-premium prohibition will reduce barriers to search, by facilitating comparisons between PPI products, as well as removing the barrier to switching associated with single-premium policies (paragraph 10.245 of the 2009 report).

(c) The requirement to provide a personal PPI quote comes into force on the same date and also has immediate effect (paragraph 10.522 of the 2009 report).

27. All of these measures are complementary to the POSP (see, in particular, paragraphs 10.37 and 10.477 to 10.479 of the 2009 report) and will therefore enhance its effectiveness from the day on which the POSP comes into force.

28. The combination of the POSP with these other measures involves a substantial change, with immediate effect, to the context in which consumers take out PPI. In particular, where PPI is offered at the credit point of sale:

(a) All consumers will have the opportunity to search the market and to make PPI product comparisons away from the credit point of sale. As only a minority of consumers consider PPI before the credit sale (see paragraph 5.93 of the 2009

[10]This is an intrinsic part of the remedy (see paragraph 10.99 of the 2009 report).
[11]Set at seven days with a limited exemption of 24 hours for consumer-initiated transactions over the telephone or Internet.

report) and a significant proportion of consumers wrongly believe that they could not have bought PPI from a provider other than their credit provider (see paragraph 5.95 of the 2009 report), both of which factors suppress the level of search activity, we would expect this change to result in a substantial increase in the level of search activity in relation to PPI.

(b) All consumers will be made aware at the credit point of sale[12] that alternatives are available and given a personal PPI quote against which to compare alternatives and guidance on where to find more information (in particular, the moneymadeclear website) and with which to facilitate comparisons. Providing this information at the credit point of sale will increase the likelihood that consumers use the prohibition period to search the market. The informational remedies will ensure that comparative information is readily available to facilitate consumer search.

(c) The personal PPI quote includes presentations of the cost of PPI that emphasize the potential benefits to search for customers, in particular the 'combined APR' of the cost of credit with PPI and the cash cost of PPI over a year and, where relevant, over the lifetime of the credit. These ways of presenting the cost of PPI were positively received in the 'road testing' of the personal PPI quote forms that we carried out following publication of the 2009 report, as they made consumers 'stop and think' about the costs and benefits of the particular policy on offer.[13]

(d) The product complexity associated with single-premium PPI will have been removed by the single-premium prohibition, making it easier for consumers to compare PLPPI and SMPPI products with one another and against stand-alone policies (see paragraphs 10.249 to 10.255 of the 2009 report).

(e) Consumers will be made aware that PPI is optional[14] and will not help with the application for credit (see paragraph 5.49 of the 2009 report) and this will be further demonstrated by the fact that they have received confirmation that they will obtain the credit before any PPI sale is finalized. This will encourage consumers to consider the PPI decision on its own merits, further encouraging search.

29. We expect all of these changes to result in increases in search activity as soon as the POSP comes into force. We believe that the increase in consumer search is likely to be substantial from the date on which the POSP is introduced, because the POSP and the information remedies have been developed to address with immediate effect the main specific barriers to search that we identified as part of our AEC finding.[15] With the removal of the main barriers to search and in light of the potential benefits for consumers to search (see paragraphs 5.10 to 5.15 and Appendix 5.1 of the 2009 report), we would expect consumers to take advantage of the opportunity to compare

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[12]Through the personal PPI quotes and the obligation to disclose information in marketing materials. In the event that a personal PPI quote is not provided at the credit point of sale, it must be sent to the consumer in a durable medium before the prohibition period commences.
[13]Insight Research PPI forms consumer testing (April 2009).
[14]Through the personal PPI quotes and the obligation to disclose information in marketing materials.
[15]The main barriers to search were summarized in paragraph 5.144*(b)* as follows:

> Consumers who want to compare PPI policies (including PPI combined with credit), stand-alone PPI or short-term IP insurance policies are hindered in doing so. Product complexity (the variations in pricing structures (in particular in relation to single-premium policies) and in terms and conditions, the way information on PPI is presented to customers), the perception that taking PPI would increase their chances of being given credit, the bundling of PPI with credit, and the limited scale of stand-alone provision act as barriers to search for all types of PPI policies. In addition, the time taken to obtain accurate price information is a barrier in relation to the provision of PLPPI, MPPI and SMPPI. These barriers to search impede the ability of consumers to make comparisons, and therefore effective choices, between PPI policies. They also, therefore, act as barriers to expansion for other PPI providers, in particular providers of stand-alone PPI.

PPI products in order to choose the right suppliers, just as consumers compare products in other markets where barriers to search are low.

30. In conclusion, we expect a substantial immediate impact on customer search and thereby a substantial increase in competitive pressure on credit arrangers once all elements of the remedy package are in place.

Changes to incentives on credit arrangers

31. The factors driving credit arrangers to offer PPI at keener prices (see paragraph 10.45 of the 2009 report) will also have immediate effect:

(a) In light of the immediate changes to the context in which consumers make decisions about PPI, credit arrangers will need to offer better terms to persuade customers to achieve sales at the end of the prohibition period (paragraph 10.45).

(b) The ability to market PPI at the credit point of sale and the obligation to offer a personal quote will give a credit arranger the opportunity to act on this incentive to offer better terms to customers (paragraphs 10.81 and 10.87).

(c) The lead-in time for implementation of this remedy gives credit arrangers the opportunity to develop new products to compete in the new market environment from day one (paragraph 10.519).

32. If the remedies are to have a substantial immediate effect, we would expect credit arrangers and insurers to have been considering the development of new PPI products and consumer offerings following publication of the 2009 report. The internal documents we reviewed indicated that all the retail banks that are main parties to this investigation reacted to the remedies set out in the 2009 report by developing new products; and that a number of underwriters were either active in marketing, or developing, short-term income/lifestyle protection products for distributors. This evidence is set out in Appendix G.

Opportunities for stand-alone providers

33. We considered the timescale over which the remedy package would increase incentives and opportunities for stand-alone provision, whether by insurers or by credit arrangers:

(a) The competitive opportunities for stand-alone providers will be increased by the introduction of the first tranche of informational remedies, ie the increased profile of the moneymadeclear website and inclusion of messages in marketing material to facilitate shopping around (Figure 10.3 in paragraph 10.183 of the 2009 report), although we do not consider these to be sufficient by themselves to remedy the AEC.

(b) They will be given a further substantial and immediate boost with the introduction of the POSP (paragraph 10.45 of the 2009 report), personal PPI quote and single-premium prohibition (because they aid comparability and facilitate consumer search—see paragraphs 25 to 30 above).

(c) The obligations on stand-alone providers being introduced to the same timescale enhance the ability of consumers to make comparisons, thereby enhancing the effectiveness of remedies (paragraphs 10.333 to 10.339 of the 2009 report).

(d) Measures to encourage switching which are being introduced to the same time-scale will also generate additional opportunities for stand-alone providers, though these measures would not have an immediate effect on consumer behaviour (see paragraphs 36 to 50 below).

(e) We also expect the remedies to reduce adverse selection risks for stand-alone providers (see paragraph 10.25 of the 2009 report). This is likely to improve the profitability of stand-alone provision, although this may take some years (between one and five years of introduction of our remedies) to materialize fully.

34. Through these effects, we expect our remedies package to 'increase substantially the competitive constraint posed by stand-alone PPI in relation to all types of PPI' (paragraph 10.479 of the 2009 report). We found that several distributors have already been developing policies that can be sold to their non-credit customers, and to customers with whom they do not currently have an existing relationship (see Section 6). The evidence suggested to us that, with the remedy package in force, we would expect some of the traditional stand-alone providers to remain in the market (with underwriters supporting them), though we noted that there have been some recent exits. But there would be, in our view, a key development: large PPI distributors would enter the stand-alone market. For customers, this would mean that suppliers which have been providing most PPI policies will now be making stand-alone offerings available, increasing choice and increasing the number of household names offering them stand-alone policies.

35. We would expect these effects to have an immediate impact on the constraint posed by the stand-alone sector, though this impact is likely to evolve and develop as the stand-alone sector grows and matures.

Mechanism and timescale of remedies effects in relation to existing PPI consumers

36. As well as increasing competition for new PPI business, the remedy package includes measures to remove barriers to switching and thereby increase competitive pressure in relation to existing PPI policies.

37. The following sections set out an initial consideration of the mechanisms and the timescale over which the remedy package may be expected to have an effect in relation to existing PPI customers.

Mechanism for remedies to take effect

38. There are three main mechanisms by which we expect the remedy package to increase competitive pressure in relation to existing PPI consumers:

(a) The development of a larger, more dynamic stand-alone sector—resulting both from the above remedies and the measures that increase competition for new sales—is likely to generate greater awareness of alternatives among existing customers, both when they receive an annual review and at other times during the year, for example through increased marketing of stand-alone offers (see, for example, paragraph 10.513 of the 2009 report).

(b) The single-premium prohibition will remove the switching barrier associated with single-premium PPI. This removes the main financial cost of switching for PLPPI and SMPPI (see paragraphs 10.245 to 10.277 of the 2009 report).

(c) The obligation to provide an annual review will prompt existing consumers to review their current cover and to consider alternatives (see paragraphs 10.302 to 10.322 of the 2009 report).

Timescale over which remedies will have effect

39. We next consider the timescale by which each of the above mechanisms may be expected to increase competitive pressure in relation to existing PPI customers.

Single-premium prohibition

40. The single-premium prohibition will come into effect one year from making the Order, which we expect to be in the second quarter of 2012. It will have immediate effect on PPI policies sold after that date—ie no further single-premium PPI policies will be permitted. The prohibition does not apply retrospectively to existing single-premium policies sold before the prohibition comes into effect. However, the following factors will significantly reduce the number of such policies that are still in force by the second quarter of 2012:

(a) Against a backdrop of first concern and then intervention by the FSA, most providers stopped selling new single-premium PLPPI policies either during the second half of 2008 or at some point during 2009. By the time this remedy comes into force, most PLPPI providers (by some margin the larger of the two sectors in which single-premium PPI is offered) will have stopped selling single-premium PPI for between two and three years.

(b) The recession has dramatically reduced the volume of new SMPPI policies issued. In the 11 months to November 2009, only 2,314 new SMPPI policies were sold by the largest PPI providers, and all of these were regular-premium policies (see Appendix A, Table 1).

(c) The average duration of a personal loan (and hence of a single-premium policy to protect a personal loan) is between two and three years. As noted in paragraph 18, just less than one-half of PLPPI and SMPPI policies in place at the start of a particular year are terminated during the same year.

41. As a result of these factors, the number of active single-premium policies in place has fallen from 4.2 million at the end of 2007 to 2.2 million in November 2009. We expect this rate of decline to continue, such that by the time the remedies come into force, the number of single-premium policies still in place is likely to be considerably less than 1 million and the majority of those single-premium policies that remain will be coming towards the end of their natural life. This element of the remedy package will therefore be substantially effective in removing the search and switching barriers associated with single premiums—and in preventing such barriers from being re-introduced—from the date on which it comes into force.

Annual review

42. This element of the remedy package comes into force after 12 months of making the Order.

43. In the 2009 report and in this report we have taken the view that the annual review, along with the other information remedies, will not be sufficient on its own to remedy the AEC. Nonetheless, we see the annual review as making a contribution to

remedying the AEC—which is likely to be particularly important in relation to the longer-lasting credit relationships—in particular, mortgage and credit cards.

44. The impact of the annual review on the behaviour of individual consumers will not be felt until consumers receive their first annual review. For existing CCPPI, MPPI and regular-premium SMPPI policies, the first annual review needs to be issued within a year of this element of the remedy package coming into force (ie within two years of making an Order). For existing single-premium PPI policies (a declining number) and existing regular-premium PLPPI policies (currently a small number), there is no obligation to provide an annual review.[16]

45. The consequence is that within two years of the Order being made, all existing CCPPI and MPPI consumers will have received an annual review.[17] These are the sectors for which typical credit relationships are longest lasting (see Table 1) and in which the 'back book' of existing customers is therefore most significant.

46. The annual review will remind consumers of the amount that they are currently spending on PPI, that they are entitled to cancel the policy at any time and provide comparative information and links to the moneymadeclear price comparisons website. We would expect a significant proportion of consumers each year—though we have not estimated how many—to be prompted by receipt of this form to review their PPI cover, in the same way that many consumers currently review their car insurance or home insurance cover on an annual basis. The potential benefits to consumer search combined with the removal of switching costs associated with single premiums will provide an incentive to consumers to respond to the annual review in this way. The increased possibility of losing existing customers may prompt some PPI providers to seek to improve their offer to existing customers in order to retain them.

47. We expect this element of the remedy package to have an appreciable impact on competition in relation to CCPPI and MPPI within a year of this element of the remedy package coming into force. The effect in relation to PLPPI and SMPPI will be somewhat slower, given the decision to exempt existing single-premium policies and regular-premium PLPPI policies. However, given the relatively short life cycle of personal loans and second-charge mortgages, we would expect this element of the remedy package to have an appreciable impact on competition in relation to PLPPI and SMPPI within around two years of this remedy coming into force, by which time we would expect a majority of PLPPI and SMPPI consumers to have received at least one annual review.

Stand-alone sector

48. The annual review and single-premium prohibition will open up new opportunities for stand-alone providers to market their products to existing PPI customers. We would expect stand-alone providers to respond to this opportunity by increasing the visibility and attractiveness of their products, eg through marketing, to attract new consumers including those who were prompted to review their existing cover by receiving an annual review. By opening up the market in this way, we would also expect this remedy to reduce adverse selection risks faced by stand-alone providers (see paragraph 33*(e)* above).

[16]See paragraphs 10.330–10.332 of the 2009 report.
[17]With the exception of dormant credit card accounts. See paragraphs 10.327–10.329 of the 2009 report.

49. We found that several distributors have already been developing policies that can be sold to their non-credit customers, and to customers with whom they do not currently have an existing relationship (see paragraph 34).

50. As with the POSP and the other information remedies, we would therefore expect the annual review and single-premium prohibition to 'increase substantially the competitive constraint posed by stand-alone PPI in relation to all types of PPI' (paragraph 10.479 of the 2009 report). We would expect this to have an appreciable impact on the constraint posed by the stand-alone sector within one to two years of these elements of the remedy package coming into force, though this impact is likely to evolve and develop as the stand-alone sector grows and matures.

Dynamic benefits

51. By their nature, many of the dynamic benefits of introducing competition to PPI markets through the remedy package cannot be anticipated in detail. However, we expect the remedy package to generate the following categories of dynamic benefits, over and above the purely static effects included in the modelling:

   (a) arresting any decline in the size of the PPI sector that results from the current lack of competition, for example negative publicity associated with high prices and issues around sales quality;

   (b) increased advertising and far more interest in (and awareness of) the sector, such that the demand for PPI should increase once it is sold at competitive prices; and

   (c) selection pressure, encouraging companies that develop products which benefit consumers and punishing those that develop poor products.

52. The timescale over which we would expect the first of these dynamic benefits—ie beneficial reputational effects from a more competitive market offering better value to customers—to be realized will be determined by two factors:

   (a) the time taken for the remedy package to improve outcomes for consumers (see paragraphs 16 to 50 above); and

   (b) the time taken for those improved outcomes to feed into an improved perception of the value for money offered by PPI and the quality of PPI sales.

53. We recognize that this latter mechanism may take a number of years to take effect. The PPI market has built up a negative reputation for both overpricing and sales quality issues over more than a decade and this perception may prove difficult to shift. However, as providers start to offer better value for money and as fewer sales quality issues are associated with selling PPI at the credit point of sale, we would expect consumer perceptions of the market to improve with experience and as improved value for money is reflected in lower prices and higher claims ratios. We noted that the timescale over which reputational benefits would be realized depended, in part, on how providers chose to respond to the remedy package. Reputational benefits will be realized soonest, if providers respond in a positive way to the remedy package, by reducing prices, improving information provision and making improvements to sales processes, rather than seeking to circumvent the remedies or attempting to create new obstacles to competition in PPI. While this is a matter of judgement, rather than precise forecasting, we would expect material reputational benefits to be seen within the first five years of all elements of the remedy package coming into force.

54. We would expect increases in advertising and awareness of PPI to be stimulated by the informational remedies and the increased opportunities for stand-alone provision. We would therefore expect substantial dynamic benefits from this source to be realized within the first one to two years of the remedies coming into force. Evidence from parties' internal papers indicates that while distributors appear to be adopting a phased approach to the sale of new protection products, marketing efforts will be progressively extended, initially to other customers of the bank and then to others who are not existing consumers. For example, LBG noted that there were potentially many more opportunities to sell a product not directly related to an underlying credit product. It identified that there were up to [✄] million branch interviews that did not involve the sale of a credit product compared with less than half that number of branch interviews ([✄] million) where a credit product was discussed/taken out. [✄] noted that the CC remedies were expected to open up opportunities to acquire customers through different approaches, separate to the traditional associated credit product.

55. The impact of selection pressure will develop over time. The first stage involves an increase in diversity and experimentation with the development of new products and possibly the emergence of new competitors. We expect there to be an immediate initial impact—as providers seek to develop new products to be in place by the time the remedy package comes into force. We noted that several large distributors and underwriters have been developing new short-term IP products in anticipation of the remedy package coming into force and that these new products appear to perform strongly in customer research. Subsequently, in the presence of competition, those products and providers that best meet the needs of consumers will tend to survive better than those which offer poor value for money. We therefore expect further beneficial effects of selection pressure to be realized as consumers start to make choices within the new market structure and as suppliers respond to customer demand to win business and retain market share. We would expect substantial beneficial effects arising from selection pressure to occur within the first two to three years of the remedies coming into force and for the evolution of better products available to customers to continue to be driven by this dynamic process of rivalry.

Conclusion on timescale for remedies to be effective

56. Based on the above assessment, we conclude that:

(a) The remedy package will only have a limited effect on competition before the point at which all elements of the package are implemented (expected to be the second quarter of 2012).

(b) The remedy package may be expected to have a substantial and immediate effect on competition for new sales from the date on which all elements of the remedy package come into force. Competition for new sales is likely to develop and grow in the years following this date.

(c) We would expect the remedy package to have a substantial effect on competition for existing PPI policies within two to three years of all elements of the remedy package coming into force.

(d) Some dynamic benefits may take longer to realize, particularly restoring the reputational damage caused by years of high prices and sales quality issues. However, we would expect some substantial dynamic benefits to materialize within the first five years of all elements of the remedy package coming into force.

(e) Overall, we would expect the remedy package to be substantially effective within two to three years of all elements of the remedy package coming into force.

Implementation of the POSP

Introduction

1. In this appendix, we discuss issues raised relating to the implementation of the POSP.

2. In response to the remittal provisional decision, it was put to us that the details of how the POSP would be implemented were relevant to its proportionality and therefore fell within the scope of this remittal. Although we will consult on the detail of the Order implementing our remedies following publication of this report, we took the view that it would be appropriate to review the key elements of the POSP, in light of the submissions that were made to us during this remittal.

3. In this appendix, we first summarize the specification of the POSP in our remittal provisional decision and then set out a number of clarifications and changes to how the POSP will be implemented along with our reasons. We also provide our views on other submissions made about the implementation of the POSP during the remittal.

Specification of the POSP in the 2009 report

4. We set out a detailed specification of the POSP element of the remedy package in the 2009 report. We described the POSP as a prohibition on distributors and intermediaries that arrange credit for a consumer (collectively 'credit arrangers') from selling PPI or contacting the consumer regarding PPI during the credit sale and for seven days after either the conclusion of the credit sale or the provision of a personal PPI quote (if this occurs after the credit sale). We decided there should be a limited exemption for consumer-initiated transactions made over the Internet or by telephone at least 24 hours after the credit sale (or 24 hours after the provision of a personal PPI quote, if this occurs after the credit sale).

5. Figure 10.1 of the 2009 report summarizes the main features of how we envisaged the POSP operating when implemented. These were:

   (a) a prohibition on 'pre-selling' PPI by the credit arranger before concluding the sale of credit, where this is a means of circumventing the remedy;

   (b) a prohibition preventing the credit arranger from concluding the sale of a PPI policy at any point during the credit sale—we defined a credit sale as starting with a consumer's application for credit and lasting until the consumer is provided with confirmation in a durable medium that the credit provider is bound to provide the credit;

   (c) a prohibition on including PPI in the agreement for the credit that the PPI is sold to protect;

   (d) a requirement to provide a personal PPI quote if the credit arranger gives any information about PPI during the credit sale;

   (e) a requirement to provide a personal PPI quote if the credit arranger gives any information about PPI after the credit sale and the prohibition period starts from the date on which the quote is provided to the consumer;

(f) a prohibition on the sale of PPI during the credit sale and until after the end of the prohibition period by the credit arranger or any firm in a commercial referral arrangement for PPI with the credit arranger that was either mentioned by the credit arranger during the credit sale or to which information regarding the consumer which was obtained in the credit sale period has been passed for the purpose of selling PPI to the customer. The consumer can buy PPI from any other provider during the credit sale and during the prohibition period, ie stand-alone sales are permitted at any time;

(g) a limited exemption enabling a consumer to buy PPI via the Internet or over the telephone 24 hours after the purchase of credit provided that the consumer has initiated the transaction, and can confirm the receipt of a personal PPI quote; and

(h) no restrictions on the sale of PPI seven days or more after the end of the credit sale period by any party covered by the prohibition but that party must obtain confirmation that the customer has seen the personal PPI quote, before any PPI sale can be made.

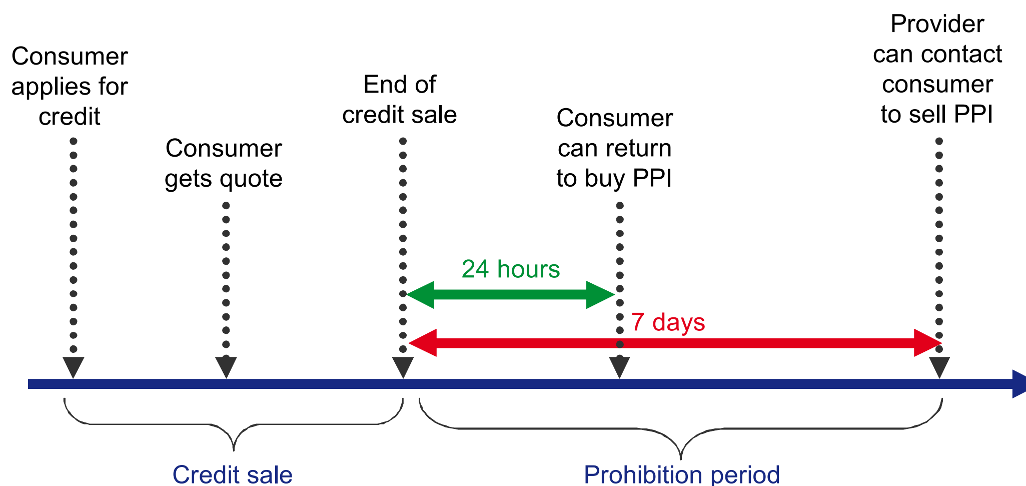
6. We did not change this specification of the POSP for the remittal provisional decision.

7. Figures 1 and 2 below illustrate the operation of the POSP. The way in which the POSP operates varies according to when the consumer is provided with a personal PPI quote.

8. In the scenario depicted in Figure 1, there is a discussion of PPI during the credit sale and the customer is provided with a personal PPI quote before the credit sale is concluded.

FIGURE 1

Personal PPI quote given during credit sale



Source: CC.

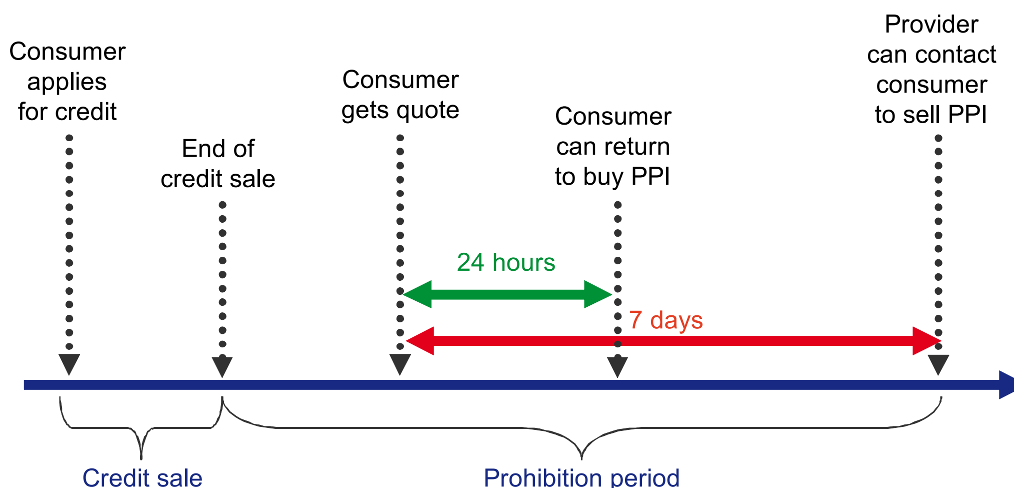
9. In this scenario, the prohibition period starts at the end of the credit sale. The prohibition period lasts for seven days, with an exception for consumer-initiated transactions by telephone or Internet from 24 hours after the end of the credit sale.

10. In the scenario depicted in Figure 2, the customer is provided with a personal PPI quote at some point after the end of the credit sale. This may happen, for example, if

PPI is not discussed during the credit sale or if a customer declines to take a personal PPI quote or if a credit arranger agrees to put a quote in the post.

FIGURE 2

Personal PPI quote given after credit sale



Source: CC.

11. The prohibition period in this situation is potentially longer, as it covers both the time it takes for the customer to be given a personal PPI quote after the end of the credit sale and also the seven-day or 24-hour period after the customer has received the quote.

12. To avoid firms being subject to an open-ended prohibition in this second scenario, we contemplated (as part of our work on implementation of the remedy package before the remittal) a 'safe-harbour' provision that PPI sales made six months or more after the credit sale are treated as stand-alone sales and not subject to the prohibition in the implementation of the POSP.

Overview of changes and clarifications

13. We made no changes to the specification of the POSP package in the remittal provisional decision. However, in response to submissions made to us by parties in response to the remittal provisional decision, we made some changes and clarifications to the specification of the POSP.

14. The changes we made to the specification of the POSP were:

    (a) to allow consumer-initiated transactions by telephone or the Internet to take place the next day following a credit sale (or following the provision of a PPI quote if that is later) rather than 24 hours after (see paragraph 34); and

    (b) to deem PPI sales made one month or more after the end of the credit sale as stand-alone sales rather than a six-month safe-harbour period (see paragraph 56).

15. The clarifications we made were:

    (a) to indicate that the POSP was not triggered by inconsequential amendments to the credit agreement (see paragraph 28);

(b) that for customer-initiated transactions, these could be concluded in the branch provided that the customer had first initiated the transaction by telephoning for an appointment or arranging an appointment over the Internet, in addition to being concluded by telephone or the Internet (see paragraph 36);

(c) to enable credit providers to establish that they are not in breach of the POSP in situations in which they sell PPI and where, despite making reasonable enquiries of a customer and of their own internal records about credit purchases in the previous month, are not aware of the fact of a prior credit sale within that month (see paragraph 56); and

(d) to indicate that the prohibition on 'pre-selling' PPI would apply only to situations in which PPI and credit are sold on the same occasion or where the customer has been provided with specific documents that demonstrate a serious intent to take out a specific credit product within a specified period before the application for PPI. In the latter situation, a credit arranger should not be subject to the pre-sale prohibition in circumstances where it had made reasonable enquiries of the customer and its own internal records as to whether he had received one of the specified documents and, having made such enquiries, was not aware of the issue of such a document (see paragraph 73).

16. In the remainder of this appendix, we give reasons for these changes and clarifications and set out our views on other issues raised by parties during the remittal about the implementation of the POSP.

Issues raised by the parties

17. The following issues were raised with us by parties during the remittal:

(a) the definition of the end of the credit sale and the start of the prohibition period;

(b) the treatment of amendments to existing credit agreements;

(c) the specification of the limited exemption for customer-initiated sales;

(d) the treatment of stand-alone sales and the definition of stand-alone PPI;

(e) the definition and treatment of short-term IP); and

(f) the prohibition on pre-selling of PPI.

Credit sale and prohibition period

18. The parameters of the credit sale and prohibition period are central to the operation of the POSP. In the 2009 report, we said that for the purposes of the remedy, the credit sale will start when the customer has made an application for credit and will end when the customer is provided with confirmation (in a durable medium) that the credit provider is bound to provide the credit.

19. We received many comments on the issue of determining when a provider is 'bound' to provide credit. In paragraph 10.103*(a)* of the 2009 report, we said that this point was when '[the] consumer should be in absolutely no doubt that they are able to access the credit irrespective of whether or not they choose to take PPI … For this reason, we consider that the completion of an application of credit or the granting of an "offer in principle" would be too early a point for the start of the prohibition period'.

20. We received submissions from parties that, as a matter of law, a creditor always has the right to withdraw from offering secured credit until the drawdown of funds (eg because of the possibility of fraud or problems arising with the property on which a loan is secured).[1] In our view, ending the credit sale at the drawdown of funds stage creates a risk that the start of the prohibition period is later than necessary, something that we were anxious to avoid (see paragraph 10.104 of the 2009 report).

21. This appeared to us to be a particularly significant issue for mortgages for two reasons:

 (a) first, because the process of obtaining a mortgage is a multi-stage process, such that the point at which a customer draws down funds could be some time after a mortgage offer, which itself may be some time after the submission of an initial mortgage application; and

 (b) secondly, because a mortgage is more likely to be subject to conditions—for example, relating to the state of the property—which are unrelated to the decision of the lender about the creditworthiness of the borrower.

22. In the light of the submissions that we received about the practical implications of determining when a creditor was 'bound' to provide credit, we concluded that in determining the end of the credit sale, no account should be taken of:

 (a) conditions relating to the value of, title to or any rights or obligations attaching to any property to be offered by way of security for the credit (eg title check on land, fulfilment of survey conditions);

 (b) conditions which it is within the power of the consumer to fulfil (eg activation of a credit card); or

 (c) conditions which it is within the power of a third party to fulfil (eg local council approval/certification, needing an employer to provide proof of earnings).

23. The implication for mortgages and second-charge mortgages is that the credit sale ends when a customer receives a mortgage offer document.[2] Although the release of funds may be subject to the borrower satisfying other conditions, in our view a customer would be in no doubt at this stage that the funds would be forthcoming irrespective of whether or not they chose to take PPI. This is consistent with the intention of the 2009 report (see paragraph 10.106 of the 2009 report).

24. For personal loans, the credit sale would end when the customer receives a consumer credit agreement signed by the credit provider even though the release of funds may be conditional upon the customer providing proof of earnings or other such matter and this may precede the final execution of the credit agreement by the customer. This is consistent with the 2009 report and advice from the OFT (see paragraph 10.102 of the 2009 report). For credit cards, the sale would end when the customer receives the credit card, although to complete the contract the card needs to be activated and used.

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[1] See paragraph 3.22 of LBG's response to the Remittal Provisional Decision and paragraph 1.12 of Nationwide's response to the Remittal Provisional Decision.
[2] The FSA's Mortgage Conduct of Business Rules defines an offer document as 'a document in which the home finance provider offers to enter into a home finance transaction with a customer'.

25. We further recognize that where confirmation is provided to the customer by post or email, it will be necessary for the sake of certainty to deem when such confirmation has been received by a customer.

Amendments to existing credit agreements

26. In response to the remittal provisional decision,[3] we were told of situations where inconsequential amendments might be made to an existing credit offer or credit agreement which would not result in a new agreement and should therefore be deemed not to constitute a new credit sale and hence a new POSP.

27. Examples included:

    (a) when a customer's credit limit was increased;

    (b) where a customer receives an updated credit card;

    (c) where the interest rate is varied;

    (d) where a customer requests or draws down credit under a facility available under an existing credit agreement; or

    (e) where corrections are made to errors in respect of matters such as the name or address of the customer, or details of any security to be offered in support of the credit.

28. We did not think that these situations amounted to a new credit sale for the purposes of the POSP and in the implementation we will make clear that these and similar inconsequential amendments which do not amount to a new credit sale are not subject to a POSP.

29. We also recognize that there may be similar situations where the amendments relate to the PPI, such as amendment of the level of cover under an existing policy or cancellation of a policy in favour of a new PPI product. Unless the prompt for upgrading or amending the policy was a new credit sale, an upgrade or cancellation in order to take out a new PPI product where there is no break or interruption in the cover does not trigger a POSP. This is because the POSP is triggered by a credit sale, rather than an insurance sale.

Limited exemption for customer-initiated sales

30. The rationale for this limited exemption from the POSP was set out in paragraphs 10.117 to 10.226 of the 2009 report. This exemption applies to customer-initiated sales, by telephone or Internet 24 hours after the end of the credit sale, or if later, the provision of a PPI quote. We said in the 2009 report (in paragraphs 10.117 to 10.226) that although a restriction on both businesses and customers was necessary given the nature and severity of the competition problems, we wanted to impose only minimum restrictions on customers. We thought that a break of 24 hours would be sufficient to enable customers to decide whether or not they wanted to purchase PPI and to search for alternatives. To ensure that this limited exemption was not exploited as a means to circumvent the POSP, we made it clear that this exemption applied only to customer-initiated transactions and not those initiated by businesses,

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[3]Paragraphs 3.37 & 3.38 of LBG response to the Remittal Provisional Decision.

and we required the customer to initiate the sale by contacting the business by telephone or via the Internet.

31. We received many comments, both following the 2009 report and during this remittal, suggesting that specification of a fixed '24-hour' period would result in practical problems in the implementation phases. Examples were given of customers needing to be turned away because they had returned after 23 but not 24 hours. We also received submissions on the practical issues raised by compliance with a 24-hour fixed period. It was suggested to us that instead of specifying a '24-hour' gap, this exemption should permit customer-initiated sales from 'the next day' onwards. We had considered, but rejected, similar submissions during the 2009 report (see paragraphs 10.118 and 10.119 of the 2009 report).

32. Two arguments were made in relation to this issue:

(a) First, parties argued that allowing consumers to come back the next day, rather than after 24 hours, was likely to be beneficial to consumers, for example in terms of convenience. For most consumers, this change would result in a shorter period during which they were prevented from taking out PPI from their credit arranger, if that is what they decided to do. It would also give them more flexibility as to the time of day that they could come back and would avoid the risk of customer dissatisfaction if, for example, a customer returned to purchase PPI slightly before the 24-hour period was completed. This change would also be easier for customers to understand.[4]

(b) Secondly, parties argued that it would be less costly to implement and demonstrate compliance if this exemption were specified in terms of days rather than hours. It would avoid the need to record the precise time of day when the prohibition period would start and, likewise, to record the precise time of day that the customer initiated a subsequent PPI transaction.

33. We thought that both types of argument were relevant to our consideration of the matters remitted to us by the Tribunal. We considered the 24-hour gap in light of the submissions on the consumer experience and practical issues associated with time recording. We found that a 24-hour fixed period was likely to be more onerous for both consumers and providers than allowing customers to return the next day. We noted that the fixed period did not produce a particular advantage in terms of monitoring over the 'next day' requirement. Apart from unusual circumstances, we thought allowing customers to return the next day would provide them with sufficient opportunity to consider the purchase and to look for alternatives. We concluded, on further consideration, that the effectiveness of this measure would not be materially reduced by a change to a 'next day' requirement and this would be the more proportionate approach.

34. We therefore decided that we should amend this limited exemption to the POSP for consumer-initiated purchases by telephone or via the Internet from the next day following the conclusion of the credit sale or, if later, the next day following the provision of a personal PPI quote. For simplicity, we propose that 'the next day' should be deemed as starting at midnight on the date that the credit sale was concluded or the personal PPI quote was provided, as appropriate.

[4]There was some evidence for this point in the consumer testing of the personal PPI quote, in that customers had found it difficult to understand why there was a specific time of day after which they could return to take out PPI. See Insight Research PPI forms consumer testing (April 2009).

35. In response to the remittal provisional decision, LBG proposed that customers should not be prevented from returning to the branch to conclude a PPI sale if this was the method they preferred provided that the customer initiated the sale by contacting the credit arranger by telephone or Internet. Nationwide also highlighted some potential difficulties associated with restricting the ability of customers to conclude a PPI sale via telephone and Internet channels. These related to the distributors' obligation to treat customers fairly and the possibility that some distributors may undertake branch sales in an advised capacity, but may undertake telephone or Internet sales in a non-advised capacity.

36. We agreed with the proposal that parties should be allowed to take advantage of this exemption if the customer contacts the credit arranger by telephone or Internet and then makes a follow-up appointment to return to a branch to conclude the purchase of a PPI product. This would enable customers to conclude a PPI transaction through their preferred channel after a break in time from the purchase of credit, whilst also enabling the remedy to be effectively monitored and enforced. This was consistent with our intention in the 2009 report (see paragraph 10.121).

Treatment of stand-alone sales by credit arrangers

Treatment in the 2009 report and subsequent consultations

37. In the 2009 report (see, for example, paragraphs 10.45, 10.57 and 10.64 of the 2009 report), we anticipated that the remedy package would increase incentives for credit arrangers who previously offered PPI only to their own credit customers also to offer PPI (including short-term IP) on a stand-alone basis to consumers with whom they do not have an existing credit relationship. This view was supported by the evidence that we reviewed during this remittal which indicated that, with our remedy package in place, large PPI distributors were actively considering how best to enter the stand-alone market (see paragraphs 6.13 to 6.17).

38. When we consulted on implementation of the remedy package before the remittal, we considered definitions of stand-alone PPI which would make it clear that PPI sales by a credit provider were not always subject to a POSP in situations where:

    (a) the credit provider sold a PPI policy to customers other than its own credit customers; and

    (b) the credit provider sold PPI to cover credit which had been sold by that same provider but a sufficiently long time previously to be considered a stand-alone sale.

39. In relation to the second of these situations, we consulted on a 'safe-harbour' period of six months after the date of the credit agreement as, in our view, that was a sufficient period of time after the sale of credit to make any subsequent sale of PPI effectively a stand-alone sale. This was the basis on which we carried out our evaluation of the proportionality of including the POSP in the remedy package in the remittal provisional decision.

Comments by parties

40. In response to our remittal provisional decision, Barclays told us that it was difficult for credit arrangers also to be stand-alone providers regardless of the circumstances, as they would have to check whether they had provided the customer with any type of credit product in the preceding six months. Barclays told us that this was likely to

stifle innovation by credit providers that wished to offer stand-alone PPI or short-term IP.[5]

41. Barclays suggested a revised definition of stand-alone PPI (or stand-alone short-term IP), which included the following elements:

(a) Complete separation from any other product sale or product holding. In practice, this could involve changing from one area in an IT system to another.[6] Crucially, the separation should be made clear to the customer and the provider should have evidence of the separation in process.

(b) Premium collection is completely separate from any other product, further confirming the complete separation in the eyes of the customer.

(c) A declaration at the beginning and the end of the sales process to ensure customer awareness of the isolated nature of this product sale and that no other sale, before or after, was in any way impacted, influenced or priced in accordance with this sale.

(d) It is the provider's responsibility to retain evidence of the customer's agreement that they were aware that the sale was stand-alone in such a way that this evidence is capable of being retrieved when required in the future. The evidence required may vary by channel and for advised vs non-advised sales.

(e) The other product offerings from the provider discussing the short-term IP product are irrelevant in terms of the status of the short-term IP, as long as tangible and effective separation is in place and can be proven to be in place. For example, a credit card issuer should be able to provide a suitably governed short-term IP product subject to the clear gaps in their respective sales processes and the evidence that this was in place for any particular sale.

42. Barclays told us that its network pilot evidence highlighted that for a majority of customers who bought its new short-term IP product (Barclays Income Insurance), no loan record was found. However, a discussion around a lending requirement could identify a customer's additional requirements in relation to their overall commitments. Barclays submitted that to enforce the prohibition for such 'stand-alone' cover would effectively prevent customers from covering these additional requirements when they were not related to the lending.

43. [✄].

44. [✄] proposed that where a credit arranger used the credit point of sale only as an opportunity to introduce short-term IP type products with benefits that *(a)* were not aligned to the credit product repayment; *(b)* were not applied directly to the credit product but instead were paid direct to the consumer; and *(c)* could include other outgoings, this constituted a stand-alone PPI product and no POSP would apply.

45. LBG highlighted, by reference to some hypothetical scenarios, some practical difficulties that could arise for credit arrangers seeking to offer PPI/short-term IP on a stand-alone basis. These practical difficulties related to the possibility of being sub-

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[5] Barclays Response to Remittal Provisional Decision, p7.

[6] Barclays told us that the significance of changing from one area in an IT system to another is that it would be a clear and certain way to comply with separation requirements. It would mean that sellers would be forced to finish one process and, if the customer wished to, move to a separate protection discussion. This clear break would also be apparent to the customer, and would be reflected in the eventual sale documentation. It would also allow providers to evidence their compliance, satisfying both their requirements to the OFT following the final order, and to the FSA under ICOBS.

ject to a POSP as a result of an unrelated credit transaction and to the difficulty of assessing whether, in practice, the POSP would apply.[7]

Our views

46. It is important that the specification of the POSP should support the development of a stand-alone market, including the provision of PPI/short-term IP on a stand-alone basis by credit arrangers.

47. On the basis of the submissions that we received, we thought any practical difficulties facing credit arrangers wishing to offer PPI away from the credit point of sale were most likely to materialize for those multi-product firms (such as Barclays and LBG), that offer a range of credit and insurance products to their customers through various business units.

48. We looked at various different scenarios to help us consider the comments that had been made to us by parties.

49. First, we looked at the situation of a corporate group containing interrelated corporate bodies such as a retail bank and an insurance business. The POSP triggered by the credit sale would extend to the insurance business if the conditions set out in paragraph 5*(f)* were met. If credit arrangers want to avoid bringing other members of the corporate group within the scope of the prohibition, they would need to ensure that there was no referral at the credit point of sale nor pass information to them about the credit transaction for the purpose of selling PPI.

50. Secondly, we looked at the situation in which a credit arranger offers multiple credit products to the same customer and PPI may be sold for each. LBG provided a hypothetical example in which a customer had recently taken out both a credit card and a personal loan with the same credit arranger and where the prohibition period had expired in relation to the credit card, but not in relation to the personal loan.[8] In this situation, our intention is that the POSP should apply to any attempt by the credit arranger to sell PPI to cover the personal loan, but not to any attempt to sell CCPPI, as the consumer would already have had a sufficient opportunity to search for alternative cover in relation to CCPPI.

51. Thirdly, we looked at the situation in which a credit arranger offers a PPI/short-term IP policy to an existing credit customer at some point after the credit sale. This might occur, for example, as part of a wider review of a customer's financial arrangements or as a follow-up marketing call.

52. We thought that, if the PPI/short-term IP policy that was offered to the customer was intended to cover the repayments on a specific credit product (either on its own or along with other financial commitments) and if the prohibition period in relation to the credit product in question had not expired, then the POSP should apply. If the POSP did not apply, there would be a risk that credit arrangers would not mention PPI at the credit point of sale, or provide a personal PPI quote to help the customer search the market, but would instead contact the consumer to sell 'stand-alone' PPI a short while afterwards. This could undermine the effectiveness of the remedies package in facilitating consumer search (see paragraph 10.109 of the 2009 report).

[7]LBG response to the Remittal Provisional Decision, paragraph 3.11.
[8]Paragraph 3.11 of LBG response to the Remittal Provisional Decision.

53. We considered whether we should vary the specification of the POSP to preserve the effectiveness of the remedy package while reducing the scope for practical difficulties to arise that would make it difficult for credit arrangers to make genuine stand-alone sales.

54. We concluded that there were two variations we could make to the specification of the POSP to achieve this aim. These related to:

(a) the duration of the 'safe-harbour' period after which PPI sales would be deemed to be stand-alone (see paragraph 39); and

(b) the standards of evidence that would be required of credit arrangers to establish that they were not subject to the prohibition in any particular situation.

55. We thought that the specification of a suitable 'safe-harbour' period after which PPI sales could be deemed to be stand-alone depended on the balance of the following factors:

(a) On the one hand, we thought that the specification of this period should be sufficiently long to retain incentives on credit arrangers to provide customers with a personal PPI quote if they wished to sell PPI to that customer at a later date. We were concerned that if the 'safe harbour' period was too short, there was a risk that credit arrangers would not mention PPI at the credit point of sale at all, and instead contact the consumer after the end of the prohibition period to sell PPI, without having previously given the consumer the personal PPI quote or any other information about PPI. This could undermine the effectiveness of the remedy package in facilitating consumer search (see paragraph 10.109 of the 2009 report).

(b) Conversely, the 'safe-harbour' period should also be sufficiently short to reduce the risk that any particular customer had taken out multiple credit products with the same credit arranger over this period or was unable to recall earlier credit transactions. This would reduce the scope for complexity in establishing whether a particular credit arranger was subject to a POSP.

56. In our judgement, a safe harbour period of one month would strike an appropriate balance. This would provide incentives for credit arrangers to provide customers with a personal PPI quote, in order to have the opportunity to sell PPI at the end of the prohibition period rather than waiting for the sale to be deemed stand-alone. It would also reduce the scope for complexity that parties had identified as being associated with a six-month 'safe harbour' period. This is because it would be less likely that customers would have taken out multiple products from the same provider and more likely that consumers would be able to recall with a reasonable degree of accuracy which credit products they had taken out during the past month and the circumstances surrounding those purchases. Shortening the 'safe harbour' period to one month would therefore make it easier for credit arrangers to establish whether the POSP applied in any particular situation.

57. In relation to the standards of evidence that would be required to establish that a credit arranger was not subject to the prohibition, [✂].[9] LBG suggested that credit arrangers might be excused from the application of the POSP after a specified initial period where it had made reasonable enquiries of a consumer as to whether they had bought a relevant credit product within a specified prior period, and, having made

[9] [✂]. We received similar submissions from other providers during consultation on implementation of the POSP before the remittal.

such enquiries, was not made aware of any prior purchase. We thought that it was appropriate that credit arrangers should be able to establish that they are not in breach of the POSP in these circumstances, although the credit arranger will be expected to check all internal systems as well as relying on the customer.

58. We also considered carefully the proposed specification of a stand-alone sale by Barclays and Nationwide in paragraphs 41 and 44 above.

59. Under Barclays' proposed specification, a PPI/short-term IP sale might be deemed to be stand-alone even if it were made at the credit point of sale, provided it met the criteria in paragraph 41. Barclays told us that this was on the basis that the PPI/short-term IP policy would not be linked to the credit product. In our view, this proposal would not therefore provide the customer with either the opportunity or the tools with which to consider alternatives before selecting a PPI/short-term IP provider, nor would it overcome the preferential access to the customer enjoyed by the credit arranger that we had found to be a fundamental element of the point-of-sale advantage (see paragraph 5.109 of the 2009 report). Allowing PPI policies sold at the credit point of sale to be treated as stand-alone sales appeared to us to pose substantial circumvention risks, which we did not think that the various disclosures and other measures proposed by Barclays would be sufficient to overcome. We therefore concluded that Barclays' proposed approach would not adequately address the point-of-sale advantage held by credit arrangers and decided not to adopt this suggestion. For effectively the same reasons, we did not accept the proposal by Nationwide.

Treatment of short-term income protection

60. In its response to the remittal provisional decision, Barclays submitted that the POSP should not apply to sales of short-term IP, as short-term IP was not linked to any credit product.[10]

61. We did not agree with this submission. We had found in the 2009 report that short-term IP was a form of PPI and that the sale of a short-term IP policy as a result of a referral made during a credit sale (and, by extension, the sale of a short-term IP policy during a credit sale) enjoys the same advantages, and gives rise to the same concerns, as PPI sold at the credit point of sale (see paragraphs 2.12 to 2.14 and Appendix 2.3 of the 2009 report). Exempting short-term IP polices from the POSP would create a substantial circumvention risk, and we would expect credit arrangers to use such an exemption to seek to sell short-term IP policies at the credit point of sale, restoring the AEC that our remedy package is designed to address.

62. We agreed with Barclays and others that it was important for short-term IP to have its own specification. In consultations on implementation of the remedy package undertaken before the remittal, we received submissions from the FSA and parties which have assisted us in clarifying the specification of short-term IP for the purposes of implementation of the remedy package.

63. Our specification of short-term IP is:

> a contract of insurance which provides a pre-agreed amount paid directly to the policyholder in the event that the policyholder experiences involuntary unemployment or incapacity as a result of accident or sickness and which:

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[10]Barclays response to Remittal Provisional Decision, p7.

(a) is written for a term which is less than five years and not predetermined by the term of any credit; and

(b) can be terminated by the insurer; and

(c) is not exempt from IPT.

64. We consider short-term IP to be a form of PPI and to be subject to the POSP irrespective of whether the amount received under the policy is the same as the amount of repayments required by the credit agreement.

Prohibition on pre-sale

65. Part of our specification of the POSP in the 2009 report included a prohibition on the pre-sale of PPI, ie the sale of PPI before the start of the credit sale (see paragraph 5*(a)*). This is an anti-avoidance measure to prevent credit arrangers from rearranging the steps in an integrated sales process for credit and PPI, such that the PPI is sold to a customer before the credit application is commenced, and thereby taking the PPI sale outside the scope of the POSP.

66. In the 2009 report, we specified the prohibition on pre-sale as applying when a credit arranger has discussed credit with a consumer and has reasonable grounds to believe that the consumer will make an application for credit within seven days of the discussion. In these circumstances, the credit arranger was not able to conclude the sale of a PPI policy for the credit discussed with the consumer before the commencement of the credit sale but may provide the consumer with a personal PPI quote.

67. When we consulted on implementation of the remedy package before the remittal, we thought that a credit arranger would have 'reasonable grounds' to believe that the consumer will make an application for credit if the credit arranger has discussed any of the following with the consumer:

(a) the amount of credit that may be provided;

(b) the terms of repayment of the credit; or

(c) the interest rate payable on the credit.

68. LBG submitted in its response to the remittal provisional decision that the scope of the prohibition was too broad. LBG also highlighted the implementation of the Consumer Credit Directive (CCD) and the OFT's Irresponsible Lending Guidance, which it submitted would make it more common for banks to initiate discussions with customers about their potential need for credit and that this could create difficulties in establishing whether a credit arranger had 'reasonable grounds to believe' that a consumer was likely to take out a credit product in the near future. LBG also told us that, if the consumer approached the credit arranger to buy PPI, the credit arranger would often not have adequate records to be able to ascertain whether the same consumer had (in a broad sense) a credit-related discussion with some other employee of the credit arranger.[11]

69. LBG made two proposals in relation to the pre-sale prohibition.

[11] LBG response to Remittal Provisional Decision, paragraph 3.12.

70. First, it proposed replacing the 'reasonable grounds to believe' criteria with references to the following specific stages in the credit application process, in particular:

(a) in relation to loans and credit cards, when the customer received a copy of the Standard European Consumer Credit Information (SECCI) required by the new consumer credit legislation to be given to customers before they signed a consumer credit agreement;

(b) in relation to mortgages, where the consumer received a key facts illustration (in accordance with MCOB requirements); and

(c) in relation to second-charge mortgages, when the consumer received a written quote.

71. We thought that this was a helpful approach to cover situations in which PPI and credit are not sold on to a customer on the same occasion, but where a discussion of credit had taken place on an earlier date. By identifying particular documents which demonstrate a serious intent to take out credit, LBG's proposal will make it easier for credit arrangers to establish whether or not they are subject to the prohibition on pre-selling. Given the anti-avoidance rationale for this measure, however, we thought that the prohibition on pre-sale should be specified to prevent PPI being sold on the same occasion as credit, irrespective of whether these particular documents have been provided to a customer before the PPI sale.

72. Secondly, LBG proposed a further safeguard for large credit arrangers who offered different credit and PPI products across different business units. This was that a credit arranger should not be subject to the pre-sale prohibition in circumstances where it had made reasonable enquiries of the customer as to whether they had received one of the documents specified in paragraph 70 above within a specified period prior to the date of their application for PPI and, having made such enquiries, was not aware of the issue of such a document. This seemed to us to be a sensible suggestion, as the type of behaviour that this article is aimed at preventing is a credit arranger who is aware of an impending credit sale, although any such provision should not enable credit arrangers to circumvent the prohibition in situations where they were able to check their own records.

73. In implementing this element of the POSP, we will therefore clarify that the prohibition on 'pre-selling' PPI would apply only to situations in which PPI and credit are sold on the same occasion or where the credit arranger has reasonable grounds to believe that the customer will enter a credit agreement. Credit arrangers will be considered to have 'reasonable grounds to believe' that the customer will enter a credit agreement if the customer has been provided with specific documents that demonstrate a serious intent to take out a specific credit product within a specified period before the application for PPI. In this latter situation, a credit arranger should not be subject to the pre-sale prohibition in circumstances where it had made reasonable enquiries of the customer as to whether they had received one of the specified documents and, having made such enquiries, was not aware of the issue of such a document. The credit arranger will be expected to check all internal systems as well as relying on the customer.

Alternatives to a POSP

1. In paragraphs 10.36 and 10.37 of the 2009 report, we explained how the POSP will contribute to addressing the AEC. We said that the POSP will directly address:

   - the AEC arising from the sale of PPI at the point of sale by distributors or intermediaries (ie the point-of-sale advantage); and

   - barriers to search, such as customers' perception that taking PPI would increase their chance of being given credit; the bundling of PPI with credit; the limited scale of stand-alone provision of PPI; and the time taken to obtain accurate price information.[1]

2. During our original investigation, several alternatives to a POSP were put to us. These were set out in paragraph 10.67 of the 2009 report. Our views on them were set out in paragraphs 10.68 to 10.71 of the 2009 report. We concluded that the alternative suggestions from the parties would either be more complicated to monitor and likely to be ineffective or would not address the AEC that we found. We saw nothing during this remittal that should lead us to change this conclusion.

3. During the course of the remittal we received representations about remedies which we were told would be effective remedies to the AEC and would be more proportionate than a POSP. We set out below the alternative remedies put to us during the remittal and our analysis on them.

4. In considering these alternatives, we had regard to whether the remedy would be 'effective to achieve the legitimate aim in question'—the first limb of the test of whether a remedy is proportionate.[2] In doing so, we looked at whether the remedy would be substantially effective—the wording preferred by the Tribunal for how effective the remedy package would need to be.[3]

Transparency remedies only

5. LBG, Barclays[4] and MBNA[5] told us that the remedy package's information remedies alone were sufficient to address the AEC. LBG said that changes to the market since the 2009 report was published had strengthened the case against the imposition of a POSP, and we should actively consider whether the transparency remedies in the remedy package[6] would, on their own, be sufficient to remedy the adverse competition effects identified in the 2009 report. LBG said that, in light of present market conditions, no further remedy was required. MBNA said that the impact of the work done by the FSA and the FOS was increased consumer awareness, which, along with the economic climate and increased competition, meant that transparency remedies alone would be sufficient.

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[1]We said that the POSP will work in conjunction with the provision of the personal PPI quote to reduce the time taken to obtain accurate price information.
[2]See paragraph 137 of the Tribunal judgment in Tesco case, set out in paragraph 20 of the Tribunal's judgment.
[3]See paragraph 102 of the Tribunal's judgment.
[4]Barclays response to the provisional decision, p11.
[5]MBNA response to the provisional decision, paragraph 2.
[6]By 'transparency remedies', we interpret parties as meaning the obligations *(a)* to include information in marketing materials; *(b)* to provide a personal PPI quote; *(c)* to provide customers with an annual review; *(d)* to provide information to the FSA for publication on its website; and *(e)* to provide claims ratios to any person on request.

The proposal

6. LBG developed the transparency proposal more fully, and we thus concentrate on that proposal. LBG proposed that the transparency measures could easily be strengthened and made more effective. It suggested that the following additional measures could be introduced:

   (a) including a PPI pricing metric in credit advertising, whilst also making clear that the PPI was optional; and

   (b) recommending to the FSA[7] enhancements to its moneymadeclear price comparisons website, namely: looking at ensuring that the moneymadeclear price comparisons website was one of the first responses on popular Internet search engines when consumers searched for PPI products; promoting the 'moneymadeclear' logo more effectively; making the comparison site more user friendly; and requiring providers to include a 'click through' link from their own websites to the moneymadeclear website.

7. The first of these additional measures proposed by LBG (paragraph 6(a)) was that all credit advertisements which included the price of credit would contain two pricing metrics: a credit APR, and the amount it would cost the consumer by way of premium to generate a single unit of benefit of £100 from PPI (the unit cost of benefit).

8. The unit cost of benefit pricing metric is fundamentally the same as the 'monthly cost/ £100 monthly benefit' metric which the remedy package requires PPI providers to disclose in PPI marketing materials, personal PPI quotes and annual reviews, albeit with a different name and the suggestion of more prescriptive (though unspecified) rules about how it would be calculated.

9. The LBG proposal is to require the price of PPI to be included alongside the advertised price of credit (ie where an APR for the credit is included in the credit advertisement).

Our view of the proposal

10. We considered transparency-only remedies during the original investigation—option 1 of the Notice of Possible Remedies published on 5 June 2008, which would have required distributors which offer PPI and credit products to disclose, in advertising and marketing material:

    (a) the annual cost to the customer of the interest and charges payable on the credit product;

    (b) the annual cost to the customer of taking the PPI product;

    (c) the annual cost to the customer of the combination of the credit product with the PPI product; along with

    (d) providing key messages.

    Our views on it were set out in paragraphs 10.193 to 10.199 of the 2009 report.

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[7]As of 26 April 2010, responsibility for operating the moneymadeclear price website and the comparison tables for PPI passed from the FSA to the newly created CFEB.

11. As set out in paragraph 10.69 in the 2009 report (and also in paragraphs 10.466 to 10.471), while informational/'transparency' remedies would help remedy the AEC identified, we did not think that the information remedies set out in the 2009 report alone would be sufficient to remedy the lack of competition we saw between PPI providers as it would not address the point-of-sale advantage.

12. We considered the changes in the market in Section 4 of this report. We concluded that the fundamental issues which prevent effective competition in PPI markets remain in place and that there were no market developments that constituted such a material change in circumstances or a special reason that it was necessary for us to amend the remedy package, including the POSP, as set out in paragraphs 10.567 to 10.572 of the 2009 report.

13. Apart from the argument about changes in the market since the 2009 report meaning that information remedies would suffice, the thrust of LBG's argument was that it thought we had rejected advertising PPI prices alongside credit prices because the remedy might lead some people to think that the offer of credit was conditional on taking out PPI, and that this could be avoided by requiring providers to make clear on the advertisement that PPI was optional, and requiring them to provide the price of PPI alongside the price of credit (see paragraph 6*(a)*).

14. We set out in paragraph 10.199 of the 2009 report our concerns regarding including PPI content in credit advertisements. These concerns related to issues raised by parties, which were more than just whether it was clear that PPI was optional. They also included concerns about: how this would impact on the sale of other products which might be sold alongside credit, such as household or fraud insurance (paragraph 10.195 of the 2009 report), and the extent to which we could require information to be provided in credit advertisements because of the Consumer Credit Directive (paragraph 10.197 of the 2009 report). There were also concerns about the number of exemptions that would be needed to the remedy on grounds of practicality in different media. We were, therefore, not convinced by LBG's arguments.

15. We were also not persuaded that LBG's suggested changes to the design of the moneymadeclear website (see paragraph 6*(b)*), while helpfully intended, would be sufficient to overcome the serious shortcomings that we had found in competition in PPI markets. These changes might increase traffic to the website, and might result in some increased use of it to take out PPI policies. However, we thought these changes would not in themselves result in a significant change in volumes of stand-alone policies taken out—in Appendix 3.8 of the 2009 report we found that moneymadeclear PPI pages achieved a similar number of hits as the second-largest commercial website, but that the number of views achieved was extremely low compared with the number of PPI policies taken out—and by extension the number of resulting sales would also be extremely small in proportion to total PPI sales. We saw no reason to expect that the changes suggested by LBG would in themselves make the moneymadeclear website a tool used by a significant proportion of PPI customers.

16. We said in paragraph 10.70 of the 2009 report: 'We concluded that a package of information remedies alone would not be sufficient and an additional structural measure would be needed to achieve a comprehensive solution to the AEC that we found'.

17. This finding was not quashed by the Tribunal. The Tribunal noted:

> the Commission evidently regarded the POSP as lying at the heart of its remedy package rather than on the periphery, albeit that it was the most

costly to implement. It is equally apparent that the Commission considered, after due analysis, that the remedy package would be ineffective as a cure for the AEC without the POSP.[8]

18. Nor did we see any new evidence that would lead us to change this conclusion. As a result, the conclusion that information remedies alone would not be effective stands. Our analysis of what has happened since the 2009 report led us to conclude that we still need to remedy all parts of the AEC addressed by the POSP, and that informational remedies alone remain insufficient. Further, we did not agree that making clear on advertising that PPI was optional would be sufficient to remedy the negative aspects of the point-of-sale advantage.

19. We did not find new evidence that would lead us to change our view that a remedy package based on information remedies would not be substantially effective in addressing the point-of-sale advantage, nor did we find a material change in circumstances, or a special reason, which should lead us to reach a new conclusion that information remedies alone would create a substantially effective remedy package.

A clear break in the sales process

The proposal

20. In its response to our consultation on the proposed approach to reconsidering the POSP as part of its remedy package, HSBC requested that we analyse the effectiveness of alternative packages of remedies, referring to the proposals set out in the 2009 report and a proposal that, instead of imposing a POSP, we require a clear break between the sale of credit and of PPI—the credit sale would have to be concluded before the PPI sale could commence. In addition, a standard quote would be provided which the customer can either accept (with the opportunity to shop around and cancel the policy during the cooling-off period but with protection in place from the date of the credit purchase) or take away and use to shop around. The two sales could, however, be conducted by the same person within the same meeting or phone conversation. Santander[9] said that the cooling-off period was a standard feature of many financial products and was understood by the average consumers, and it said that it was surprised that we had not sought to investigate ways in which it could have been highlighted to customers more effectively.

21. In its response to our provisional decision, HSBC[10] said that our analysis was flawed and that the POSP failed the proportionality test. As a result, it said that we must consider alternative remedies. It said that the AEC would be substantially mitigated in a proportionate manner by the implementation of a package of information and transparency remedies coupled with a break in the sales process (albeit that a PPI sale could be made immediately after the conclusion of the credit sale, if the consumer so wished) and the provision of a guaranteed quote which could be taken away by the consumer and would remain valid for a fixed period.

Our view of the proposal

22. We considered such a proposal in the 2009 report in paragraph 10.69, where we concluded that:

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[8]Paragraph 119 of the PPI judgment.
[9]Santander response to provisional decision, paragraph 2.9.
[10]HSBC response to provisional decision, p15.

without a point-of-sale prohibition, providing a personal PPI quote at the point of sale, after the consumer has taken out the loan and during the sales process for a linked PPI product, would not have a sufficient effect on a consumer's searching behaviour for such a remedy package to be effective in remedying the AEC identified.

23. We do not believe that this 'clear break' proposal would address the point-of-sale advantage held by distributors and intermediaries arranging credit. It would, at best, partially address questions as to whether consumers think that taking out PPI would improve their chances of obtaining credit, though it would still be very difficult to monitor effectively whether a perception of obligation was created within a particular meeting or phone conversation. In this regard, we noted that, as set out in paragraph 2.66 of the 2009 report, the FSA, in its September 2007 report, found that 92 per cent of the businesses it visited in its mystery shopping exercise did make it clear that the purchase of PPI was optional, yet despite this, as noted in paragraph 5.49 of the 2009 report, a survey conducted for us in the same year showed that between 25 and 49 per cent of customers (depending on the product) still perceived, or believed they were told, that taking out PPI would improve their chances of obtaining credit.

24. Moreover, we would expect distributors and intermediaries subject to such a measure, as now, to seek to maximize sales made at the credit point of sale, rather than encourage customers to search the market and revert to purchase the product at a later date. Once customers had decided to purchase PPI from their distributor or intermediary, we would expect their appetite for further search to diminish substantially.

25. We concluded that this was not a proposal which could, with transparency remedies, form a substantially effective remedy package.

26. We did not investigate how further to highlight the cooling-off period, as suggested by Santander, as providers are already required to highlight it. The cooling-off period works as a way of allowing consumers to reconsider whether they need the product, and cancel it if appropriate. However, as we found in the 2009 report, it is hardly used, and it was not designed to encourage post-purchase search for a better product nor is it used for such purposes. Further, we did not think it realistic that it could be so used; as noted in paragraph 10.68*(a)* of the 2009 report, consumers are less likely to search for a product once they have already bought one.

A clear break with additional remedies

The proposal

27. RBSG[11] said that, to the extent that the CC did not consider that the original remedy package less a POSP was sufficient to address its concerns, then a number of other remedies could be included. It suggested the following package:

    (a) a requirement for a 'clear break' between the credit sale and PPI sale (see paragraphs 20 to 26);

    (b) all policies to be annually renewable on an 'opt-out' basis (with an obligation on providers to contact customers reminding them that their policy was due for renewal, so as to avoid passive renewals);

[11] RBSG response to the provisional decision, pp11–12.

(c) providers to ensure that their products could be sold on a stand-alone basis; and

(d) increased informational requirements in order to ensure that customers were made better aware of their right to cancel their PPI product in the cooling-off period. For example, there could be a requirement that firms make cancellation even easier for customers, eg by including a phone number or other contact details very prominently on all policy documents.

28. RBSG said that this unknown threat of cancellation would mean that firms would work hard to: *(a)* ensure that their products were good value and competitive in order to retain customers; and *(b)* market themselves to rivals' customers, for instance, in order to win back business lost during the cooling-off period. It said that this would: lead to a more dynamic stand-alone market yet would allow the majority of customers who did want to buy PPI at the credit point of sale to do so; would ensure that there was no protection gap for those who wanted to have the benefit of cover from the outset; and would also encourage customers to shop around for a better deal elsewhere.

29. RBSG said that it considered that this remedy package would easily address each of the remaining features of the AEC. It said that failure to compete was addressed through the requirement to provide a stand-alone product and customer awareness of the cooling-off period/ability to cancel the product. Barriers to search were addressed by the informational remedies, the clear break in sales process, the cooling-off and the cancellation opportunities. Barriers to switching were addressed by the informational remedies, the annual renewal remedy and a customer's right to cancel. And finally, the point-of-sale advantage was addressed by the informational remedies, the clear break in the sales process and the cooling-off period.

30. RBSG concluded that this remedy package would be an effective substitute for the POSP, and avoided the detriment of the 2009 remedy package which, it said, would deny those who wanted to buy PPI at the same time as credit the opportunity to do so, leaving customers who needed cover at risk of going without it.

Our view of the proposal

31. We considered RBSG's proposal carefully.

32. We noted first that RBSG said that the point-of-sale advantage was addressed by a combination of the informational remedies, the clear break in the sales process and the cooling-off period.

33. We considered the clear break proposal (paragraph 26*(a)*) with informational remedies in paragraphs 19 to 25 and concluded that it was not a proposal which could, with transparency remedies, form part of a substantially effective remedy package. Similarly we considered the use of the cooling-off period in the 2009 report (see paragraph 10.68*(a)* of the 2009 report)) and concluded that it would not form part of a substantially effective remedy package without a POSP.

34. We considered whether combining the two proposals would substantially remedy the point-of-sale advantage. We concluded that it would not. We found that the clear break would, at best, only partially address the point-of-sale advantage, in addressing questions as to whether consumers think that taking out PPI would improve their chances of obtaining credit (see paragraph 23), and the cooling-off period would not be effective because consumers seem less inclined to change policies once they have purchased them (see paragraph 10.68*(b)* of the 2009 report). We also noted that the main purpose of the cooling-off period is to allow customers to reconsider the

need for their policy and possibly cancel if they conclude that they do not need it, rather than to encourage them to shop around after having bought a policy. As such, we would be relying on a mechanism that was designed for one purpose successfully fulfilling another, very different purpose. We saw no prospect of two remedies which were, in our view, well short of being effective combining to be substantially effective addressing the point-of-sale advantage.

35. We also considered the effectiveness of the other aspects of RBSG's remedy package. The annual renewal on an opt-out basis was a remedy proposal considered in the 2009 report, where we concluded in paragraph 10.68*(b)* that combining this with the other elements of our remedy package, except for the POSP, would not effectively address the AEC, having insufficient impact and emphasis on the point-of-sale advantage and barriers to search. We consider an opt-in remedy, which we would expect to be both more onerous on PPI providers and have more impact on consumers, in paragraphs 40 to 71, and conclude that it would not be an effective remedy; we see no reason to think that this lighter variant of that remedy would be more effective.

36. The requirement that providers ensure that their products can be sold on a stand-alone basis (paragraph 27*(b)*) might help address the AEC in two possible ways:

- First, it might increase the number of products that were available on a stand-alone basis.
- Secondly, it might encourage some customers to delay their purchase of PPI and search for alternatives, if they were aware that they could purchase PPI on a stand-alone basis from the credit arranger at a later date.

37. Looking at the first of these effects, if it were a requirement that all providers must actively market their products on a stand-alone basis then this might, in principle, increase the number of stand-alone providers and contribute to the development of a more competitive stand-alone market. However, a requirement to have a policy for sale says nothing about the extent to which it is marketed and offered to customers. If it is only passively sold, with minimal advertising, it would achieve little (and parties' incentives might be expected to lead them in this direction if it allowed them to maintain their monopoly at the credit point of sale). Nor is it practicable to specify, monitor or enforce the degree of marketing effort that firms put into promoting a stand-alone product.

38. Looking at the second of these effects, we were told during the investigation that some customers might feel pressurized into taking out PPI at the credit point of sale because it was the only opportunity to secure cover. If consumers knew that they could return to the credit provider to purchase PPI at a later time, then they might take the time to consider their option, and search around for the best product. However, there are two issues. First, as noted above, a requirement to have a policy for sale says nothing about the extent to which it is marketed and offered to customers. If it is only passively sold, with minimal advertising, it would achieve little. And secondly, for those who might take advantage of searching opportunities, we would need to ensure that they were not steered in a particular direction by sales staff. In that respect, we have set out our comments relating to implementation of the menu regulation proposal in paragraphs 91 to 105.

39. We concluded that the RBSG remedy proposal would not form an effective remedy, to the AEC. In particular, we concluded that it would not address to any material extent the point-of-sale advantage, which lies at the heart of the AEC.

Annual renewals on an opt-in basis

The proposal

40. During the remittal, LBG proposed that, instead of imposing a POSP, we should allow PPI sales at the credit point of sale but require that policies last no longer than one year and have an annual renewal on an opt-in basis (we refer to this as the 'opt-in remedy' as opposed to an opt-out model, proposed by Lloyds TSB during the original investigation and also proposed by RBSG during the remittal (paragraph 27*(b)*).

Our view of the proposal

41. We considered the likely effectiveness of a remedy package based on an opt-in annual renewal ('the opt-in remedy') combined with informational remedies and a single-premium prohibition. We refer to this package as the 'LBG package' as it contains the essential elements of the remedy package put to us by LBG during the remittal. Our consideration is structured in four parts:

- First, we review our consideration of the opt-in remedy during the original market investigation and the points raised by parties at that stage.

- Secondly, we examine the extent to which the LBG package would deal directly with the features that we had found gave rise to the AEC and resulting consumer detriment.

- Thirdly, we consider whether the LBG package could be effective by means of indirect effects, whereby the creation of competition in relation to existing customers at the point of renewal would have beneficial feedback effects that increased competition or improved outcomes for consumers at the initial point of sale.

- Fourthly, we conclude, in light of this analysis, whether or not we expect the LBG package to be an effective remedy to the AEC that we found.

Consideration of opt-in remedy during original investigation

42. The proposed remedy of an opt-in annual renewal was first raised in June 2008 in our Notice of Possible Remedies, as a potential remedy aimed at removing barriers to switching.[12] In responding to the Notice of Possible Remedies, both Lloyds TSB and HBOS strongly opposed this proposed remedy.[13]

43. In the 2009 report, we decided against requiring that all PPI policies be renewed annually on an opt-in basis. The views of most parties on this proposal were in line with those of HBOS and Lloyds TSB.[14] The views were summarized in our provisional decision on remedies:[15]

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[12]Notice of Possible Remedies under Rule 11 of the Competition Commission Rules of Procedure, 5 June 2008, Option 5. For retail PPI, the remedy was proposed in the Supplementary Notice of Possible Remedies under Rule 11 of the Competition Commission Rules of Procedure, 10 October 2008.
[13]See: for Lloyds TSB, www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/response_pf_lloyds.pdf, paragraphs 6.2–6.9, and for HBOS, www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/response_pf_hbos.pdf, p8, and www.competition-commission.org.uk/inquiries/ref2007/ppi/pdf/response_pf_hbos_appendix_a.pdf, p8.
[14]See paragraph 10.346 of the 2009 report.
[15]Provisional decision on remedies, 13 November 2008, paragraph 350.

> Parties told us that option 5 (annually renewed PPI policies with a requirement for customers to opt in each year) would result in customers not being covered when they thought they were. Parties told us that many customers would ignore the renewal statements and would continue to think they were covered when they were not. They said that most insurance products were sold on an opt-out basis. Some parties interpreted the option as requiring that PPI policies be sold with annual premiums. They told us that such a remedy would be expensive to introduce as the parties would have to follow up with customers once a year and having an annual policy would require a change in the policy terms and in the distributors' systems. Furthermore, some parties suggested that the move to annual products would mean that continuing customers would have exclusion periods each year. Others, however, disagreed with this assertion. Parties also said that customers were currently able to cancel and switch a regular-premium policy at any time and if the remedy moved firms from regular to annual policies the remedy could decrease rather than increase these customers' ability to switch.

44. In the 2009 report we set out our conclusion on this option:[16]

> We decided not to require PPI policies to be renewed annually on an opt-in basis as we considered that this would introduce a risk of PPI cover lapsing accidentally, and that a requirement annually to renew policies would be more onerous on parties than the package of remedies that we have decided to implement. We decided that the package of remedies, and in particular the provision of an annual statement in conjunction with the other elements of the remedy package, would be effective in providing sufficient information and impetus to encourage consumers to consider whether they should switch, and that a more intrusive measure was not needed to remedy this aspect of the AEC. This consideration also applies to the proposal by Lloyds TSB to require an annual renewal on an opt-out basis, which we therefore decided not to include in our remedy package.

45. Our consideration of the opt-in remedy as explained in the 2009 report was therefore focused on its ability to address switching barriers, rather than the point-of-sale advantage. However, we did conclude in paragraph 10.37: 'We have decided that a point-of-sale prohibition is the only option that will effectively address the point-of-sale advantage, and as such is essential to achieving a comprehensive solution to the AEC and resulting consumer detriment.'

Extent to which the LBG package addresses features giving rise to AEC

46. We looked next at the extent to which the LBG package would address the features that we had found gave rise to an AEC, as summarized in paragraph 9.2 of the 2009 report.

47. As a starting point, we noted the mutually reinforcing nature of the remedy package in the 2009 report (see paragraph 10.478 of the 2009 report) and in particular the importance of the POSP in strengthening the effectiveness of the informational remedies in reducing barriers to search and thereby promoting competition. This was acknowledged by the Tribunal:

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[16]See paragraph 10.347 of the 2009 report.

the Commission evidently regarded the POSP as lying at the heart of its remedy package rather than on the periphery, albeit that it was the most costly to implement. It is equally apparent that the Commission considered, after due analysis, that the remedy package would be ineffective as a cure for the AEC without the POSP.[17]

48. We thought that the effectiveness of the LBG package in remedying the failure of suppliers to compete on the price or the terms of PPI (paragraph 9.2*(a)* of the 2009 report) would be largely determined by its effectiveness in remedying the other features that we had identified as giving rise to the AEC (ie the barriers to search and switching and the adverse effects on competition arising from the sale of PPI at the credit point of sale). We therefore looked at the impact of the LBG package on these other features.

49. We found that the LBG package would not deal directly with the restriction on the extent to which other providers can compete effectively, which results from the sale of PPI at the point of sale by credit arrangers (see paragraph 9.2*(d)* of the 2009 report). We also found that the removal of the POSP from the remedy package was likely to reduce the effectiveness of the remedies in reducing barriers to search (see paragraph 72*(c)* of the 2009 report). Our reasoning on these points is set out in paragraphs 50 to 54 below.

50. First, LBG's proposal does not include any measures that would deal directly with the restriction on the extent to which providers other than the credit arranger can compete effectively, which results from the sale of PPI at the point of sale by credit arrangers (see paragraph 9.2*(d)* of the 2009 report). This feature of the market—which we have referred to as the point-of-sale advantage—was a significant aspect of the AEC. In the absence of a measure to address the point-of-sale advantage, credit arrangers would still have an effective monopoly on PPI provision at the credit point of sale, and therefore the ability of other providers to compete for the sale of PPI policies at this point would remain significantly restricted. LBG seems to have acknowledged this in its submissions on the opt-in remedy, where it has suggested that an increase in competition will arise in the sale of renewal policies, rather than in the initial sale of policies at the credit point of sale.

51. Secondly, by removing the POSP from the remedies package, the LBG package would weaken the effectiveness of the informational remedies in reducing barriers to search (see paragraph 9.2*(b)* of the 2009 report). This is because we had found the POSP and the informational remedies to be mutually reinforcing in reducing barriers to search (see paragraphs 10.36 and 10.37 and paragraphs 10.477 to 10.479 of the 2009 report). In the absence of a POSP, informational remedies such as the personal PPI quote would be significantly less effective in promoting competition through customer search (see paragraph 10.471 of the 2009 report).

52. Looking at the specific barriers to search, we thought that LBG's package would not be as effective in addressing the customer perception that buying PPI helps to obtain credit, as would a package that included a POSP. This is because, by creating a clear break between the sale of credit and PPI, the POSP clearly demonstrates to customers that taking PPI will not help to obtain credit, reinforcing the messages contained in the informational remedies. Whilst the informational remedies require credit arrangers to disclose that PPI is optional, and this is an important part of the remedy package, we noted that credit arrangers have been required by the FSA to make this type of disclosure for several years, without fully shifting this perception.

[17]Paragraph 119 of the PPI judgment.

So whilst informational remedies would help reduce this barrier to search, absent a POSP, we would not expect this barrier to search to be addressed adequately.

53. Similarly, we considered that the LBG package was unlikely to address adequately the barrier to search created by the time taken to obtain accurate information, and would not do so as effectively as a package including a POSP. This is because we expect the POSP to enhance the impact of the personal PPI quote in providing consumers with information to help them compare products when first considering taking out a policy. Without a POSP, we thought the personal PPI quote would be of only limited impact in facilitating search as we would expect most credit arrangers, as at present, to seek to complete PPI sales at the same time as the customer takes out credit. Once customers have taken out a PPI policy with a specific provider, we expect their appetite for search during the cooling-off period—and hence the usefulness of the personal PPI quote to them—to diminish.[18] We recognized that, for existing customers seeking to search the market at some point after an initial purchase, the LBG package—assuming that it was accompanied by some form of annual review document—would have a similar effect on this barrier to search to the remedy package in the 2009 report.

54. We also found in the 2009 report that the small scale of the stand-alone market was a barrier to search. By failing adequately to address the barriers to competition when customers first take out PPI, the LBG proposals do not materially increase the opportunities for stand-alone providers to compete at this stage. We acknowledge that the LBG package (and, through the annual review and the single-premium prohibition, the remedy package in the 2009 report) seeks to encourage competition for existing customers to switch. However, we thought that a package of remedies which increased the scope for stand-alone sales both at the initial point of sale and subsequently was likely to create additional opportunities for stand-alone providers (including credit arrangers offering PPI on a stand-alone basis) compared with one which focused primarily on generating competition through switching. We discuss whether a remedies package that focused primarily on generating competition through switching would, nonetheless, be sufficient to generate effective competition indirectly at the point of sale in paragraphs 58 to 71.

55. We did not find any material difference between the effectiveness of the remedy package in the 2009 report and the LBG package in addressing the specific barriers to switching that we identified (see paragraph 9.2*(c)* of the 2009 report). We discuss whether the LBG package would be effective in generating competition to encourage existing customers to switch away from their current supplier in paragraphs 59 to 66.

56. We concluded that there were several important areas in which the LBG package either did not address significant features directly (ie the point-of-sale advantage), or where we expected the removal of the POSP from the remedies package, was likely materially to reduce the effectiveness of the remedies in remedying the adverse effects on competition of these features (ie some of the main barriers to search). This failure to deal directly with important features of the AEC—including the point-of-sale advantage, which lies at the heart of the AEC—and their adverse effects on competition led us to be concerned that the LBG package would not be effective in remedying the AEC.

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[18] This is sometimes referred to as 'status quo bias'—see paragraph 10.68*(a)* of the 2009 report and FSA, *Financial Capability: A Behavioural Economics Perspective*, 2008.

Consideration of whether the LBG package could be substantially effective through indirect effects

57. We recognized, however, that there was a possibility, at least in principle, that the LBG package might still be substantially effective in addressing the AEC, even if it did not directly address important features that contributed to the AEC. This might be the case if the opt-in remedy resulted in a competitive switching market in relation to existing customers, and if the competition for consumers at the point of renewal had beneficial feedback effects that increased competition or improved outcomes for consumers at the initial point of sale. For this to be the case, we thought that two conditions would need to hold:

- First, the LBG package—and in particular, the opt-in remedy—would be effective in generating competition to encourage existing customers to switch away from their current supplier. The extent to which this would be the case will depend on the incentive and ability of existing consumers to switch PPI policies, and on the incentive and ability of providers to develop and market stand-alone PPI policies to these consumers.

- Secondly, increased competition in relation to existing customers, in combination with the information remedies, would be translated into increased competition for new sales that was sufficient to overcome the point-of-sale advantage and the barriers to search that we had found in relation to new PPI sales.

58. We looked first at whether the LBG package would be effective in generating competition for existing PPI customers.

59. In this context, we considered whether an opt-in remedy was likely to be more effective in promoting switching than the annual review. While it was clear to us that the opt-in remedy was a more intrusive measure than the annual review (see paragraph 10.347 of the 2009 report), it was not evident that it would be a more effective way of promoting competition for existing PPI customers. On the one hand, we recognized that an opt-in remedy would, by its nature, require customers to take action in order to continue to be covered. We thought that it was possible that this requirement on consumers to act could provide an additional impetus to search, compared with an annual review which provided information to consumers, who remained covered by the policy. On the other hand, under an opt-in remedy, consumers would be presented with the prospect of losing cover within a relatively short period of time, if they did not renew their existing cover. We would expect incumbent providers to emphasize this possibility to their consumers—alongside the ease with which existing cover could be renewed—and thought that resulting concerns about losing existing cover might deter some consumers from shopping around.

60. Whether an annual review or an opt-in renewal is more effective in promoting switching, we recognize that either measure, by raising consumer awareness of the opportunity to switch on a periodic basis, creates additional opportunities for stand-alone providers to attract existing customers. This was part of the rationale for including the annual review in the remedy package.

61. We thought that such opportunities were potentially significant in all PPI markets, though they were likely to be relatively more significant in relation to CCPPI and MPPI, when compared with other forms of PPI. This was because the proportion of customers who had held these products for more than one year—and who would therefore be required to renew their policy or receive an annual review—was higher than for SMPPI or PLPPI. Based on Table 1 of Appendix M, we estimated that, at the end of 2007, 86 per cent of MPPI policies and 82 per cent of CCPPI polices were

more than one year old, compared with just over 60 per cent of PLPPI and SMPPI policies. Likewise, we thought that the average length of PPI policies (which varies from around two and a half years for PLPPI to six years for MPPI) is likely to be sufficient to create an incentive for some existing consumers to search for a different PPI policy. We thought this incentive was likely to be most powerful in relation to consumers who expected to continue to use the policy for longer (ie MPPI and CCPPI) as well as for consumers who pay larger premiums.

62. However, we had two main concerns that, while the opt-in remedy (like the annual review) could increase such opportunities for competition for existing customers, the LBG package may not lead to the development of a competitive switching market in practice.

63. First, without our intervening to break the link between PPI and credit at the initial point of sale, we were concerned that many credit arrangers would choose to pursue commercial strategies that focus on maximizing sales of PPI to their own credit customers and on retaining those customers at the point of renewal, rather than seeking to take these opportunities to win new business from others. This was the prevailing strategy of credit arrangers up to and during our investigation and proved highly profitable. We have seen several credit arrangers respond to the possible introduction of the POSP by developing products that can be sold on a stand-alone basis (see Section 6). This appeared to us to be an important mechanism by which PPI markets would become more competitive. Without the impetus of the POSP—both in terms of a threat to credit arrangers' existing business and the opportunity to win new business from others—we were not confident that this increased appetite among credit arrangers for developing their capacity to make stand-alone sales would continue, even if measures to promote switching were put in place.

64. Secondly, we were concerned that the absence from the LBG package of a measure that directly addressed the point-of-sale advantage could increase the risk of 'status quo bias' (see paragraph 10.68 of the 2009 report) at the point of renewal. As consumers would not be given the opportunity to consider alternatives when they first took out PPI, the perception that taking out PPI with their credit arranger was the normal state of affairs could be established by the time the first annual renewal came up. Incumbent providers would have limited incentive to correct any such perception and we would expect them to position the annual renewal as a formality to renew the policy with them, rather than as an opportunity to search and switch. By contrast, we thought that the promotion of competition at the initial point of sale through the POSP, in conjunction with the informational remedies, was likely to establish the message to consumers that they have a choice between suppliers and that this would increase their motivation to search and to compare alternatives both when they first take out PPI and subsequently, for example when receiving an annual review.

65. We concluded on this point that, while the LBG package would increase opportunities for competition for existing consumers, there was a substantial risk that these opportunities would not be sufficiently taken up by providers or consumers, if the package did not also contain effective measures to promote competition at the initial point of sale.

66. We then considered the question of whether, if the LBG package was effective at developing a competitive switching market (and we were concerned that it may not, for the reasons set out in paragraphs 58 to 65 above), this would translate into increased competition at the initial point of sale. We thought there were two possible mechanisms through which this might happen:

- First, a larger stand-alone market resulting from increased competition for existing consumers could increase the visibility of marketing and other information about PPI to such an extent that consumers started to search for PPI before the credit point of sale.

- Secondly, credit arrangers could feel compelled to offer lower prices to new customers in order to avoid losing customers at the next annual renewal.

67. On the first point, we recognized that a beneficial consequence of a larger, more dynamic stand-alone PPI sector (whatever its cause) would be an increase in the extent to which new consumers were made aware of PPI before the credit point of sale. However, we were not persuaded that the boost to the stand-alone sector from the LBG package, even in conjunction with the informational remedies, would be sufficient to overcome the adverse effects of the barriers to search and the point-of-sale advantage on competition for new business. This was because of our concerns about the extent to which the stand-alone market would develop in the absence of a POSP (see paragraphs 58 to 65 above) and because the LBG package would not adequately address the underlying causes of these barriers to competition (see paragraphs 50 to 56 above).

68. On the second point, we thought that there were a number of possible ways in which credit arrangers would be able to differentiate the prices they charged to new consumers from those that they offered to existing customers at the point of renewal. For example, credit arrangers could offer reduced premium rates on renewal, perhaps in the form of a 'no claims bonus', offer selective discounts (eg to those consumers who do not renew immediately) or offer some or all consumers at renewal the option of taking cheaper products which offer less cover ('downselling'). These types of customer-retention techniques are common within financial services and other consumer-facing markets and we also saw some evidence that they had been used or considered in PPI markets.[19] There is nothing inappropriate in using such techniques. However, given the barriers to competition that we found in relation to new PPI sales, we thought that these types of technique could be used to insulate competition for new sales from competitive pressure for existing customers at the point of renewal.

69. We concluded that, even if the LBG package was effective in promoting competition for existing consumers—about which we had concerns—the mechanism by which such competition would be transmitted to new business was uncertain and, in our judgement, unlikely to operate effectively in practice.

70. We concluded that, although the LBG package could, in principle, under certain conditions, be an effective remedy to the AEC that we found, there were a number of factors which, in our judgement, meant that these necessary conditions would not hold in practice.

Conclusion on effectiveness of the LBG package

71. In conclusion, we found that the LBG package does not deal directly with important elements of the AEC. We considered whether it could nonetheless be effective in addressing the AEC through indirect mechanisms, but we found that the necessary conditions for this would not hold in practice. We therefore concluded that the LBG package would not be effective in remedying the AEC that we had found.

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[19] See Appendix G. [✂].

Menu regulation

The proposal

72. Following the publication of our provisional decision, Barclays[20] proposed a new remedy. It said that the Accent survey had highlighted that some consumers preferred to buy PPI at the same time as credit and some preferred to buy later, and that smart regulation would cater for both types of consumer. It therefore suggested what it called 'menu regulation', where a consumer could buy PPI at the same time as credit but those who preferred to wait were not artificially discouraged from doing so (eg by biased information, undue pressure, etc). It said that, in practice, a minimum arrangement might involve offering the customer simultaneously three different options: a default which involved being contacted in a week; another which allowed for PPI or STIP to be taken out immediately; and a third which said that the customer did not want to be contacted in relation to those products.

73. Barclays said that a menu regulation approach involved providing a menu of options to the customer. It said that menu regulation had been used by Ofgem in relation to gas and electricity distribution price controls and Ofwat had also considered using it. In the utilities context, Barclays said that each contract had a different set of incentive properties, and the regulated firm chose the contract which best suited its profile.

74. Barclays pointed to the strength of the differences in consumer preferences indicated by the Accent study, which suggested to it that an effective, self-sorting remedy should be feasible. It said that, even if waiting were valued at only about 25 per cent of the Accent estimates, the willingness to pay (for waiting) of those who would prefer to wait appeared to it to be sufficiently strong enough to require only that those consumers be given the opportunity, free of undue pressure, to do so (although it provided no analysis to back up this statement).

75. Barclays said that this menu regulation approach had two main advantages:

    - it avoided the consumer welfare losses that a POSP would cause by preventing a large number of consumers purchasing PPI in their preferred way (ie the 'gains from trade' that would be eliminated by the POSP); and

    - it involved a lower risk of unintended consequences, because it left more choice in the hands of the consumer.

76. Barclays said that the Accent survey showed that the POSP was not the least restrictive way of achieving the relevant objectives, and that the evidence indicated that information and behavioural remedies previously considered, particularly if adjusted to take account of the new Accent findings, were likely to be more effective than previously thought.

77. In a hearing with Barclays, Barclays emphasized the need to design sales processes which allowed for auditability that a correct sales process had been followed. Barclays said that it had not yet designed how such processes would work but it had some processes elsewhere in the bank where they made declarations face to face with customers. It also used welcome calls, where it called customers who had just purchased a product and checked the customer understood what they were buying. Barclays said that it successfully contacted customers for welcome calls in about [✂] of cases, and that it sampled customers to ensure that they got the right blend of

[20] Barclays response to provisional decision, p12, and Annex 1, paragraphs 9–18.

customer contact. Barclays said that monitoring was easier for telephone sales as all calls were recorded and could be checked and that some people listened in on calls.

78. In terms of the incentives on sales staff to try and complete the sale at the credit point of sale rather than consumers opting to consider their options, Barclays said that incentives were not designed to create behaviours leading to inappropriate sales. Barclays said that one of the most important controls against this was the consequence for a seller being found to have made an inappropriate sale—[✂]. Barclays said that incentives could be dealt with in the remedy design.

79. Barclays also said that, to the extent that we were concerned about the effectiveness of monitoring of this proposed remedy, it did not think that compliance, and monitoring of that compliance, would be more difficult for this remedy than for a POSP.

The views of the FSA and the OFT

80. We sought the views of the FSA and the OFT on this new remedy proposal.

Menu regulation

81. The FSA said that Barclays' proposal was not 'menu regulation' in the sense in which it was employed by Ofgem in setting price controls for gas and electricity distribution. Ofgem's menu regulation allowed a regulator to close an information asymmetry regarding a regulated utility's cost profile; in the case envisaged by Barclays, the consumer did not enjoy an information asymmetry over the PPI retailer. Instead, the consumer was more likely to be unaware of the availability of an open market for PPI contracts, which might offer better value than that offered at the point of sale of credit.[21]

82. The FSA said that the 'menu' of options presented to the consumer simply represented a reinforcement of some of the options available to him or her under the existing regulatory regime, and that it was unclear from Barclays' proposal how this differs from the existing regime other than that consumers would be given an explicit reminder of three options rather than no reminder as at present.

83. The OFT suggested that the POSP was premised on a similar menu approach to Barclays' proposal, with customers able to return proactively after 24 hours or wait and be contacted after seven days.

Menu regulation as a remedy to the AEC

84. The FSA said that the proposed 'menu regulation' remedy would be significantly less effective than a POSP in reducing the AEC resulting from the effective monopoly position held by credit providers over PPI sales, would not reduce the barriers to search and as such would present little improvement on the status quo. It made the following points:

    (a) The success of the remedy depended on the customers having sufficient information on their options. It required the available options to be given equal weighting by the sales person and for oral disclosure of adequate price information relating to the PPI product. However, customers were unlikely to know the

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[21] We also noted that with regulatory menu regulation the regulated firm has longer to decide which option to choose than the typical length of a PPI sales interview.

potential costs and benefits of other products available on the market in order to make an informed decision as to whether to buy the credit provider's PPI product at the point of sale. Hence customers would not be best placed to decide whether the convenience of buying at the point of sale would exceed any potential benefit from the possibility of buying a better value or more suitable product from an alternative provider.

(b) A competitive market for stand-alone or portable PPI would have to exist with marketing and advertising of these products such that potential customers had a general awareness of the product features and price ranges. It said that the persistence of PPI sales at the point of credit sale under 'menu regulation' would reduce the chances of a viable competitive market for stand-alone PPI being created, or for firms to have the opportunity to reach the customers of incumbent credit providers.

(c) Firms may have an incentive to limit disclosure around sales of PPI, and hence consumers were likely to give insufficient consideration to the PPI product and focus on the primary product when purchasing PPI at the point of sale, or might proceed with a PPI purchase in the belief that it would increase their likelihood of the primary credit sale being agreed. It said that it was unclear how 'menu regulation' would address the problem of biased misleading or unclear information when these had been and continued to be features of PPI sales which were made alongside credit sales.

85. The FSA concluded that, as with other information remedies, the reminder to consumers that they could buy later, as envisaged under 'menu regulation', would not be sufficient in itself to foster increased competition by removing the point-of-sale advantage, nor would it effectively prevent firms from behaving in such a way as to steer the customer towards buying from the credit provider at the point of credit sale.

86. The OFT questioned whether menu regulation as proposed by Barclays would help consumers decide whether they wanted PPI at all or, if they did, what product was right for them. It said that credit providers would have every incentive to seek to sell PPI with the credit product. As a result, it expected that fewer customers would search the market than with a POSP in place.

87. The OFT said that, without an incentive for customers to search the market, there would likely be an impact on the incentives of providers to introduce stand-alone products.

Compliance

88. We asked the FSA for views about the effectiveness of monitoring the remedy across the industry. The FSA noted that Barclays recommended that a process similar to the archive of Statements of Demands and Needs 'would ensure adequate and reliable reporting of the remedies'. However, the FSA said that monitoring statements of demands and needs was not an effective way of determining compliance where sales were primarily made face to face with a requirement for oral disclosure. Whilst it was not a reflection of its experience with any particular regulated firm, it said that a potential weakness was that the documentation might not accurately reflect the customer's actual experience. Monitoring compliance with a clearly defined requirement such as the POSP would be much less open to equivocation than monitoring and determining compliance with a remedy which relied on the salesperson's delivery of information. The FSA said that this was particularly problematic where the salesperson had incentives to influence the customer's choices.

89. The FSA did not agree that compliance would be no more costly than that required for implementation of a POSP. It said that monitoring of a POSP should require no more than a demonstration of the temporal separation of the credit sale and PPI sale, to allow customers the chance to survey the market for alternative PPI products, or a demonstration that contact was initiated by the consumer. Effective monitoring of 'menu regulation' would add an extra dimension to monitoring of oral disclosure at the credit point of sale to ensure that all three options were clearly given to consumers, that these options were given equal weighting when explained to the customer, and that the salesperson was not seen to be recommending one of the options above any other.

90. The OFT said that POSP mystery shopping would be a primary means of monitoring face-to-face transactions. It said that mystery shoppers might be better able to report a simple yes/no answer to whether a POSP was adhered to rather than whether a menu regulation approach was adhered to, bearing in mind different possible selling tactics and how consumers might be persuaded to buy at the point of sale. It said that if it were required to monitor menu regulation it would be hard to draw a consistent line as to what represented fair selling tactics or policies and what constituted a breach of the remedy—and hence it would also be harder for companies to know whether or not they were complying with the remedy.

Our view of the proposal

91. We considered Barclays' proposal carefully. First, we noted that menu regulation in regulated markets is really about providing choices to the regulated firms to self-select, not about providing choices to customers and requiring them to make a nearly instant decision on whether to proceed with one of those options there and then. However, the main issues appeared to be:

- with this remedy how many customers would search the market because they have the option of buying at the point of sale; and
- whether the remedy would work in practice, bearing in mind our previous views on monitoring and the risk of circumvention.

How many consumers would search the market?

92. With a menu regulation approach, consumers could choose to buy PPI at the same time as credit.

93. The evidence suggests that a significant proportion of consumers prefer to do this—the relative proportions vary depending on the survey (see paragraphs 5.43 to 5.52). Based on distributors' existing practices and their responses to the point-of-sale prohibition, we expect that most credit arrangers would strongly prefer to conclude the PPI transaction at the credit point of sale—rather than risk losing the sale—and we would expect most credit arrangers to encourage customers to do so, emphasizing the convenience of concluding the transaction 'there and then' and the risks of remaining uncovered.

94. With a POSP, although some of the people who value the convenience of buying at the point of sale may not buy PPI, others are likely to search the market and find alternative policies. It is likely therefore that there would be fewer consumers searching the market if a menu regulation approach were used, instead of a POSP. In that respect, it may be a less effective remedy than the POSP—though we did not reach

a conclusion on whether there would still be sufficient customers searching the market to drive competition and force prices down, for the reasons set out below.

Would the remedy work in practice?

95. We considered whether the remedy package including menu regulation instead of a POSP would be effective in encouraging consumers to search for the best-value product for them.

96. We agreed with the FSA that the success of the remedy depended in part on the customers having sufficient information on their options (paragraph 84*(a)*). We know that most consumers currently do not decide they want to buy PPI until they are at the point of sale, and we saw little prospect, with a menu regulation remedy in place, that consumers would become more aware of their options before the point of sale. In our view, most customers entering into a sales conversation about PPI at the point of sale would still not have any information about alternatives available to them. They would not have sufficient information at the credit point of sale to know whether it was worth shopping around, and in our judgement this would reduce the incentive for them to do so. We thought this would act to frustrate the effectiveness of the remedy.

97. We were concerned that, as with the LBG opt-in remedy, many credit arrangers would choose to pursue commercial strategies that focus on maximizing sales of PPI to their own credit customers and on retaining those customers at the point of renewal, rather than seeking to take these opportunities to win new business from others (see paragraph 63). This may result in the option for a delay being 'lost' or marginalized within the context of the overall sales conversation, or positioned in such a way that customers are encouraged to feel that it is safest for them to conclude the purchase of PPI at the credit point of sale, rather than taking the risk of waiting. We noted the FSA's views on the importance attached to the different options having equal weighting (paragraph 84*(a)*), which seemed to us to be logical for the remedy to be effective. We also noted that Barclays said that incentives to frustrate the remedy's success, for example by sales staff having an incentive to close the sale of PPI at the credit point of sale and discourage people from taking the time to consider their options, could be designed away in the implementation of the remedy. Barclays also indicated that the incentives on sales staff to complete inappropriate sales were low because of the penalties faced if found out.

98. In our view, it is likely to be very difficult to regulate—and monitor—every aspect of sales processes in sufficient detail to avoid all of the potential biases to the way in which an option for delay is framed when it is presented to customers. We accept that compliance programmes within businesses can discourage inappropriate sales through ex-post penalization. However, we also note that the number of upheld complaints about mis-selling (see Table 2 and paragraph 35 of Appendix B) suggest that there is not strong past evidence of compliance programmes being substantially effective across the industry as a whole.

99. In our judgement, the incentives on distributors and their sales staff to conclude a sale of PPI at the credit point of sale are significant—it is in each individual distributor's, and sales staff's, interests to encourage purchase at the point of sale.

100. Given the incentives to maximize uptake of PPI at the credit point of sale, we considered whether compliance programmes, and monitoring of the remedy, would enable the remedy to work effectively.

101. We agreed with the FSA that looking at archives of statements of demands and needs was not in itself sufficient to monitor compliance. We agreed that it is important

to know what was actually said. This is not captured by distributors in their compliance programmes for face-to-face interviews (telephone interviews are usually recorded, though only a selection are checked for compliance). Monitoring by the OFT of face-to-face sales would be through mystery shopping, which could only ever capture a small fraction of the sales taking place across the hundreds of thousands of PPI sales per year.

102. We also agreed with the FSA that monitoring of whether a POSP was imposed would be far clearer and easier for both a distributor and for the OFT. With a menu regulation approach as proposed by Barclays, there would be no bright line denoting what was and was not a compliant sale, leaving both the distributor and the regulator with sometimes difficult judgements to make.

103. In our judgement, it would be extremely difficult for both distributors and the OFT to monitor effectively the enforcement of this remedy. The scope for sales staff to steer conversations to favour buying PPI at the credit point of sale is significant and could not, in our view, be effectively monitored in face-to-face sales, or systematically monitored in telephone sales, even though calls are usually recorded, because of the sheer volume of calls that would require checking. In addition, the absence of a bright line test for whether the remedy has been complied with would make ensuring compliance with the remedies far more difficult than with a temporal remedy such as a POSP for distributors and regulator alike.

Would menu regulation be a substantially effective remedy?

104. We concluded that Barclays' menu regulation remedy proposal would not be substantially effective at remedying the point-of-sale advantage, and would therefore not form part of a substantially effective remedy package. We concluded this because, in our judgement:

- customers would not have sufficient information at the credit point of sale to know whether it was worth shopping around, reducing the incentive to do so;
- the alternatives would need to be given equal weighting, but the incentives on distributors, and their sales staff, would be to encourage purchase at the point of sale; and
- the monitoring of this for distributors and the OFT would be very difficult, given the likely volume of sales and as there would be no bright line as to what constituted a compliant sale and what did not. We did not think that this remedy could be effectively monitored.

Conclusion on alternatives to a POSP

105. We concluded that none of the alternative remedy packages put to us would form a substantially effective remedy package.

Assessment of remedies for retail PPI

1. In this appendix, we set out the parties' comments on the potential remedies options and our reasoning for the selection of the measures that form our remedy package for retail PPI:

   (a) We first look at the remedy options we have decided should form part of the overall remedy package. For each of these, we set out the original remedy option consulted on, summarize the responses received on the option, and our views on the points made, and how we envisage the remedy should be formulated (paragraphs 2 to 81).

   (b) Second, we set out the remedy options consulted on in the 2010 Retail PPI Remedies Notice that we have decided not to implement, summarizing responses to the supplementary notice and provisional decision, and explain why we are not taking them forward (paragraphs 82 to 105).

The remedy package for retail PPI

2. The remedies are:

   (a) an obligation to offer PPI separately from merchandise cover if both are offered as a bundled product (unbundling retail PPI from merchandise cover);

   (b) an obligation to provide information about the cost of PPI and 'key messages' in marketing materials (information provision in marketing materials);

   (c) an obligation to provide information to CFEB for publication and to provide information about claims ratios to any party on request (provision of information to third parties);

   (d) a recommendation to CFEB that it uses the information provided to it under the above obligation to populate its PPI price comparisons table (recommendation to CFEB);

   (e) an obligation to provide a personal PPI quote to customers before the end of the cooling-off period (personal PPI quote);

   (f) an obligation to provide customers who have spent more than £50 on retail PPI premiums in the preceding 12 months with a written annual review of PPI costs including a reminder of the customer's right to cancel (annual review);

   (g) an obligation to remind all customers of their cancellation rights and of key messages on an annual basis (annual reminder); and

   (h) a prohibition on the selling of single-premium PPI policies and on charges which have a similar economic effect (single-premium prohibition).

3. Some of the issues raised by parties have already been considered in the 2009 report. Where this is the case—and in the absence of new evidence or argumentation—we rely on and refer to our earlier reasoning.

Unbundling retail PPI from merchandise cover

Views of the parties

4. A summary of the responses to the original consultation on this remedy option is set out in paragraphs 10.278 to 10.301 of the 2009 report. The responses from the retail PPI providers to the 2010 Retail Remedies Notice were similar to those summarized in the 2009 report. In summary, the parties questioned whether there were significant numbers of customers that would purchase the unbundled product. The parties were also concerned about the cost of the remedy if they were required to offer the bundled and unbundled products over the telephone and said that they should not be required to offer both in sales calls.

5. SDGFS said that it did not believe any such remedy was necessary because the CC had recognized that it now offered an unbundled policy. As a consequence, it considered that any barrier to searching that might have existed had been significantly reduced. It said that it was not clear, from the GfK research commissioned by the CC, that many customers would want the option to purchase the PPI element of the bundled product separately and consumers would prefer to purchase a bundled policy of merchandise cover and PPI. However, SDGFS told us that it had introduced the unbundled Life Event Plan (LEP) policy because it believed that there were customers who would buy this product. It said that it would be costly to offer the bundled and unbundled products to customers over the telephone since it would involve a lengthy explanation of the different options and increase call time significantly, and may cause difficulties to SDGFS in meeting its FSA obligations to make non-advised sales. It suggested that retail PPI providers should market both the bundled and unbundled options in their catalogues and on their website but they should sell a customer an unbundled product over the telephone only if the customer requested it. JD Williams was also concerned about the impact of the remedy on sales calls and cost. It told us that its customers greatly valued the merchandise cover and it would be forced to create a new product that very few customers would want. It said that the difference in price between the bundled and unbundled version of PPI would be small. However, JD Williams recognized that developing an unbundled retail PPI product would contribute to increasing transparency in retail PPI and assist search. It said that it would be willing to offer an unbundled PPI product if the CC concluded that this was necessary to address the AEC. It suggested the same option as SDGFS, marketing both the products in catalogues and on the website but only selling the unbundled product over the telephone if the customer requested it.

6. FGH said that there was little or no evidence of customer demand for the unbundled product. FGH referred to its own experience of offering an unbundled advised product which it later withdrew for commercial reasons. Express Gifts said it believed that the vast majority of its customers would not undertake a search of alternative PPI cover and therefore the measure would not be effective.

7. Citizens Advice supported the measure and the OFT said that the remedy was required to enable customer switching and for customers to search and choose alternative retail PPI policies from other providers.

Our views

8. For the reasons set out in paragraphs 9 to 12, the evidence we received during the remittal confirmed to us that it is necessary to continue to require the unbundling of retail PPI from merchandise cover to address the barriers to search and switching

that we found (see paragraph 10.280 of the 2009 report) in order to allow the retail PPI to be compared with other PPI offers, including short-term IP.

9. We considered first the arguments that there would be no customer demand for an unbundled product. SDGFS told us that it had taken a commercial decision to offer an unbundled retail PPI product, and it confirmed that it would continue to sell the product because it saw customer demand for it. SDGFS had not sold many policies to date (it estimated the number of such policies sold to be less than [1,000] since it was introduced in October/November 2009), though this was, in large part, due to IT difficulties that meant it had been unable to offer the product from February 2010 until September 2010. We noted that FGH had previously withdrawn such a product on commercial grounds. We also noted that participants in the GfK customer research (section 3.4.2 of the GfK report) had expressed a preference for merchandise cover to be included with retail PPI and a willingness to pay more to be covered for a range of eventualities even if some cost saving could be made through selecting elements of the bundled product. We thought that the demand for an unbundled product would, in part, be affected by the price at which the unbundled product was offered to consumers, compared with products that included merchandise cover. SDGFS offers its unbundled product at around a 25 per cent discount to its bundled product, which was broadly consistent with evidence presented to us by SDGFS during the original investigation about the proportion of GWP accounted for by merchandise cover (paragraph 6.16 of the 2009 report). JD Williams showed us that less than 1 per cent of claims made (by value and volume) in most years on its home shopping insurance related to merchandise cover, which was consistent with its submission that it would not offer an unbundled product at a significant discount.

10. We concluded, on the basis of the above evidence, that some customers would prefer to take out an unbundled product, though others would prefer to pay more for a product that included merchandise cover. Even if the demand for unbundled retail PPI policies was low, an obligation on retail PPI providers to offer an unbundled product and to publish pricing and other information about it (as required by the informational remedies that we propose to take forward as part of the remedy package) would increase transparency by providing an additional reference point for consumers to compare the offerings of retail PPI providers against other forms of PPI. We do not consider that offering both an unbundled product and a bundled product would put at risk any party's non-advised sales status, and note that the FSA has not raised any concerns in this regard.

11. We looked next at the proposal by SDGFS that retail PPI providers should not be required to offer the unbundled product to every customer over the telephone during every sales call. We thought there was a risk that this might reduce the effectiveness of this measure, in that some customers would be unaware when taking out retail PPI that an unbundled product was available. However, the SDGFS proposal, in combination with the informational remedies, would make information about the unbundled product available before and after the point of sale of the PPI. Consumers who were motivated to compare the bundled and unbundled products would be able to do so and to act on the comparison. We noted that the GfK customer research for the CC suggested that many retail PPI customers would not search for alternative policies and that those more likely to search would be those whose retail PPI premiums were larger than average, and/or who held other PPI or short-term IP policies already. We found that the reduction in effectiveness from the SDGFS proposal would not be substantial as those customers who were motivated to search and switch would be able to use the cost of an unbundled product to make comparisons.

12. We noted the large differences in estimated costs between requiring the unbundled product to be promoted in all calls and the proposal to develop and market such a

product and to make this available to customers over the telephone on request (estimated annual costs for the two largest retail PPI providers were over £[✂] if the product was promoted in all calls compared with a cost of below £[✂] otherwise—see Appendix S). While we could not validate the precise magnitude of the cost difference, we received consistent evidence from providers that the impact on the length of calls was substantial and was the main ongoing cost of this measure. Given the difference between the costs of the two alternatives, and our view that this would not make a substantial difference to the effectiveness of this measure, we decided that the variant of this remedy suggested by SDGFS would be more proportionate and we have modified the remedy in line with this suggestion.

Information provision in marketing materials

Views of the parties

13. Responses to our original consultation on this remedy are set out in paragraphs 10.185 to 10.222 of the 2009 report, with specific comments related to retail PPI discussed in paragraphs 10.218 to 10.222. In response to the 2010 Retail Remedies Notice, the parties broadly supported the information provision measures but had strong reservations about being required to provide the cost per £100 of benefits to consumers.

14. SDGFS said that it agreed in principle that the provision of certain information (in a targeted way) from retail PPI providers would result in a lower cost to SDGFS than the imposition of the other remedies. It said that, to the extent that there were some retail PPI customers who wished to search, the information remedies should enable them to do so more effectively and produce consumer benefits in excess of implementation costs. SDGFS said that the remedy could increase transparency, assist in developing markets and encourage competitive entry, but suggested that the information should only include messages that were easily understood by customers, and said that the information should be contained in documents that customers were likely to read (eg catalogues and on the website). SDGFS said that it should not be required to provide the information to customers over the telephone when they discussed the purchase of PPI, since customers would be likely to have already seen the information.

15. SDGFS said that a requirement to publish the monthly cost for every £100 of monthly benefit might cause confusion and have little meaning to customers because monthly premiums and credit balances were typically low. In response to our provisional decision, SDGFS said that its average customer balance was £300 and the ASU element of the policy would pay a monthly benefit of 20 per cent of the balance a month (ie £60 per month), so the average SDGFS customer would never have £100 monthly benefit. Therefore the measure would cause customer confusion. In addition, it said that the illustration contained in Appendix Q would provide different results depending on the time period over which the benefit was paid (eg if a customer's outstanding balance was paid back in a single payment rather than being spread over several monthly payments). SDGFS said that it would be difficult, if not impossible, to calculate a monthly cost per £100 of benefit, as customers would often have purchased different items on a number of different credit terms so outstanding balances would fluctuate. Instead of the monthly cost for every £100 monthly benefit, SDGFS suggested that it should be required to state the percentage of the outstanding balance that would be paid per month in the event of a claim.

16. SDGFS said that it could not inform customers that PPI was available from other providers because there were no alternative PPI providers that could provide retail

PPI because they could not track customers' outstanding balances. It said that this would mislead and confuse its customers, since we had found in the 2009 report that there were no suitable alternative PPI products to retail PPI. Products that did not track the outstanding balance were not suitable substitutes, so customers would only be able to switch to other retail PPI or short-term IP providers. In the case of retail PPI providers, customers would only be able to switch in relation to the future purchasing of goods, credit and retail PPI, such that the opportunity to switch would be limited.

17. JD Williams broadly supported measures which enhanced transparency and comparability but also expressed reservations about providing cost per £100 of benefits. It believed that the best time to provide consumers with information was before a PPI sale and during the cooling-off period, and suggested that information could be made available in letters explaining PPI and in a separate leaflet within the customer's credit statement. JD Williams suggested that the same information could be provided in repeat mailings after the sale of the PPI policy. However, it also said that the information should not be included in sales calls because it would cause confusion to the customer, information overload, and longer sales calls would be costly and were likely to increase rather than reduce barriers to switching. It suggested that firms should be required, in the sales call, to refer the customer to the information already supplied within their marketing material or policy documents. JD Williams also told us that a significant number of its customers did not work and so received hospitalization cover instead of unemployment cover, and that the benefits paid varied significantly depending on the event, so it would be difficult to provide a meaningful cost per £100 of benefit figures.[1]

18. Express Gifts agreed that the provision of meaningful information would be beneficial, but expressed concern about customer overload. FGH also expressed concern about customer overload. It was in broad support of appropriate information provision which would enable customers to shop around and make informed choices. It said pre-sale documents, such as catalogues, were the proper environment for such information. It gave shoppers time and space to make a meaningful assessment of their own personal requirements in advance of a sales call. The OFT agreed that the information provision remedy should allow retail PPI customers to make more informed decisions on whether to take out PPI and should allow those who were interested in searching for alternatives to be able to acquire an awareness of these. It said that some strong targeted messages, such as around eligibility to claim under a policy and the annual cost of a policy, may be of particular relevance for retail PPI customers. Citizens Advice believed that the remedy would be beneficial, but would be insufficient on its own to remedy the detriment identified.

19. The parties' submissions about the costs of this measure under alternative specifications are summarized in Appendix S.

Our views

20. The evidence provided during the remittal did not show any lessening of the barriers to search that this measure is intended to address and therefore gave us no reason to change our view, as expressed in paragraph 9.9 and in paragraphs 10.182 to 10.184 of the 2009 report, that this remedy is a necessary element of the remedy package. We also note that the parties' estimates of the costs of implementation of this remedy are low.

[1]For example, JD Williams pays a customer's minimum monthly payment in the event of an unemployment claim compared with twice the outstanding balance if a customer is in hospital for more than 14 days in a row.

21. We noted that all parties agreed that there would be benefits to providing information to customers to enable them to compare PPI products. However, we also note the concerns raised by providers over whether we should require the information to be given in sales calls and over requiring price to be disclosed as a monthly cost or for every £100 of monthly benefit. The original formulation of the remedy required the information to be included in any PPI marketing materials that include pricing claims or cost information but did not require the information to be made orally in sales calls. This oral disclosure was, however, required as part of the POSP remedy as we considered that it would reinforce the beneficial impact of the POSP on competition.

22. As we are not taking the POSP forward for retail PPI (see paragraphs 83 to 88), we considered whether there would still be merit in requiring these disclosures to be made orally. We thought that the key messages that PPI was optional and available elsewhere would increase the possibility of subsequent search, as would drawing customers' attention to the moneymadeclear website. We were less sure that oral disclosure of pricing in a prescribed format would impact on customer search because the benefit of the disclosure is the ability to compare prices, which is unlikely to happen during a telephone call. We noted that the FSA already expects retail PPI providers to disclose price information during the PPI sales process.[2] We also noted the evidence of the parties that it could take some time to explain the price of PPI using a variety of metrics, which would add to the cost of this measure.

23. In light of the evidence, we require retail PPI providers to state during sales calls that PPI is optional and available from other providers and that information on PPI, alternative providers and other forms of protection products can be found on CFEB's moneymadeclear website, but not to require retail PPI providers to state the price of PPI using any particular metric during sales calls.

24. The parties also raised strong objections to having to provide the price of retail PPI as a monthly cost for every £100 of monthly benefit. This was an issue that we considered in paragraphs 10.203 to 10.212 of the 2009 report, with specific discussion of its applicability to retail PPI in paragraphs 10.218 to 10.221. The main issues raised in this further consultation were:

   (a) the suitability of this metric for retail PPI, in particular concerns that the cost for every £100 monthly benefit metric focuses on ASU cover, whereas retail PPI policies offer a range of other benefits including some that are not paid monthly;

   (b) whether £100 of monthly benefit is the correct amount to use as a benchmark for calculating monthly cost; and

   (c) the practicability of calculating the metric for retail PPI.

25. The monthly cost for every £100 of monthly benefit metric compares the monthly cost of PPI with the monthly benefit a customer receives if he or she makes a valid AS or U claim. It does not reflect the value of benefits (eg life cover) that are not paid in regular monthly payments for a period. In the 2009 report, we concluded that the monthly cost for every £100 monthly benefit provided a useful comparison between retail and other PPI policies, which added value to this disclosure. In particular, this measure facilitates comparison with short-term IP and stand-alone PPI policies and provides an indication of the ASU benefits available to customers, which we had found could vary substantially, notwithstanding the similar headline pricing of retail PPI policies (see paragraph 6.96 of the 2009 report).

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[2]ICOBS 4.2.4.

26. We did not think that it was practicable to develop a pricing measure that incorporates the value to customers of every element of a PPI policy into a single number—the nearest thing to such a measure is probably the claims ratio—and none of the parties has suggested to us how this might be done. We decided, in developing this measure as a 'common currency' for all PPI policies, that it was appropriate to focus on ASU benefits as these were a core element of PPI policies, including retail PPI policies. Use of this metric would be consistent with the approach taken by CFEB in the comparative tables on its moneymadeclear website, which present the cost per £100 of monthly benefit for an ASU claim as an appropriate comparator.

27. We noted in paragraph 10.221 of the 2009 report that distributors would be free to promote other features of their policy that were not incorporated in this metric. We thought that they were likely to wish to do this as it would enable them to explain to potential customers that their product offers additional benefits which may justify any additional cost compared with ASU-only policies. For example, if a policy provides features such as life or hospitalization cover that pays a benefit in a one-off amount or over a short period, it is likely that the distributor would wish to promote these features.

28. In light of the rationale for this element of the remedy package to encourage search and to enable customers to make comparisons, we see strong benefits in applying the same pricing metric to retail PPI as to other forms of PPI. Nonetheless, we considered whether there were unique features in relation to retail PPI which made it inappropriate for this sector. We noted that retail credit and retail PPI customers are less likely than other credit and PPI customers or the population as a whole to be in full-time work and more likely than these other groups to be in part-time work. GfK's Financial Research Survey indicates that a substantial proportion of mail-order loan customers (46 per cent) do not work and a further 4 per cent are self-employed. We also noted that JD Williams markets its bundled PPI product to around 90 per cent of its credit customers, a substantial proportion of whom would not be eligible for the ASU elements of its cover (but would be able to receive other benefits such as hospitalization).

29. However, in paragraph 10.220 of the 2009 report we noted that, like other providers of PPI, retail credit providers offer ASU as a core part of their PPI offering and these benefits are paid out monthly. This view of ASU being an important part of the retail PPI offering was supported by the GfK customer research where ASU and merchandise cover were recalled by the majority of participants as elements of their policy cover. Evidence submitted by JD Williams during the remittal indicated that around 80 per cent of successful claims made between 2004 and 2010 were for AS or U, although the largest source of claims by value related to life cover.[3] We concluded that ASU was an important element of the PPI products offered by all retail PPI providers and that quoting the price for every £100 of monthly benefit was likely to add value to the disclosure of other indicators of retail PPI price.

30. We also considered SDGFS's argument that many PPI customers had small outstanding balances, so that few would in practice be liable to receive a monthly benefit of £100 in the event of making a claim. However, we did not think that this would make this metric incomprehensible to customers—particularly as this metric would also be widely used in other PPI markets. We noted that the submissions from SDGFS implied that the monthly benefit would on average be £60 for its shopping insurance (see paragraph 15) and we do not think this is so different from the £100

[3]50 per cent of claims by value between 2004 and 2010 were for life cover, where the payment is made as a lump sum to pay off the outstanding balance on the account.

figure to make it difficult for customers to understand the idea of receiving £100 in benefit. We took the view that the benefits of showing price on a consistent basis across all forms of PPI—which is important to the effectiveness of this measure in facilitating comparisons—would outweigh the limited benefits, if any, in terms of better consumer understanding from presenting costs for retail PPI only by reference to a smaller monthly benefit. We noted SDGFS's suggestion that we should instead use the percentage of outstanding balance that would be paid per month in the event of a claim but did not consider that this adequately captured the aim of this measure, which was to relate the amount paid by a customer in PPI premiums with the benefit the customer would receive.

31. We therefore concluded that this was an appropriate metric to use for retail PPI, notwithstanding the differences between retail PPI and other forms of PPI. We considered the practicability of applying this metric to retail PPI. Appendix Q sets out how this metric could be applied to the different types of credit account on which retail PPI is offered. We concluded from this analysis that it would be practicable to apply this metric to retail PPI.

32. We noted SDGFS's comments that the opportunity to switch would be limited because of the lack of competing products, particularly that there were no alternative PPI providers that could track customers' outstanding balances and that it would mislead its customers if it said that 'PPI is optional and available from other providers'. In paragraph 8.12, we said that any incumbency advantage associated with knowing the outstanding balance on the credit product was capable of being overcome by stand-alone providers offering good-value, fixed-balance products. Consequently we continue to believe that alternative products to retail PPI are already available (and will become increasingly so) and that customers would not be confused or misled by a statement that this was the case. In paragraph 11, we noted that customers most likely to search would be those with larger PPI premiums and/or with short-term IP policies. Although we accept that customers with smaller balances may be less interested in switching, we believe that, with the remedy in operation, the number and size of customers that would consider switching would be enough to justify the imposition of this remedy.

Provision of information to third parties

Views of the parties

33. Responses to our original consultation on this remedy are set out in paragraphs 10.226 to 10.242 of the 2009 report. In response to the latest consultation, the points raised by the parties were generally also raised in the original consultation. Generally parties felt that the information provision might help to increase customer search. However, the parties were opposed to providing claims ratios to any person on request because the information would not be understood by customers.

34. SDGFS cautioned that the GfK survey had found that most retail PPI customers were unlikely to search for alternative products because of low premiums but said that, in principle, the development of independent reference sites could be beneficial for customers. It said that information provided should reflect the different nature of the products and providers as well as price and, provided that the information to be provided was limited to what was necessary, the cost of the remedy would be low. SDGFS did not agree with the requirement to provide claims ratios to any person on request. It said that claims ratios would be ineffective in enabling customers to search because they were difficult to interpret in the absence of more detailed information and might mislead so that a 'man in the street' might believe that it reflected

the scope of the cover provided or the likelihood of the claim being accepted. SDGFS also said that customers would be unable to balance the relative merits of policies with different prices but also different claims ratios. It said that the ratios would not enable customers to compare PPI products and would need to be heavily caveated.

35. JD Williams agreed that it would be feasible to provide comparative data to CFEB for publication on a comparison website and noted that this remedy might increase customer search. It was also concerned about the comparability of retail PPI policies with other policies. It said that it would be misleading if the comparison basis was cost per £100 of monthly benefit because the metric would not reflect the enhanced benefits that JD Williams said PPI policies provided, so there was a risk that retail PPI cover could be reduced to that of the lowest common denominator. JD Williams strongly objected to the obligation to supply claims ratios to any party on request. It also said that they would not be fully understood by customers and would not allow customers to take an informed decision to buy PPI. It said that the measure should instead be the percentage of claims made that were paid. It also said that if we required this information, it would be necessary to require underwriters to supply it to distributors, and it suggested that underwriters should be bound to provide this information in a timely manner. Finally, it said that the timing of the disclosure of claims ratios should be brought in line with the FSA's current complaint-handling rules and a reply be made available 'orally' by the end of the next business day following the day the request was received.

36. Express Gifts also opposed the provision of claims ratio information and suggested that most customers would not understand what they meant. It also said that it did not presently offer a PPI policy but still had customers under old policies and that these should not need to be disclosed to third parties because they were not available for sale now. FGH said that the remedy would have little impact on the AEC but it was feasible to provide the suggested information to CFEB for inclusion in price comparison tables. FGH said that the comparison should include the other benefits available from retail PPI as well as the basic ASU cost. It said that it did not object to providing information to the OFT for it to monitor the effectiveness of remedies but was concerned about customer confusion. It said that claims ratios were commercially sensitive and required actuaries to make meaningful assessments of them, so it was inappropriate to disclose this information to any party on demand and this could fuel frivolous and vexatious complaints.

37. The OFT supported the inclusion of this remedy; however, Citizens Advice thought it unlikely that web-based comparative tables and claims ratios would have any significant effect on the majority of mail-order/catalogue users.

Our views

38. We considered whether the GfK customer research (see paragraphs 8.15 to 8.21) meant that this remedy, or indeed any remedy aimed at facilitating customer search and switching, would be ineffective. Although we thought that the parties had interpreted the GfK research in a pessimistic way, we accepted that the GfK findings suggest that, because of the low amount typically spent on retail PPI premiums, many customers do not feel the effort to search is justified and measures aimed at increasing the level of search will have limited effect on these customers unless attitudes to searching change. However, we noted that a significant minority of retail PPI customers spend in excess of £50 a year on retail PPI (see paragraph 64), and that for these higher-spending retail PPI customers there were potential benefits from searching the market which could justify the effort, particularly if we put in place measures to make searching easier.

39. We noted that most of the other points raised by parties were also raised in response to our first remedies consultation and were discussed in the 2009 report. In paragraph 10.231 of the 2009 report, we considered whether the fact that the CFEB tables used the cost of PPI for every £100 monthly benefit, as a metric for comparing the price of PPI policies was likely to mislead users of that site if this approach were extended to retail PPI; and we did not agree that it would (also see paragraph 30). We acknowledged that there may be differences in the levels of cover but considered that it was important for consumers to be able to compare the overall value for money of alternative PPI policies. We also noted that consumers could take into account other product features disclosed on the moneymadeclear website.

40. In paragraphs 10.239 and 10.240 of the 2009 report, we considered whether parties should be required to provide claims ratios. We concluded that claims ratios were an important measure of both absolute and comparative value for money and that this was the only readily available quantitative comparison of PPI providers. We anticipated that consumer groups and others would make use of this information to inform consumers about the value for money on offer from different providers. Making claims ratio data publicly available will therefore serve as an additional discipline on providers, will help address the failure of distributors to compete on price and will thereby increase competition. We noted that in a more competitive market for PPI we would expect to see claims ratios increase, and making this information available would enable the OFT and others to monitor the effectiveness of our package of remedies. We concluded that the availability of the claims ratios had an important role to play in addressing the AEC that we found. To address concerns of a number of parties (retail and other PPI providers) about commercial confidentiality, we decided in the 2009 report that claims ratios provided to parties other than the OFT could be presented in the form of a range (for example, 0–10 per cent, 10–20 per cent) with one aggregated banding above a certain figure (our current thinking is that this should be 80 per cent). In paragraph 10.242 of the 2009 report, we considered, but decided against, imposing a requirement to publish an indication of the percentage of claims accepted (proposed by JD Williams as an alternative to claims ratio) as this would not address the AEC that we had found to any material respect. We have seen no new evidence, including the submissions made in response to our provisional decision, to lead us to change this conclusion.

41. We also noted Express Gifts' argument that it should not need to disclose details of policies still in place but that were not presently being sold to new customers. We thought that this point had merit in relation to the obligation to provide information to CFEB for publication on its moneymadeclear price comparisons website. We thought that it could be confusing to customers of this website if it contained information about products that are not available to new customers, and could reduce the impact and usefulness of the website as a whole. However, we thought that it was important that the additional discipline imposed on providers from being required to disclose claims ratios (see paragraph 40) should apply to all providers and not just to those that were seeking new business. This would ensure that customers with policies that are no longer offered to new customers can benefit from this additional information on the value offered by their existing policy. Therefore we require the obligation to disclose claims ratios to apply to all distributors, even those that are not offering new policies.

42. We noted the issues raised by JD Williams in paragraph 35 about the way in which the obligation to disclose claims ratios would be implemented. We had noted in paragraph 10.241 of the 2009 report that 'should it prove necessary, during the drafting of the Order, we will include consequential obligations on underwriters to provide the information needed [for PPI providers] to meet their obligations'. During consultation on a draft Order prior to the remittal, underwriters indicated that they

would be able to provide this information to distributors, if required to do so. We will consider whether such consequential obligations are indeed necessary as well as JD Williams' comments about the timescale for disclosing claims ratios orally, during the development of the Order that will give effect to our remedies.

Obligation to provide a personal PPI quote during the cooling-off period

Views of the parties

43. In general, the parties supported this measure. SDGFS told us that it agreed in principle with this measure and that a well-designed set of information remedies would increase transparency and encourage and assist increased future competition. It suggested that the measure would be most effective and least costly if the personal PPI quote could be included with other policy documents sent to customers, and if it could be sent electronically for those customers who used the Internet to manage their Shop Direct account. SDGFS also provided us with some suggestions about the specification of the personal PPI quote. Among these, SDGFS said that the combined APR was misleading because most of SDGFS's credit was provided interest free. SDGFS said that the APR was precisely defined in consumer credit legislation and the EU Consumer Credit Directive, which was currently being implemented in the UK. It said that the formula did not include scope for a combined APR with optional PPI charges to be included in the standard APR calculation. It suggested that to avoid confusion we should say that PPI does not affect the true APR of the credit agreement, but we have included a notional APR that reflects the combined cost of the credit and the PPI. SDGFS also said that it should not use the phrase 'cheaper or more appropriate cover' as this was not correct given that price was directly related to benefits. It said that by making this statement to its customers it was likely to be providing advice under the FSA rules and SDGFS sold PPI on a non-advised basis; it did not hold details of customers' employment status; and the credit limit was not a good indicator of the cost of PPI because customer balances were likely to be significantly lower than their credit limits.

44. JD Williams told us that the provision of the personal quote would give customers the information required to compare alternative PPI products. When supplied around the time they had already decided to purchase the policy, it might encourage customers to consider other policies. It said that supplying the quotation to customers with their policy documentation would allow them to make a fair comparison with other suppliers, and the costs involved would be proportionate to the AEC found. JD Williams commented on some of the figures we were proposing to specify in the personal quote. It said that at the time retail PPI was offered to customers the average customer balance was £[✄], and suggested that the quote should be based on a figure of £150 of outstanding balance, and not the £300 we specified, to avoid confusion. In addition, it suggested that we replace the word 'unbiased' with 'impartial' in the quote.

45. FGH expressed concerns about the cost and complexity of the personal PPI quote specified in the 2009 report and suggested that this might discourage new entrants to the retail PPI market and might cause others to question the long-term viability of the product. If this measure were introduced, FGH would prefer to include a personal quote with other policy documents. In terms of the content of the quote, FGH was concerned about the wording 'cheaper or more appropriate cover may be available from other providers' and suggested that this presupposed that retail PPI was neither cheap nor appropriate. It suggested that 'cheaper or more appropriate' should be replaced by 'alternative'. Express Gifts told us that it did not currently sell a PPI product, but that if a personal PPI quote was to be provided, it should be enclosed

with other policy documentation. This would reduce cost and would mean that the customer saw the quote as quickly as possible after the sale was made.

46. The OFT questioned whether, on its own, this option would offer a sufficiently effective intervention. Citizens Advice believed that a reminder of cancellation rights could be effective in helping consumers to understand that there had been an insurance sale and the steps they could take to cancel. The FSA said that if the POSP was removed, this remedy would be beneficial to competition by providing an additional opportunity for consumers to consider whether to cancel their policy. The FSA later suggested that the CC should consider requiring the quote to be provided as early as possible following purchase of a retail PPI policy, and considered that providing the quote no later than 14 days from conclusion of the contract would provide customers with sufficient time to search, switch or cancel before the end of the cooling-off period. The retail PPI providers did not object to this proposal. Finally CFEB agreed that the word 'unbiased' should be replaced with 'impartial' in the quote.

Our views

47. In our view, this measure would make a contribution to addressing the AEC by encouraging customers to search and switch during the period immediately after taking out a retail PPI policy, reminding customers that they can cancel PPI policies and providing information that would help them look elsewhere for cover.

48. In paragraph 10.68 of the 2009 report, we found that measures aimed at encouraging customers to search and switch during the cooling-off period were generally less likely to be effective than measures, such as the POSP, which encouraged consumers to search before committing to a particular provider. We also noted that participants in the GfK customer research did not generally look in much detail at policy details after taking out retail PPI.[4] We acknowledged these limitations on the impact of this measure, but thought that the information contained within the quote would enable those customers who took the opportunity to read it to compare their retail PPI policy against alternatives and that the key messages contained in the personal PPI quote could act as a prompt for some to shop around.

49. In considering the design of this measure, we considered whether to require a personal PPI quote in a standard format or whether a 'lighter-touch' disclosure would be equally effective. In particular, we considered whether customers could instead be provided with the following key messages:

(a) taking out PPI is optional;

(b) cheaper or more appropriate cover may be available from other providers;

(c) where to find more information about alternatives; and

(d) how to cancel the policy.

50. In our view, requiring providers to send customers a personal PPI quote would provide the customer with a fuller set of comparative information in a standardized format than simply disclosing the above key messages. The personal PPI quote has been developed in the light of consumer testing by Insight.[5] The content was also

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[4]See Retail PPI Qualitative Research Findings, section 3.3.1.
[5]Insight Research PPI forms consumer testing (April 2009).

tested in the GfK consumer research[6] and was generally well received by participants. For these reasons, we thought that, for those customers who sought to use this information to search the market after taking out PPI, the provision of a personal PPI quote would be more effective in facilitating search than simply providing customers with the key messages in paragraph 49. We concluded that customers should be provided with a personal PPI quote in a standardized format, as set out in Appendix R.

51. We also considered what restrictions, if any, we should place on the way in which the personal PPI quote was provided to customers during the cooling-off period. We considered first whether to require that the quote be sent as a separate mailing or to allow the quote to be provided to customers with other sales documentation, which the customer would normally receive during this period. We thought that providing the quote with the sales documentation was a pragmatic approach, which we expected providers to adopt if permitted, and was likely to ensure that customers received the quote relatively promptly after the PPI sale. We note that the evidence on the relative effectiveness of single-item mailings compared with statement inserts was mixed (see paragraph 75), but we had no reason to believe that sending the quote along with sales documentation, rather than as a separate mailing, would reduce the likelihood of the quote being read by customers. Parties also told us that the cost of providing a personal PPI quote would be significantly lower if the personal PPI quote was provided to customers with sales documentation than as a separate mailing. SDGFS told us that providing the personal PPI quote electronically, where possible, would reduce costs further. We thought that, where customers manage their retail PPI accounts electronically, it would be appropriate to provide the personal PPI quote electronically.

52. We concluded that retail PPI providers should be allowed to send the personal PPI quote with other sales documentation and, where appropriate, deliver the personal PPI quote to consumers electronically. We also concluded that, taking into account this flexibility in implementation, the costs associated with sending a personal PPI quote were justified by the contribution this measure makes to addressing the AEC. We agreed with the FSA that the quote should be provided no later than 14 days after the conclusion of the contract.

53. We accepted the parties' submissions that the precise format of the personal PPI quote should be amended to reflect the fact that we are not introducing a POSP for retail PPI. These changes are incorporated into the proposed template at Appendix R. We did not agree that including a combined APR in the quote would be misleading. We considered this issue in paragraphs 10.173 to 10.176 of the 2009 report, and concluded that a combined APR provided consumers with useful information and was an effective tool for comparison. Further, this way of presenting the combined cost of credit with PPI was also well received by participants in our consumer testing.[7] The consumer testing included retail PPI customers, and the combined APR was seen as very important information. Nor did we agree that a combined APR was an inappropriate measure of the combined cost of credit with PPI, simply because the credit in question was 'interest free' and therefore had a 0 per cent APR. In our judgement, comparison of the combined APR with the APR of the credit alone would, in these circumstances, still provide consumers with an indication of the additional cost of PPI. The combined APR, in these circumstances, also provides an indicator of the price of a combination of credit with PPI (see paragraph 10.176 of the 2009 report). We noted the SDGFS comments about Consumer Credit Regulations not

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[6]See Retail PPI Qualitative Research Findings, section 3.4.5.
[7]Insight Research PPI forms consumer testing (April 2009), p22.

including scope for a combined APR to be quoted. While we agree that these requirements apply to consumer credit agreements, they do not apply to the personal PPI quote and do not prevent us from requiring a combined APR. We note that the personal PPI quote also shows the APR of the credit separately, which will help to distinguish between the combined APR and the credit APR.

54. We noted SDGFS's comments that some of the information contained in the specimen quote was not always available at the time at which the quote would be issued. We would not expect parties to include information on the personal PPI quote that they do not possess at the time of issuing the quote (this might, for example, sometimes include information about a customer's employment status).

55. We noted the various objections to the phrase 'cheaper or more appropriate cover may be available'. We thought that this was an accurate statement that would be of help to consumers. With the remedy package in place, other PPI offers may well be cheaper and/or more appropriate for some consumers than the retail PPI product offered by the retail credit provider—for example, a stand-alone PPI/short-term IP policy may be more suitable for certain customers, for example because it may be cheaper or offer additional cover against particular events or may enable a customer to cover a wider range of outgoings than just retail credit. Therefore we consider the wording to be accurate and should serve to encourage the customer to search the market. We noted that customers had strongly supported this form of wording, when we tested the forms with customers, including retail PPI customers.[8] We did not agree that this phrase could be construed as meaning that the sale was on an advised basis, and noted that the FSA has not expressed any concerns about this possibility.[9] We have agreed to change the phrase 'unbiased information about insurance' to 'impartial information about insurance' in the template in Appendix V as we had no reason to think that this would affect the impact of this statement.

56. We also noted the comments from JD Williams that the illustrative monthly and annual expenditure in the quote should be less than the £300 outstanding balance we specify because the customer balance at the time retail PPI is offered is lower than this (JD Williams said that average customer balance was £[✂] at the point when a customer took out retail PPI). However, we thought that the average outstanding balance was a more appropriate figure to use as a basis for comparison than the initial balance. This is because a typical retail PPI customer might be expected to operate the account for several years. The average outstanding balance for JD Williams' customers is higher than the average initial balance. Based on the evidence that we collected from retail PPI providers, we remain of the view that, while there is some variation between suppliers, £300 is a reasonable approximation of the average outstanding balance that a retail PPI customer might be expected to operate (see paragraph 6.8 of the 2009 report and paragraph 15). Therefore we concluded that these illustrations should be based on an outstanding balance of £300.

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[8]Insight Research PPI forms consumer testing (April 2009), p15: 'The phrase "more appropriate or cheaper" was thought to have much greater impact than the phrase "alternative cover". "Alternative" was thought to be the kind of disliked vague or "woolly" language used by financial institutions. However, it was thought the preferred phrase could be improved if it said "cheaper or more appropriate" rather than "more appropriate and cheaper".'

[9]The FSA referred us to a factsheet published by the FSA that explains the difference between advised and non-advised sales: www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/factsheet_sales.pdf. This explains that an advised sale is one where a personal recommendation is made to the customer. In making a recommendation, an adviser is required to explain why the particular product and/or provider would meet a customer's demands and needs. This will be specific and individual advice to the customer and should not be generic.

Obligations to provide annual reviews[10] *and annual reminders*

Views of the parties

57. SDGFS said that the CC had concluded that some consumers with higher balances might search around, but the GfK research showed that these customers would only do so if 50 per cent plus savings could be obtained. It repeated its view that there were no alternative retail PPI products for customers to compare and said that the remittal provisional decision did not provide evidence that such a saving would be offered by any stand-alone PPI or short-term IP provider and the savings possible would not be enough for customers who might consider searching for alternatives. SDGFS said that an annual review was not necessary because customers could cancel their PPI policies at any time without penalty, and monthly statements showed customers the cost paid for PPI each month. Customers were therefore getting a more frequent reminder of the cost of their policy and one which met their monthly budgeting needs so it was unnecessary to send an annual statement. SDGFS said that it would serve no purpose to provide an annual review even on a targeted basis to larger PPI consumers. It would be complex, costly and provide only a limited benefit for a small minority of customers who may switch. SDGFS also said that it would be confusing for customers with a balance over a threshold one year but not the next if their balance reduced. SDGFS said that it believed customers would gain a greater benefit by the provision of an annual reminder of the terms of their policy rather than an annual statement of the amounts paid. It said that the reminder could contain: a reminder that customers could cancel at any time; a direction to the CFEB website; and a reminder that SDGFS sold another PPI policy. SDGFS said that such an annual reminder would encourage those customers who wished to search to reconsider their options and look for alternative policies. It said that the annual reminder should be sent with the monthly statement on the anniversary of taking out the policy, which would ensure that customers saw the information and keep costs low. SDGFS said that age, employment status and the requirement to include a summary of the policy were not relevant to the annual review and should be removed. In any event, it did not keep details of employment status.

58. JD Williams said that the annual review was likely to be expensive to implement, unnecessary and ineffective. Customers might regard it as junk mail. It said that retail PPI providers already provided details of PPI charges on monthly statements and customers were free to terminate the policy at any time without penalty. JD Williams said that the GfK research showed that the majority of retail PPI customers took a monthly view of their finances and an annual review would bring no real benefit to their financial decisions. It also said that customers might be confused by the information, might not realize that PPI premiums were payable only when the customer had a balance and might cancel their PPI, so if the CC decided that an annual review was necessary it should be targeted at customers with balances on which PPI was payable at the time of the annual review. JD Williams believed that the annual reminder was proportionate and would be effective. It said that a reminder notifying customers of their right to cancel should be sent with the first statement after the policy anniversary, which should include information required by the CC, remind the customer that the policy was optional, cancellable without penalty, and where to find information on alternatives. JD Williams believed that costs would be moderate and proportionate to the AEC.

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[10]In the 2009 report, we referred to this element of the remedy package as an annual statement. Following consumer testing in April 2009, we decided that this document should be referred to as an 'annual review' as consumers felt that this more accurately described its purpose.

59. Express Gifts said that the costs of the annual review would outweigh the benefits for all except a small percentage of customers. It said that customers took a monthly view of their finances, providing the information would cause confusion, and the remedy would not be effective. It said that premiums might have to increase to offset cost increases caused by the remedy. It would have no objection to providing customers with a reminder of their cancellation rights annually; reminders should be sent with the regular statements that the customer received and if this reminder was sent to all customers, there would be no need to send the annual review.

60. FGH said that customers were already given sufficient information each month to enable them to decide whether to keep their PPI policy or cancel; PPI was itemized on the monthly statement. It said that if a customer decided to cancel PPI in reaction to the annual statement, it might not be able to reinstate the cover.[11] It said that it was not appropriate to discriminate between customers on the basis of their PPI spend and some customers may receive the annual statement one year and not the next (however, it said that customers would not remember whether they had received a statement the previous year.) FGH said that the costs of the remedy (set-up and annual costs) would be substantial. It did not object to the annual reminder but questioned its relevance given that customers could cancel at any time. It said that the monthly statement would be the best way to send the reminder and said that some system development work would be required. FGH suggested we replace the customer's age in the annual review with date of birth.

61. In our provisional decision, we proposed a threshold of £50 of customer expenditure on retail PPI in the last year for requiring the annual review to be sent. In response, SDGFS noted that in principle it did not object to providing customers with an annual review if they had spent more than £50 on retail PPI in the past year. However, it doubted whether there was any evidential basis that this would mitigate or remedy the AEC. It also said that the CC had no rationale for concluding that a solus mailing would be more effective than one sent with other sales documentation (such as the monthly statement) and wanted to retain flexibility in how to send the annual review. JD Williams said that £50 was not the appropriate threshold (it suggested a £150 threshold because a 20 per cent saving on PPI achieved through switching would then be over £30 a year, whereas a 20 per cent saving for a customer who spent £50 a year on retail PPI would be equivalent to only £10 a year) and also queried the requirement for it to be sent as a solus mailing.

62. The OFT supported the annual review and said that it had the potential to encourage customers to switch PPI providers or cancel existing policies when they saw the amount they were paying annually. It said that if annual reviews were only sent to customers paying above a certain threshold, the threshold set should recognize that even a low annual figure may have the capacity to stimulate poorer customers, paying relatively small amounts monthly, to switch and the annual review should contain key messages to remind customers to shop around and other switching or cancellation messages. The OFT questioned whether, on its own, the annual reminder would offer a sufficiently effective intervention, and that the lack of annual reviews was likely to be a barrier to retail PPI customers switching. Citizens Advice said that the annual review may produce consumer benefits.

[11]FGH said that it had implemented processes to ensure that customers who sought to cancel were recontacted prior to final cancellation to explain that the PPI could not be reinstated.

Parties' views about costs and impact of alternative specifications of the remedy

63. We explored with the two largest providers how the costs and likely impact of the remedy were affected by alternative specifications of it. Our analysis of costs is detailed in Appendix S. The annual review is more costly than the annual reminder in terms of ongoing costs because it involves the disclosure of more information and includes product and customer-specific information. There are a large number of customers who pay only small amounts for PPI. 20 per cent of active customers pay around two-thirds of total premiums and 10 per cent of active customers pay around half of total premiums. Requiring an annual review to be sent only to customers who had spent over £50 on retail PPI in the past year (around one-third of active customers) would proportionately reduce ongoing costs compared with sending the annual review to all customers (ie reduce it by two-thirds). Further reductions in cost are possible by allowing providers to deliver these messages to consumers electronically, where requested by customers. SDGFS told us that it would cost it nearly £[✄] to implement and operate the remedy with a customer size threshold of £50.

64. In general, the cost of including information with credit statements is lower than sending single-item ('solus') mailings. However, SDGFS told us that there were opportunity costs and practical difficulties associated with including annual reviews as inserts with credit statements. We asked SDGFS and JD Williams for evidence relating to the effectiveness of statement inserts and solus mailings. SDGFS said that open rates (the proportion of correspondence opened by customers) were significantly lower for direct mail than for statements, and presented customer research that supported this view.[12] However, it noted that conversion rates for single-item mailings were generally higher, because direct mail allowed for more flexibility and it was possible to provide more product content in a single-item mailing than a statement insert. JD Williams detailed analysis which it said showed that it generally got higher response rates to marketing leaflets included with monthly statements than those sent as single-item mailings (although the material sent was different in the two cases), and that regular purchasers of catalogue products were more likely than others to respond to statement inserts.

Our views

65. We considered two main issues in relation to these measures:

(a) what information should be sent to what size of customer; and

(b) how that information should be delivered.

What information should be sent to which customers

66. We thought that the appropriate information to be sent to customers should vary according to the amount spent by that customer on retail PPI. For higher-spending retail PPI customers, we remain of the view as set out in paragraphs 10.302 and 10.303 of the 2009 report that an annual review would increase switching because it would increase transparency and help consumers compare PPI prices. We note our conclusion in paragraph 8.18 that those customers who were more likely to search would be those whose retail PPI premiums were larger than average, and who already held other PPI policies or short-term IP policies. We also note that the GfK research found that retail PPI customers responded positively to the content of the

[12] SDGFS provided a slide from a 2009 customer research programme carried out by Illuminas for the SDG Home Shopping Business.

annual review (section 3.4.5 of the GfK report), particularly the summary of the policy cover and the prompt to shop around, and that they would appreciate a reminder of their policy as they currently had low engagement with it. We remain of the view that the annual review will increase consumers' awareness of PPI and the cost they are paying.

67. We note the parties' arguments in paragraphs 57 to 60 that customers are told each month how much they have spent on PPI in the month and that customers can cancel their policy at any time without penalty. However, we remain of the view that providing information about a customer's retail PPI policy in a structured way in an annual review will give consumers an important prompt to consider whether their PPI policy meets their current needs, and the information needed to compare it with other PPI policies. This would add substantially to the impact of this measure, particularly in relation to higher-spending customers, compared with the much more limited details of monthly expenditure that customers currently receive.

68. The information suggested to us that we should target the annual review at customers with an annual retail PPI spend of over £50—this is the group we thought were most likely to search the market and consider switching—while still accessing those customers that spend the majority of retail PPI expenditure. Targeting the annual review at customers with an annual spend on PPI of over £50 would mean that around 32 per cent of customers, accounting for 71 per cent of retail PPI expenditure, would benefit from this measure. The cost information suggests that the £50 threshold would reduce the cost of the remedy by around two-thirds compared with requiring all active customers to receive an annual review.

69. We considered the parties' arguments that a higher threshold (eg of £100 or £150) would be more appropriate than £50. Raising the threshold to £100 would mean that the number of customers who received an annual review would reduce to around 17 per cent (61 per cent of expenditure) and raising it to £150 would reduce the number of customers who received an annual review to around 10 per cent (46 per cent of expenditure). We thought that this would unnecessarily exclude a significant number of customers who could benefit materially from receiving an annual review. We noted the comments of JD Williams about the level of saving that customers could potentially gain with a 20 per cent reduction in price (see paragraph 61). While it is possible that some customers whose expenditure slightly exceeded a £50 threshold may not be motivated to search for alternatives, we thought that other customers may be more motivated and that there could be other factors that would mean that the perceived benefits could be higher. For example, as the PPI market develops, some customers may become aware of the availability of short-term IP to cover a wider range of outgoings than retail PPI, and some customers may anticipate higher expenditure on retail credit in the coming years. In determining the level of the threshold, we have sought to strike an appropriate balance between avoiding unnecessary costs by sending annual reviews to customers with little or no interest in searching for a better offer and enabling those customers who could benefit from this remedy to do so. In our judgement, we still consider that a threshold of £50 would strike the appropriate balance.

70. We therefore decided that all customers who had spent more than £50 on retail PPI in the preceding 12 months should receive an annual review.[13] Our template for the annual review is at Appendix R. As in the 2009 report, the annual review includes information about the retail PPI policy and the customer's use of it (including, for example, the amount spent on retail PPI in the past 12 months) alongside information

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[13]Paragraph 10.311 of the 2009 report sets out when the annual review should be sent.

about cancellation rights and how to make comparisons. We agreed that customer age could be replaced by date of birth—if this were more straightforward to provide—and that if information such as employment status is not available, the distributor should allowed to leave this field blank. However, we consider that the requirement to include a policy summary with the annual review should remain, so that those customers who were prompted by the annual review to think about their retail PPI would have the core information to hand when doing so.

71. We then considered what information, if any, should be provided to those retail PPI customers who spend lower amounts on retail PPI. We thought, in light of our assessment of the GfK research (see paragraph 8.18, that lower-spending retail PPI consumers were less likely to be prompted by an annual review to search for alternatives and so the additional costs of requiring an annual review to be sent to all active customers were unlikely to be justified. However, we also noted that the GfK research showed that customers were positive about the provision of information about retail PPI periodically[14] and we thought that some lower-spending customers would respond to the prompt provided by an annual reminder to reconsider their current retail PPI policy. This would impose an additional constraint on retail PPI providers to that introduced by the other measures in the remedy package. We thought that this additional contribution towards addressing the AEC would justify the cost of sending an annual reminder to lower-spending customers.

72. We decided that retail PPI providers should be required to provide an annual reminder including the following information to any customer who has an active balance on their retail credit account, on the date when they would otherwise be due to receive an annual review:

(a) that PPI is optional;

(b) that cheaper or more appropriate cover may be available from other providers;

(c) where to find more information about alternatives; and

(d) how to cancel the policy.

73. As this information is already included in the annual review, this measure only imposes an additional obligation in relation to those active customers who have spent less than the threshold of £50 on retail PPI in the preceding 12 months.

How information should be delivered to customers

74. We considered whether we should relax the requirement in the 2009 report preventing the annual review from being sent to customers along with information about credit (see paragraph 10.311 of the 2009 report). In the 2009 report, we were concerned that sending credit and PPI statements together would risk linking them in consumers' minds, which could discourage switching, undermining the effectiveness of this element of the remedy package. We still consider that this is an important consideration in favour of keeping this communication separate from information about the credit account.

75. The new evidence we received on the relative effectiveness of single-item mailings against statement inserts was mixed (see paragraph 64). The evidence we received from parties indicates that customers are more likely to open a retail credit statement

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[14]See paragraph 75.

than other material from the retail credit provider. We also note that the GfK customer research showed that while participants were very positive towards the idea of information provision, a couple of respondents noted that if this type of information were mailed to customers, the envelope should be clearly distinguishable from the usual catalogue 'junk mail' to ensure that customers opened and read the information enclosed (section 3.4.5 of the GfK report). However, we note that retail PPI providers also see a use for single-item mailings in communicating more detailed information, and this sometimes generates a higher response rate. We decided that this new evidence did not indicate a clear advantage of either means of distribution in terms of their likelihood of generating a customer reaction.

76. We considered carefully SDGFS's comments that it wished to retain flexibility in how it sent the annual statement to customers. However, we also noted that SDGFS had submitted that it was unable to provide a personalized annual review as an insert to its credit statement and that there were opportunity costs and practical difficulties associated with doing this. This suggested that, at least with its current systems, SDGFS would be unable to make use of the opportunity to send an annual review with credit information. We also noted SDGFS's comments that there were opportunity costs if it were to send the annual review as an insert in the credit statement. We thought that a purely generic document that did not include, for example, the amount spent by a customer on PPI in the past year would be of less value than one which reflected actual experience and was likely to reduce the annual review's impact. We noted that, for JD Williams, the additional ongoing costs associated with a single-item mailing compared with a statement insert were in the region of 20 to 30 per cent.

77. On balance, we thought that this measure would be more effective if we retained our requirement for the annual review to be sent separately from credit information. This was most likely to establish in the minds of those customers who spent significant amounts on retail PPI that the decision to continue taking it was an important decision in its own right. We noted that SDGFS said that it might be able to reduce the annual cost of this and other informational measures if it were able to use its secure 'My Account' facility to deliver messages to its consumers electronically and we think this would be an effective way of communicating the annual review to customers. In paragraph 10.311 of the 2009 report, we concluded that the provision of the annual review by electronic means should be permitted where it is requested by a consumer, and consider that this should remain part of the specification of the remedy.

78. For the reasons set out in paragraphs 74 to 77, we concluded that the additional costs of requiring annual reviews to be sent separately from information about credit were justifiable in terms of the impact on the effectiveness of this measure.

79. We were less concerned about separating the annual reminder from other retail PPI information. Given the smaller impact that we expect this measure to have on the AEC, we thought it was important to ensure that the costs of this measure were modest. We concluded that there should be no restrictions on how the annual reminder should be provided to customers other than that it should be provided in a durable medium and it should be sufficiently prominent that a consumer would reasonably be expected to take notice of it. We thought that allowing this flexibility would enable providers to find the most cost-effective way of delivering these messages to consumers without compromising the measure's impact.

Single-premium prohibition

Responses to the 2010 Retail Remedies Notice

80. The parties all noted that this element of the remedy package would not have any practical implications for retail PPI because they did not sell any single-premium products or levy any charges on consumers for administration costs, set-up or early termination of retail PPI policies. The OFT supported the remedy. Citizens Advice said that there was some evidence on barriers to cancelling insurance, which were usually administrative rather than charge based, but welcomed any intervention that made it easier for consumers to cancel.

Our views

81. We note that none of the parties has expressed concern about this remedy because it does not have any immediate practical implications for their business. We consider that it would be appropriate to retain this remedy for retail PPI as a preventative measure—to prevent the emergence of cancellation fees or other forms of pricing complexity—and note that in practice its implementation would not impose any costs on retail PPI providers. We have therefore decided to include this measure in the remedy package for retail PPI.

Options we are not taking forward

82. There were a number of options set out in the 2010 Retail Remedies Notice or suggested to us by parties which we are not proposing to take forward. Our reasons are set out below.

The point-of-sale prohibition

83. In paragraph 10.36 of the 2009 report, we said that this element of the original remedy package would directly address the AEC arising from selling PPI at the credit point of sale by distributors or intermediaries, and address a number of barriers to search.

84. However, in Section 8 we discussed the new evidence from the GfK customer research (see paragraphs 8.16 to 8.18) which suggested that many retail PPI customers would not in practice search for alternative policies, even if provided the opportunity to do so by the POSP. Our view was that those more likely to search would be those whose retail PPI premiums were larger than average, and/or who held other PPI policies or short-term IP policies already. We concluded that we could not be sure that by imposing a POSP we would encourage sufficient customers to search to generate competition between providers and we could no longer be confident that our original remedy package would be substantially effective for retail PPI.

Views of the parties

85. The retail PPI distributors agreed with this reasoning. SDGFS said that the POSP (with the personal PPI quote) would be disproportionate since it would not be effective in encouraging sufficient competition between providers to outweigh its costs and could not be targeted at customers who may wish to switch, although JD Williams considered that, subject to detailed drafting of any Order, it would not have any particular concerns. Express Gifts agreed that the new evidence showed that the POSP

would not encourage sufficient customers to search and the remedy would not be effective. FGH said that the POSP was a high-cost remedy that the CC's work had shown would be ineffective. For retail PPI, we saw only one estimate from internal documents on the impact of imposing a POSP; an [✂] document stated that it expected a significant decline in sales.

86. The OFT said that a remedy package designed to stimulate competition was most likely to offer a durable solution, and if the CC concluded that the POSP remedy could not be justified, it should consider whether to enhance information provisions to increase consumer benefits at the point of sale. It said that without a change in consumer behaviour, the remedies in the 2009 report might be ineffective for retail PPI, but some of the lower-cost remedies may be a first step in driving change. Citizens Advice broadly agreed that a POSP may not be an appropriate remedy for retail PPI.

87. The FSA said that it had no reason to believe that the problems associated with sales of other PPI products did not exist in retail PPI, but it was not possible to predict exactly how the market might develop with remedies designed to enhance competition. It also noted that there were other potential benefits from the POSP including allowing customers to decide whether they wanted PPI and to decline it if they did not want it, so it may mean that customers did not buy products that they did not value or want.

88. In the 2009 report, SDGFS said that the POSP remedy (including the personal PPI quote) would cost it £[✂] a year, while JD Williams said that the ongoing costs to it would be £[✂] (mostly relating to providing a personal PPI quote to all potential customers) with upfront costs of £[✂].

Our views

89. We said in paragraph 8.21 that we could not be sure that by imposing a POSP in relation to retail PPI we would encourage sufficient customers to search to generate effective competition between providers. Based on the further submissions we have received from parties, combined with the GfK survey evidence, we remain of that view.

90. In the 2009 report (paragraphs 6.182 to 6.184), we found that there was a point-of-sale advantage for retail PPI but that it was likely to be weaker than for other forms of PPI for two reasons. First, retail PPI is a tertiary product, so its customers were less likely to believe that their ability to purchase goods on credit is dependent on them taking out PPI. Secondly, because retail PPI is advertised in the same catalogues as the goods being purchased and sold alongside other insurance products, its customers were more likely to be aware of PPI before the point of sale than with other PPI policies. These factors suggested that the need for a POSP to be included as part of any remedy package was lower for retail PPI than for other forms of PPI.

91. We further noted that this remedy was likely to add substantially to the costs of our package of remedies for retail PPI. While we thought that more customers might be prompted to search as a result of the POSP, in light of the GfK research we did not think that the increase in consumer search would be sufficient to justify the additional costs involved.

92. In summary, new evidence about customer behaviour meant that we could not be confident that such a remedy package would be substantially effective for retail PPI. In the light of this new evidence and taking into account its likely costs, we concluded that introducing a POSP was unlikely to generate a sufficient increase in competition to justify its inclusion in the remedy package for retail PPI. For these reasons, and as

set out in paragraphs 89 to 91, we have decided not to impose the POSP in relation to retail PPI.

Obligation to renew retail PPI policies annually on an opt-in basis

93. In our 2010 Retail Remedies Notice, we considered the option of requiring customers to opt in to a retail PPI policy every year, with their cover being discontinued if they did not do so. The rationale for the remedy was that it might increase the competitive pressure on distributors, by creating an annual break in retail PPI policies and giving customers better-defined opportunities to switch.

Views of the parties

94. The retail PPI distributors opposed this remedy option strongly. Each raised similar concerns: that the remedy risked leaving many customers uninsured as they may not understand properly any mailings about the opt-in; that the remedy would be expensive as the distributors would incur significant telephone costs to ensure that customers needed to opt in if they wanted to renew; if a customer had developed a condition during the previous 12 months, this could be taken into consideration at renewal and result in the customer paying higher premiums. However, the OFT said that the opt-in should help to limit renewal to customers who actually believed they required PPI and would create pressure on the existing distributor and provider to promote PPI products along with an opportunity for stand-alone PPI providers to propose an alternative. The FSA said that it believed the opt-in would encourage customers actively to consider the benefits and costs of their retail PPI policy annually but the benefits must be balanced against the potential for customers inadvertently to become unprotected. Citizens Advice said that the opt-in might provide a long-stop safeguard to customer inertia, meaning customers paid too much for unwanted insurance products.

Our views

95. The parties were not able to provide specific costing information for this remedy option. However, we thought that the associated costs would be significantly above the costs of sending an annual review to all active customers (see Appendix S) because of the additional costs in seeking to contact those customers who had not renewed, and dealing with any customer complaints about inadvertent lapses in cover.

96. We thought that this remedy might encourage some retail PPI customers to reconsider their PPI coverage when they were prompted to opt in and some of these customers might then be prompted to switch to alternative providers. However, we had concerns about the effectiveness of this remedy in generating competition, as set out in paragraphs 8.53 to 8.57 and Appendix O. These concerns applied equally to retail PPI as to other forms of PPI. We also agreed with the parties' submissions that there would be a risk of consumer detriment arising where customers inadvertently fail to renew their policy and subsequently finding that they are uninsured when a claimable event occurs. The cost of the remedy would also be high. We have therefore decided not to impose this remedy for retail PPI.

Price caps

97. In our 2010 Retail Remedies Notice, we discussed the option of imposing a price cap on retail PPI providers. We noted that PPI prices were higher than in a competitive

market and there was a risk that the other remedies may not be substantially effective or act sufficiently quickly on their own in addressing the identified AEC and resulting detrimental effects. Therefore we explored whether a price cap could bring prices closer to competitive levels or do so more rapidly, directly reducing consumer detriment, while other measures took effect.

Views of the parties

98. SDGFS said that a price cap was not justified or necessary and would be disproportionate. SDGFS argued that there was a waterbed effect which would mean that a price cap would lead to the loss of relevant customer benefits (see paragraph 9.28).[15] It said that individual price caps would be required for each product and each provider (because each had a different business model), price caps would distort competition, would not encourage customers to shop around and would impede the development of short-term IP policies. SDGFS told us that it would be prepared to relaunch its unbundled PPI product at a lower price and undertake to maintain this price reduction for a maximum of two years subject to enforced material changes.

99. JD Williams said that price caps were unnecessary and would lead to a significant loss of consumer benefit, particularly for poorer and older customers who might not be offered PPI as a result. It said that the price cap could not take into account all relevant factors, would not be effective or workable, and would stifle innovation. Express Gifts also said that price caps were disproportionate since the premiums paid by retail PPI customers were low. It believed that they would stifle entry, innovation and products would become very similar.

100. FGH believed that there was little justification for price capping since retail PPI customers were not charged excessive amounts. It said that there was a waterbed effect and that the credit price might increase or other features might be withdrawn. It said that a price cap would stifle innovation and policies might move towards the lowest common denominator or provide less cover, making the market unattractive to new entrants.

101. The OFT thought price caps would be unlikely to contribute to a lasting solution through increased competition or to make the market work better. The FSA was also concerned that price caps did not directly address the competition concerns or lead to dynamic benefits. However, it said that price caps might provide the only sure way of reducing prices. Citizens Advice strongly supported price caps and said that only a remedy that directly addressed the consumer detriment was likely to be effective.

102. In the 2009 report, we rejected price caps on the basis that we considered that our remedy package would be substantially effective in addressing the AEC in a timely manner (see paragraph 10.373 of the 2009 report). This remains our view in relation to other PPI markets. In relation to retail PPI, we considered carefully whether a price cap directly to address the consumer detriment associated with high retail PPI prices would be an appropriate measure, either on a temporary or a permanent basis.

[15]SDGFS told us that a waterbed effect was more likely with a price cap than with competition-enhancing measures. This was because with competition-enhancing measures there would be a possibility that it could win as well as lose business as a result of the remedies, whereas with a price cap there would be an automatic negative impact on profitability of retail PPI, which it would seek to recover elsewhere.

Our views

103. We thought that there were some significant practical obstacles to developing an effective price cap in relation to retail PPI. First, as merchandise cover is outside our terms of reference, we thought that any cap would have to apply to the unbundled product. While we have some indication from parties of the proportion of GWP accounted for by merchandise cover (see paragraph 6.16 of the 2009 report), we thought that it would be difficult to set a price cap for a product that either does not exist or, in the case of SDGFS, has only been recently introduced. Second, we agreed with the parties that differences between retail PPI providers would make it difficult to apply a market-wide price cap. For example, the proportion of GWP merchandise cover accounts for differs substantially across providers (see paragraph 6.16 of the 2009 report). This suggests that different caps would be necessary for the unbundled product. We also thought that the variations in scale across retail PPI providers—in terms both of the total GWP and GWP per active customer (see paragraph 6.8 of the 2009 report)—were likely to mean that any market-wide cap could have substantially different impacts on the viability of different providers' retail PPI businesses. This could result either in the price cap being ineffective (if set at a level which allowed less profitable providers to earn normal returns) or, if set at a level which reduced the more profitable providers' profitability levels to normal returns, could result in some providers being unable to operate profitably, distorting the market. In principle, we could regulate profits rather than the PPI price; however, we consider that the cost and degree of scrutiny necessary for rate of return regulation was likely to be disproportionate to the likely benefits.

104. We also considered whether we should cap the price of SDGFS only, particularly in light of the offer from SDGFS to undertake to cap the price of its unbundled product. However, we were concerned with the monitoring cost and proportionality of imposing a price cap on just one provider, particularly where we had not found material differences in competitive conditions facing the various providers in retail PPI markets.

105. For the reasons set out in paragraphs 102 to 104, we have decided not to impose a price cap.

Application of monthly cost for every £100 monthly benefit metric to retail PPI

1. In this appendix, we set out how we propose that the monthly cost for every £100 monthly benefit price metric should be applied to retail PPI. The application of this metric to retail PPI would depend on the type of credit account that was offered.

2. Where a retail credit provider offers a running credit account facility that operates in a similar way to a credit card account, the calculation of this metric is a relatively straightforward matter.

3. This is because both the monthly cost of PPI and the monthly ASU benefit are both typically calculated as a fixed percentage of the outstanding balance. This means that the monthly cost for every £100 monthly benefit (which is the basis on which the price of CCPPI is displayed on the moneymadeclear website (see paragraph 10.217 of the 2009 report)) is also a constant amount.

4. In this situation, the calculation of price as a monthly cost for every £100 monthly benefit is illustrated in the following example. The PPI policy in this case pays out up to 12 monthly payments.

TABLE 1 **Example of calculation of monthly cost for every £100 monthly benefit for a 'credit card' type of account**

			Notes
	Details of PPI policy		
A	% of balance repaid monthly in event of valid ASU claim	8.33%	1/12 of outstanding balance
B	Maximum number of months covered by ASU claim	12	Balance paid off in 1 year
C	Retail PPI price as cost for every £100 outstanding balance	£1.98	
	Illustrative example		
D	Outstanding balance	£100.00	
E	Monthly cost of PPI	£1.98	Equals C * D
F	Monthly benefit if customer makes valid ASU claim	£8.33	Equals A * D
G	Monthly cost for every £100 monthly benefit	£23.76	Equals E * 100/F

5. Where the cost of credit is embedded in the price of the goods and customers pay for the goods and the credit over a fixed period (eg 52 weeks) and the monthly ASU benefit is equal to the monthly credit repayment, we propose that the metric be calculated using the following approach.

TABLE 2 **Illustrative calculation of monthly cost for every £100 monthly benefit: embedded credit**

			Notes
Details of credit			
A	Total amount payable	£100.00	
B	Number of monthly repayments	12	
C	Amount of monthly repayments	£8.33	Per month
Details of PPI			
D	Retail PPI price as cost for every £100 outstanding balance	£1.98	
E	Monthly cost of PPI	£1.98	In first month
F	Monthly benefit if customer makes valid ASU claim	£8.33	Equals C
G	Maximum number of months covered by ASU claim	12	In first month
H	Monthly cost for every £100 monthly benefit	£23.76	Equals E* 100/F

6. This approach produces the same estimate of monthly cost for every £100 monthly benefit as for an equivalent PPI policy on a 'credit card' style account, which therefore provides an appropriate basis for comparison. It is worth noting that the monthly cost of the PPI will decline during the term of an embedded credit purchase, as the number of months for which the customer would be covered, in the event of a claim, also reduces.

7. The price of PPI measured in this way may vary according to the timescale over which the goods are bought. This is because the monthly repayment—and hence the monthly benefit—will be higher if the goods are bought over a shorter period.

8. Where it is not possible to use a single price to communicate the cost of PPI to every customer who sees an advertisement, we propose that retail PPI providers can fulfil their obligations under this element of the remedy package by quoting this price in relation to a typical situation (eg the most frequently-offered credit terms or an average based on the relative weighting of different credit terms), providing they comply with ICOBS and other rules governing financial promotions (see paragraph 10.214 of the 2009 report).

Templates for personal PPI quotes and annual reviews

[Name]
[Address Line 1]
[Address Line 2]
[Address Line 3]
[Address Line 4]
[Postcode]

Reference [x]
Date [x]

Logo

Quote for Optional Payment Protection Insurance on your Home Shopping Account

This form gives you information about how much this insurance will cost

Things you should know about Optional Payment Protection Insurance

Taking out this Insurance is optional and does not increase your chances of obtaining credit.

Cheaper or more appropriate cover may be available from other providers. You can compare product features and costs using the Consumer Financial Education Body's comparison tables at **www.moneymadeclear.org.uk/tables/bespoke/PPI**.

Payment Protection Insurance is not the only product designed to protect you against loss of your income. For impartial information about insurance, please visit the website at: **www.moneymadeclear.org.uk/products/insurance/insurance.html**.

Further details of cover, including any significant exclusions and limitations, are in the attached policy summary.

Payment Protection Insurance quote

Type of cover included

Life	[Repays outstanding balance up to a maximum of £10,000]
Accident & Sickness	[Repays 10% of your outstanding balance for up to 6 months in any claim]
Unemployment	[Repays 10% of your outstanding balance for up to 6 months in any claim]
[Other]	[Not included]

Cost of Payment Protection Insurance cover

Illustrative annual cost of Payment Protection Insurance (based on a typical outstanding balance of £300)	£[xxx]
Illustrative monthly cost of Payment Protection Insurance (based on a typical outstanding balance of £300)	£[xxx]
Monthly cost of Payment Protection Insurance for every £100 outstanding balance covered	£[xxx]

We have calculated a **combined APR** to illustrate the cost of taking the credit and Payment Protection Insurance together. Comparing this measure with the APR of the credit alone gives an indication of the additional cost of Payment Protection Insurance over a period.

Combined APR (credit and Payment Protection Insurance)	[xx]%

We have calculated the cost of our Payment Protection Insurance as a **monthly cost for every £100 of monthly benefit below**. This number explains how much this insurance costs you each month for every £100 in benefit that you would receive each month if you made a successful claim for accident, sickness or unemployment. For example, if the number is £5 this means that for every £5 that you pay as a monthly premium, you will get £100 for each [full] month that the claim lasts [less the excess period on the policy]. This number can be used to make comparisons with the cost of insurance from other providers. You should also compare the cover offered and the way in which benefits are paid out.

Monthly cost of Payment Protection Insurance for every £100 of monthly benefit	£[xxx]

The credit on which this quote is based

Credit limit	£[xxx]
Annual Percentage Rate of Charge (APR)	[xx]%

Cancellation rights
You can cancel your Payment Protection Insurance at any time [by providing [X] days' notice]. To cancel, call [xxx xxxx xxxx] or write to [Customer Services at [X]]. There is no charge for cancellation.

For general enquiries, please call: [xxx xxxx xxxx].

[Name]
[Address Line 1]
[Address Line 2]
[Address Line 3]
[Address Line 4]
[Postcode]

Reference [x]
Date [x]

Logo

Annual Review of Optional Payment Protection Insurance on your Home Shopping Account

This form gives you information about how much this insurance has cost for the past year

Things you should know about your Optional Payment Protection Insurance

Taking out this Insurance is optional and does not increase your chances of obtaining credit.

Cheaper or more appropriate cover may be available from other providers. You can compare product features and costs using the Consumer Financial Education Body's comparison tables at **www.moneymadeclear.org.uk/tables/bespoke/PPI**.

Payment Protection Insurance is not the only product designed to protect you against loss of your income. For impartial information about insurance, please visit the website at: **www.moneymadeclear.org.uk/products/insurance/insurance.html**.

Further details of cover, including any exclusions and limitations, are in the attached policy summary. You should check this form to make sure that all the recorded details are correct, otherwise your insurance cover may be affected.

Payment Protection Insurance cover

Type of cover included

Life	[Repays outstanding balance up to a maximum of £10,000]
Accident & Sickness	[Repays 10% of your outstanding balance for up to 6 months in any claim]
Unemployment	[Repays 10% of your outstanding balance for up to 6 months in any claim]
[Other]	[Not included]
We have recorded your current employment status as	[Employed 16+ hours a week]
We have recorded your current age as	[Age]

Cost of Payment Protection Insurance cover

Annual cost of Payment Protection Insurance in past year	£[xxx]
Average monthly cost of Payment Protection Insurance in past year	£[xxx]
Average monthly cost of Payment Protection Insurance for every £100 outstanding balance covered	£[xxx]

We have calculated the cost of our Payment Protection Insurance as a **monthly cost for every £100 of monthly benefit below**. This number explains how much this insurance costs you each month for every £100 in benefit that you would receive each month if you made a successful claim for accident, sickness or unemployment. For example, if the number is £5 this means that for every £5 that you pay as a monthly premium, you will get £100 for each [full] month that the claim lasts [less the excess period on the policy]. This number can be used to make comparisons with the cost of insurance from other providers. You should also compare the cover offered and the way in which benefits are paid out.

Monthly cost of Payment Protection Insurance for every £100 of monthly benefit	£[xxx]

The credit protected by this cover

Credit limit, as at the date of this annual review	£[xxx]
Average outstanding balance in past year	£[xxx]

Cancellation rights

You can cancel your Payment Protection Insurance at any time [by providing [X] days' notice]. To cancel, call [xxx xxxx xxxx] or write to [Customer Services at [X]]. There is no charge for cancellation.
For general enquiries, please call: [xxx xxxx xxxx].

Framework for the assessment of remedies and relevant customer benefits

1. Having identified a set of features of the markets for the supply of retail PPI in the UK that give rise to an AEC, the CC has a duty to consider what, if any, action should be taken to remedy the adverse effect and resulting customer detriment. As well as taking action itself, the CC may recommend that action be taken by others.

2. The CC is required by the Act[1] 'in particular to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition'. Such detrimental effects may affect existing or future customers and must be in the form of higher prices, lower quality, less choice or less innovation in relation to goods or services in any UK market (whether or not in the market to which the feature or features concerned relate).[2] As noted in its guidance *Market Investigation References: Competition Commission Guidelines, CC3* (paragraph 4.9): 'when deciding what is an appropriate remedy, the Commission will consider the effectiveness of different remedies and their associated costs and will have regard to the principle of proportionality'.

3. *CC3* makes several general observations about factors relevant to its consideration of effectiveness (*CC3*, paragraph 4.13 et seq):

   (a) first, the CC will 'consider whether it is possible to devise a remedy that is both clear and not overly intrusive in its regulation of a firm's behaviour';

   (b) second, in considering its effectiveness, the CC will consider the prospects of a particular remedy being implemented and complied with; and

   (c) a third relevant consideration is the timescale within which the effects of any remedial action will occur.[3]

   The CC will take full account of the OFT's functions in terms of monitoring remedies and regulating the consumer credit market (*CC3*, paragraph 4.15). Other factors may also be relevant to the CC's consideration of effectiveness, depending on the facts of the case.

4. The guidance also makes the following points regarding proportionality. In considering whether a remedy is reasonable and practicable, the CC will consider the cost associated with implementing the remedy (*CC3*, paragraph 4.10). The CC will endeavour to minimize any ongoing compliance costs to the parties, subject to the effectiveness of the remedy not being reduced (*CC3*, paragraph 4.12). However, the CC will balance those costs against the benefit to the UK economy and to customers in particular. In 'choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is the least restrictive' (*CC3*, paragraph 4.10).

[1] Section 134(6).
[2] Section 134(5).
[3] The guidance says (*CC3,* paragraph 4.23) that 'if the remedy is not likely to have speedy results, the Commission may choose an alternative remedy or implement additional remedies such as those to remedy the detrimental effects on customers during the interim period. Otherwise, not only might there be uncertainty as to whether the effects would ever materialise, but in the meantime customers would continue to suffer from the consequences of the adverse effects on competition'.

5. Other relevant points in the guidance outline what remedies can address, and the likelihood of remedial action in a market in which the CC finds an AEC. The CC 'will seek to implement (or recommend) remedies that address the cause of the problem, it may also choose to address the detrimental effect on customers in addition or as an alternative' (*CC3*, paragraph 4.6). However, the CC is prevented from taking action to address future (rather than existing) detrimental effects on customers if it is not also remedying the AEC (section 138(6) of the Act). Although it remains an option, 'it is unlikely that the Commission, having decided that there is an AEC, will decide that there is no case for remedial action, at least before it has given attention to any relevant customer benefits that may accrue from the market features'.

6. In deciding on appropriate remedies, we may also have regard to the effects of any remedial action on any relevant customer benefits arising from the adverse feature or features of the market concerned.[4] Such benefits comprise lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature(s) concerned relate) or greater innovation in relation to such goods and services. To qualify as a relevant customer benefit within the meaning of section 134(8), we must believe that the benefit has accrued as a result (whether wholly or partly) of the feature(s) concerned, or may be expected to so accrue within a reasonable period and that the benefit would be unlikely to accrue without the relevant feature or features.

7. If the CC is satisfied that there are relevant customer benefits deriving from a market feature, the CC will consider whether to modify the remedy that it might otherwise have imposed or recommended. When deciding whether to modify a remedy, the CC will consider a number of factors including the size and nature of the expected benefit and how long the benefit is to be sustained (*CC3*, paragraph 4.39).

8. In general, we should seek to implement (or recommend) remedies that address the AEC, though we may also choose to address the detrimental effect on consumers (*CC3*, paragraph 4.6).[5] In our guidelines, we say that it is unlikely that, having decided that there is an AEC, we will decide that there is no case for remedial action, at least before we have given attention to any relevant customer benefits that may accrue from the market features.

[4] Section 134(7) of the Act.
[5] The CC has said (*CC3*, paragraph 4.22) that it 'will first look for a remedy that would be effective in dealing with the adverse effects on competition of the market features rather than seeking to deal with any detrimental effect on consumers'.

Implementation of remedies for retail PPI

How the remedies should be implemented

1. The CC can take remedial action in a number of ways. These are:

   (a) making an Order;[1]

   (b) accepting undertakings to stop or to take particular action 'from such persons as the CC considers appropriate';[2] or

   (c) recommending the taking of action by others.[3]

2. The CC's guidance notes that a market investigation remedy will often be most effective if it is imposed by an Order rather than sought through undertakings, due to the likely number of parties involved.[4] There are only a small number of retail PPI distributors actively selling retail PPI. However, it is possible that other retail credit providers will choose to enter or re-enter PPI markets in the future.[5] In light of this possibility, the large number of other PPI distributors active in the UK and the many common elements in the remedy package for different forms of PPI, we have provisionally decided that an Order is likely to be the most suitable means of addressing the AEC in this case. We envisage producing a single PPI Order relating to all relevant parties, incorporating variations in relation to retail PPI as appropriate.

3. We propose to make one recommendation to CFEB, that it use the information provided to it to populate its PPI price comparison tables.

The timescale for implementation

4. In the 2009 report, we decided that the following remedies should come into force within six months of the implementing Order:

   (a) information provision in marketing materials; and

   (b) information provision to third parties.

5. In the 2009 report, we decided that the following remedies should come into force within 12 months of the implementing Order:

   (a) unbundling retail PPI from merchandise cover;

   (b) personal PPI quote;

   (c) annual review; and

   (d) single-premium prohibition.

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[1]Section 161 of the Act.
[2]Section 159 of the Act.
[3]Section 134(4)(b) of the Act.
[4]*CC3*, paragraph 4.44.
[5]In this respect we noted that during the remittal, FGH restarted selling a bundled PPI product.

6. We see no reason to change our decision in relation to the timing of the introduction of any of the above measures. This would enable consistency with the approach taken in other PPI markets.

7. We have introduced the following new measure, specifically in relation to those customers who spend less than £50 in retail PPI premiums in the past 12 months:

   (e) an obligation to provide an annual reminder.

8. In light of the interaction between this measure and the annual review, we propose that this obligation be introduced to the same timescale as the annual review—ie within 12 months of the implementing Order.

9. In the 2009 report, we said that we would aim, so far as possible, to make use of the two common commencement dates each year for new legislation and regulations of 6 April and 1 October. We will aim to make use of these dates, so far as possible.

Monitoring compliance

10. Once the remedy package is implemented, it will need to be monitored under the Act by the OFT.[6]

11. In paragraphs 10.523 and 10.566 of the 2009 report, we set out our decisions about the appropriate compliance reporting regime for all PPI markets, including retail PPI. These were summarized in paragraph 10.566 of the 2009 report, the substance of which is reproduced in paragraph 12 below.

12. We concluded that the OFT's monitoring should be supported by suitably comprehensive reporting requirements. As is standard practice in our remedies orders, this shall include the OFT having an ability to obtain from any relevant person and, from time to time, any information and documents reasonably required for the purposes of enabling the OFT to monitor and review the operation of the remedies Order or any provision of the Order. In addition, we concluded that the package of compliance reporting requirements should include:

   (a) A requirement on all PPI providers with GWP above the relevant specified thresholds in paragraph 10.538 of the 2009 report[7] to provide the OFT with six-monthly compliance reports in the first two years following commencement of our remedies Order, with annual reporting thereafter. These compliance reports are to be in the format specified by the OFT and are either to be produced by an independent party or prepared by the PPI provider and subject to verification by an independent third party. In either case, each compliance report must be signed by a company director and a non-executive director.

   (b) A requirement that, subject to any additional or different requirements that the OFT may impose pursuant to its monitoring duties, the compliance report should include the information set out in Figure 10.4 of the 2009 report (ie annual GWP, split by product type; distributor penetration rates, split by product type; aggregate claims ratios, split by product type); the percentage of their PPI consumers

[6] Section 162 of the Act.

[7] In paragraph 10.538 of the 2009 report, we concluded that the largest distributors of PPI overall and of each type of PPI should report to the OFT. On this basis, we decided that, for the first year of implementation of the remedies, this obligation should apply to distributors which in 2007 achieved a total GWP of more than £30 million and/or a GWP of more than £10 million in relation to any individual type of PPI (ie PLPPI, CCPPI, MPPI, SMPPI or retail PPI). After the first year of implementation, those distributors whose GWP exceeded the above thresholds during the previous year will be obliged to provide compliance reports to the OFT.

whose credit agreement is with another distributor; the percentage of consumers who receive a firm quote who ultimately take PPI from their credit provider; and the percentage of consumers who reject PPI notwithstanding a firm quote and follow-up by the credit provider at or after the end of the seven-day prohibition; any steps taken to ensure compliance; representative samples of advertising materials, sales scripts etc; details of any incidences of non-compliance and steps taken to rectify this; details of training of staff regarding compliance; and details of their internal monitoring systems.

(c) A requirement on all PPI providers to appoint a compliance officer who has responsibility for monitoring compliance, facilitating provision of information to the OFT and acting as a point of contact at the firm if the OFT has any questions. Firms would have to notify the OFT of the identity of the compliance officer.

(d) A requirement on distributors with a total GWP of more than £10 million, but who do not meet the thresholds specified in paragraph 10.538 of the 2009 report to provide the OFT with a breakdown of GWP by product type annually.

(e) A requirement on all PPI providers with GWP above the relevant specified thresholds (see paragraph 10.538 of the 2009 report) either to provide to the OFT an annual report from an independent research agency establishing that wording used in its sales and marketing materials for PPI is easy to understand or to satisfy this verification requirement through use of customer focus groups, provided that such consumer testing is carried out by an independent and expert market research organization.

(f) A requirement that all PPI providers with total GWP above £60 million in the preceding year commission an annual, independent mystery shopping exercise and report results to the OFT within a compliance report.

13. JD Williams told us that all retail PPI companies were currently authorized and regulated by the FSA and supplied regular Retail Mediation Reports to them. These reports were self-certified and this was acceptable to the FSA. It anticipated that the costs of independent reporting would be high and suggested that retail PPI distributors should self-certify their compliance. However, we note that the nature of the information provided to the FSA will be financial in nature and much of the information will already have been audited. On balance, we felt it important for the OFT to receive independently-audited information.

14. We see no reason to change the application of this monitoring regime for retail PPI, with the exception that those reporting requirements in paragraph 12*(b)* that related specifically to the POSP[8] need not apply to retail PPI, as this remedy is not being taken forward in this sector.

[8]The percentage of consumers who receive a firm quote who ultimately take PPI from their credit provider; and the percentage of consumers who reject PPI notwithstanding a firm quote and follow-up by the credit provider at or after the end of the seven-day prohibition.

Mechanism and timescale by which we expect our remedies to deliver benefits

1. We expect our remedies to deliver increased competition and thereby benefits to retail PPI consumers through the following mechanisms.

2. First, the application of our remedies across all PPI markets will generate new opportunities for stand-alone providers, including credit arrangers offering PPI on a stand-alone basis. While we do not consider that retail PPI customers are likely to be a particular priority for stand-alone providers, this development will increase the visibility of the stand-alone market to all PPI customers, including retail PPI customers. We expect that our remedies will have an immediate impact on the constraint posed by the stand-alone sector, once all elements of the remedy package have been introduced, though this impact is likely to evolve and develop as the stand-alone sector grows and matures (see Appendix L of the remittal provisional decision).

3. Second, the remedy package includes measures aimed at facilitating consumer search when customers first take out PPI—these are the obligations to include material in marketing materials, to provide data for CFEB to use in its comparative tables, to provide a personal PPI quote, and to unbundle retail PPI from merchandise cover. These measures will assist those customers who are motivated to search to compare the products offered by retail PPI providers against alternatives. We expect these measures to start to take effect as soon as they are introduced and, in combination with the development of the stand-alone sector, to have an appreciable impact on competition within one to two years of all elements of the remedy package coming into force.

4. Third, the remedy package includes measures aimed at prompting customers to compare existing PPI policies against alternatives on a periodic basis. These are the obligation to provide an annual review to heavier users of retail PPI and to remind all customers of their cancellation rights. We would expect these measures, in combination with the development of the stand-alone sector, to have an appreciable impact on competition within two to three years of all elements of the remedy package coming into force, by which time all customers will have received either an annual review or an annual reminder.

5. Fourth, we expect the increased competitive pressure on retail PPI providers that results from the development of a stronger stand-alone market, combined with the impact of the specific remedies that we are introducing in retail PPI, to deliver some dynamic benefits—for example, increased selection pressure—within a period of two to three years. We recognize that other dynamic benefits—for example, reputational benefits—may take longer to be realized depending, in part, on the extent to which retail PPI providers engage positively with our remedies and the extent to which the results of increased competition are manifested in outcomes such as lower prices, increased cover and higher claims ratios.

6. We concluded that we would expect our remedies to deliver appreciable benefits to consumers within a period of around two to three years.

Cost of remedy package

1. The estimated costs to the two main retail PPI providers of the remedies we have selected for the retail PPI remedy package are shown in Table 1. In total, the estimated annual cost of the remedy for these two providers is in the region of £0.8 million, with implementation costs of around £1.0 million. The rationale for these figures by remedy, as well as information about the costs of alternative specifications of these measures, is shown in the paragraphs below.

TABLE 1 **Cost of remedies**

Remedy cost, £'000

	Annual cost SDGFS	*Annual cost JDW*	*Total annual cost*	*Implementation cost SDGFS*	*Implementation cost JDW*	*Total implementation cost*
Unbundling retail PPI from merchandise cover	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Information provision in marketing materials	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Information provision to third parties	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Personal PPI quote	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Annual review	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Annual reminder	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Single-premium prohibition	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	827	[✂]	[✂]	1,003

Source: Submissions from SDGFS and JD Williams.

Note: N/A = not available.

Unbundling retail PPI from merchandise cover

2. SDGFS said that, if the CC required the bundled and unbundled products to be offered to all customers over the telephone at the point of sale, the remedy would cost £[✂] annually (comprising additional call handling costs of £[✂] and an additional £[✂] cost of storing the recording of calls). However, it made an alternative proposal that would require retail PPI providers to market both the bundled and unbundled options in their catalogues and on their website but which would only require retail PPI providers to offer a customer an unbundled product over the telephone if it was requested by the customer. It said that this proposal would not entail additional costs over those it already incurred in promoting its unbundled product—providing there was flexibility in the detail of how an unbundled product was promoted.

3. JD Williams estimated that the annual cost of the remedy would be £[✂] (of which £[✂] represented additional call-handling costs) with set-up costs of £[✂] if the unbundled product was offered to all customers over the telephone at the point of sale. This would reduce to an annual cost of £[✂] and set-up costs of £[✂] for the alternative proposal only to require retail PPI providers to offer a customer an unbundled product over the telephone if it was requested by the customer.

4. We have decided to implement the SDGFS alternative proposal (see paragraph 12 of Appendix P), so have included the lower costs in Table 1.

Information provision in marketing materials

5. In Table 1, we are using the previously submitted costs from the parties for this element of the remedy package. SDGFS estimated that the annual cost would be £[✂] and JD Williams estimated an annual cost of £[✂] with £[✂] of set-up costs.

Information provision to third parties

6. SDGFS and JD Williams both suggested that the costs of the remedy would be small. SDGFS said £[✂]. JD Williams said that the annual costs would be £[✂] with minimal implementation costs.

Personal PPI quote

7. We collected information from retail PPI providers about the costs of alternative specifications of this remedy option. These alternative specifications included:

   (a) providing all new customers with a personal PPI quote as a separate mailing towards the end of the cooling-off period;

   (b) providing all new customers with a personal PPI quote as a statement insert with their first credit statement, providing that this was during the cooling-off period; and

   (c) providing all new customers with a personal PPI quote with other policy documentation sent to customers after the PPI sale.

8. The responses of SDGFS and JD Williams are shown in Table 2.

TABLE 2 **Cost of alternative ways of delivering the personal PPI quote**

£

	SDGFS annual cost	*JD Williams annual cost*	*SDGFS implementation cost*	*JD Williams implementation cost*
Solus mailing to all new PPI customers	[✂]*	[✂]	[✂]	[✂]
Statement insert	[✂]†	[✂]	[✂]	[✂]
Include with policy documents	[✂]	[✂]	[✂]	[✂]

Source: Submissions from SDGFS and JD Williams.

*Reduces to £[✂] if Internet sales customers receive the information by email.
†Reduces to £[✂] if Internet sales customers receive the information by email.
Note: N/A = not available.

9. In Table 1, we have used the cost for the two largest parties to include the information with policy documents, which appears to be the cheapest option and also the approach that these parties are most likely to pursue.

10. We also obtained some information about the cost of providing a personal PPI quote from FGH and Express Gifts:

   (a) FGH told us that the set-up cost for a solus mailing for 8,000 new customers would be £[✂], with annual ongoing costs of £[✂]. For a combined mailing, which was its preferred option, the set-up cost would be £[✂] with an annual ongoing cost of £[✂].

(b) Express Gifts does not currently offer a PPI product, but told us that the cost of a solus mailing worked out at [✂]p per mailing, whereas if the personal PPI quote was included with the other policy documentation it would only add approximately [✂]p to its existing costs.

Annual review

11. We asked SDGFS and JD Williams to provide estimates of the cost of providing an annual review under various assumptions, relating both to the number of customers the annual review is sent to and whether we require the annual review to be sent as a solus mailing or whether we relax the requirement in the 2009 report and allow the annual review to be sent alongside information about the credit, such as the monthly credit statement. These are detailed in Table 3.

TABLE 3 **Cost of alternative specification of obligation to provide an annual review**

		£
	SDGFS	*JD Williams*
Solus mailing		
Cost of solus mailing to all customers	[✂]	[✂]
Cost of solus mailing to customers who have paid PPI premiums over £50 in 2009	[✂]	[✂]
As above, to customers who have paid over £100	[✂]	[✂]
In addition, set-up costs for the three options above of	[✂]	[✂]
*Insert to monthly statement**		
Sent to all customers	[✂]†‡	[✂]
Sent to customers paying over £50 a year	[✂]	[✂]
Sent to customers paying over £100 a year	[✂]	[✂]
In addition, set-up costs for the three options above of	[✂]	[✂]

Source: Submissions from SDGFS and JD Williams.

*SDGFS told us that it would not be possible to include the annual statement with the monthly statement. This option would therefore only be suitable where the annual review mailing was generic (ie did not contain personal information) and could simply be inserted into the same envelope as the customer's monthly statement.
†The costs for SDGFS are based on the cost of providing a generic statement on the assumption that personalized information could be included elsewhere (eg as an additional statement page or in the body of the credit statement).
‡SDGFS said that an insert would have to replace existing marketing material (as there was a limit on the weight of the envelopes it could mail) and there would be an opportunity cost for this.

12. For the option of including the annual review as an insert in the monthly credit statement, SDGFS said that there were systems constraints that meant it was not operationally possible to match up a separate personalized insert with a customer's monthly statement and to include these in the same mailing to the customer. SDGFS said that generic information could be sent in the insert and additional personalized information could be sent as a solus mailing and/or added to the monthly credit statement. The figures presented above are based on the cost of providing a generic statement as a statement insert, including the opportunity cost. JD Williams said that there were issues around the Consumer Credit Directive that meant that it was unlikely to be possible to add other personalized information to the customer's monthly statement, but said that it would be possible to send the information as a statement insert and provided the costs on this basis in Table 3.

13. For SDGFS, while the set-up costs of £[✂] are the same irrespective of the number of customers to whom an annual review is sent, the ongoing costs of sending the annual review as a solus mailing are in direct proportion to the number of customers in the mailing.

14. JD Williams provided us with a more detailed breakdown of how it had arrived at its estimates. This was as follows:

(a) The basic mailing cost is £[✂] per customer.

(b) JD Williams then assumed that some 20 per cent of the customers mailed would enquire about the information that had been sent. We note that this response rate is higher than JD Williams' usual response rate to a mailing of around 10 to 15 per cent. It said that it assumed a higher response rate because the annual review would be unexpected. The cost of responding to each inquiry was estimated by it to be £[✂].

(c) JD Williams also assumes that 6 per cent of customers will require their details to be amended, at a further cost of £[✂] for each amendment. It explained that the amendments would be required where the information held on the customer was wrong. It suggested that examples would be where the customer's date of birth, the statement start date or the employment status of the customer were wrong. Where an amendment was made, JD Williams assumed that the cost of a confirmation letter mailed to the customer would be £[✂] each.

15. The level of responses assumed in paragraph 14*(b)* appeared to us to be somewhat high, although we recognize that there is an element of judgement in evaluating the likely volume of calls that will be prompted by receipt of an annual review. We do not consider the costs in paragraph 14*(c)* above, which again appeared to us to be somewhat high, to be a relevant cost of the remedy, since the costs are primarily caused by JD Williams holding incorrect or out-of-date information about its retail PPI customers. We thought that keeping accurate customer records was a normal cost of doing business for a PPI provider. If these costs are excluded, the estimated costs for solus mailings would fall by 56 per cent and the estimated costs for statement inserts would fall by 72 per cent.

16. Taking both providers together, requiring an annual review to be sent only to customers who had spent £50 on retail PPI in the past year (around one-third of active customers) would reduce ongoing costs by around two-thirds compared with sending the annual review to all customers. If the annual review were only sent to customers who had spent £100 on retail PPI in the past year (around one-fifth of active customers), this would reduce ongoing costs by around four-fifths. SDGFS also said that it might be able to reduce the annual costs of this and other informational remedies if it was able to use its secure electronic 'My Account' facility to deliver messages to consumers.

17. We explored with the two largest providers how the costs and likely impact of the remedy were affected by alternative specifications of the remedy. Key points are:

(a) The annual review is the more costly of the two measures in terms of ongoing costs. This is unsurprising, given that the annual review involves the disclosure of more information and includes product and customer-specific information.

(b) Significant reductions in the ongoing cost of the annual review measure could be achieved by sending an annual review only to customers who meet a certain specification. Taking both SDGFS and JD Williams together, requiring an annual review to be sent only to customers who had spent £50 on retail PPI in the past year (around one-third of active customers) would reduce ongoing costs by around two-thirds compared with sending the annual review to all customers. If the annual review were sent only to customers who had spent £100 on retail PPI in the past year (around one-fifth of active customers), this would reduce ongoing costs by around four-fifths.

(c) Allowing providers to deliver these messages to consumers electronically, where this is requested by customers, would enable further reductions in ongoing costs.

(d) In general, the cost of including information with credit statements is lower than sending annual reviews or annual reminders as single-item (or 'solus') mailings. For example, for JD Williams, the additional costs associated with a single-item mailing compared with a statement insert were in the region of 25 to 30 per cent, on the assumption that the annual review was sent only to higher-spending customers of retail PPI. However, SDGFS told us that there were also opportunity costs and practical difficulties associated with including annual reviews as inserts with credit statements because its operating systems did not allow it to match up a personalized insert with a customer's monthly statement (see Appendix P, paragraph 64).

18. We asked SDGFS and JD Williams to provide a breakdown of the number of customers and the value of those customers in terms of PPI expenditure. This data is presented in Figure 1 and shows that while there are a large number of customers that buy only small amounts of PPI, there is a significant tail of customers, so that 20 per cent of active customers pay around two-thirds per cent of total premiums and 10 per cent of active customers pay around half of total premiums. FGH provided information that also showed that while there are a large number of customers that spend small amounts on PPI, there is a significant tail of higher-spending customers accounting for a substantial proportion of total premiums paid.[1]

FIGURE 1

SDGFS and JD Williams customers: volume and value of customers by annual PPI spend

[✂]

Source: CC analysis of parties' submissions.

19. We asked SDGFS and JD Williams for evidence relating to the effectiveness of statement inserts and single-item (solus) mailings. SDGFS said that open rates (ie the proportion of correspondence that is opened by customers) were significantly lower for direct mail than for statements, and presented customer research that supported this view.[2] However, it also noted that conversion rates for single-item mailings were generally higher, because selling by direct mail allowed for more flexibility and it was possible to provide more product content in a single-item mailing compared with a statement insert. JD Williams showed us some analysis which it said showed that it generally got higher response rates to marketing leaflets included with monthly statements than those sent as single-item mailings (although the marketing material sent was different in the two cases), and that regular users were more likely to respond to statement inserts than less frequent users.

20. We have decided that the annual review should only be sent to customers who had spent more than £50 on retail PPI in the preceding year and that the annual statement should not be included alongside credit statements or other credit information (see paragraphs 70 and 78 of Appendix P). Therefore we have assumed in Table 1

[1]In this case, [✂] per cent of customers pay [✂] of total premiums and [✂] per cent of customers pay [✂] of total premiums. FGH told us that the information that it had submitted to us was a snapshot of one month's activity and that customer balances fluctuated over time to coincide with spending activity. We acknowledge these caveats but, unlike FGH, we consider that the information provided to us by FGH gives a reasonable indication of the distribution of premiums across the customer base.
[2]SDGFS provided a slide from a 2009 customer research programme carried out by Illuminas for the SDG Home Shopping Business.

that SDGFS costs would be £[✂]. We have adjusted the cost JD Williams specified of £[✂] by removal of the customer amendments items (detailed in paragraph 14*(c)*), to give an updated annual cost for JD Williams of £[✂].

Annual reminder

21. SDGFS said that the implementation costs for this remedy would be £[✂]. The cost if the messages were printed on the statement would be small. However, SDGFS said that if an additional page were required for the reminder, the cost would increase because of opportunity costs of not being able to include other information in the mailing. We have adopted a conservative approach, and assumed that an additional page would be required. SDGFS told us that the cost of mailing an annual review as a statement insert to all customers would be £[✂] and the cost of mailing customers with a PPI spend of over £50 would be £[✂] (see Table 3). Therefore, we have conservatively assumed the cost of sending an annual reminder only to customers who have spent less than £50 on retail PPI would be £[✂] a year (ie £[✂] minus £[✂]).

22. JD Williams said that the annual cost of providing an annual reminder of key messages with customers' credit statements would be £[✂], with implementation costs of £[✂].

Prohibition on selling of single-premium PPI policies

23. Both parties have said that this remedy would not have any practical implementations for retail PPI, therefore we have assumed zero cost for the remedy.

Glossary

2009 report	*Market Investigation into Payment Protection Insurance,* Competition Commission, 29 January 2009.
A	Accident cover.
ABI	Association of British Insurers.
Accent	Accent, a market research company. Conducted the Consumer attitudes to Payment Protection Insurance customer survey on behalf of the **CC** in January 2010.
Act	Enterprise Act 2002.
Adverse selection	Sometimes referred to as anti-selection, adverse selection occurs as a result of information asymmetries between the insurer and the customer. Customers who know that they face a large risk of needing to make a claim on an insurance policy are more likely to take out insurance than those who face small risks; however, the insurer does not know which customers fall into which category and so cannot price its insurance **premium** accordingly.
Advised sale	Sale by an adviser or intermediary who makes a personal recommendation to the customer.
AEC	Adverse effect on competition.
Annual premium	Annual amount payable under a contract of insurance by the policyholder to the insurer.
APR	Annual percentage rate.
ASU	Insurance cover limited to accident, sickness and unemployment.
BBA	British Bankers' Association.
BII	Barclays Income Insurance.
BMRB	BMRB, a market research company. Conducted the **PPI** customer survey on behalf of the **CC** in October and November 2007.
Broker	A party that arranges, for commission, a contract between a buyer and a seller.
CC	Competition Commission.
CCPPI	Credit card **PPI**.
CFEB	Consumer Financial Education Body.
CI	Critical illness insurance. A contract where an insurer makes a lump-sum cash payment if the policyholder is diagnosed with one of the critical illnesses listed on the insurance policy and survives a minimum number of days (the 'survival period') from the date the illness was first diagnosed.

Citizens Advice	A registered charity which assists people in resolving legal and financial problems. The body responsible for the **super-complaint** to the **OFT**.
Claims ratio	Claims payable as a percentage of **premium** income, specifically calculated as: the sum of claims paid, net of reinsurance, and the change in provision for claims, net of reinsurance, divided by net **premium**s earned.
CML	Council of Mortgage Lenders.
Credit arrangers	**Distributor**s and **intermediaries** arranging credit.
Credit provider	Natural or legal person who grants or promises to grant credit in the course of his trade, business or profession.
Credit score	Each lender has its own credit-scoring system which is used to assess creditworthiness. Points are awarded to information provided on the application form (including time spent in current job, other loans or outstanding debts) and recorded on the applicant's credit report (which the lender purchases from a credit reference agency). This process helps the lender decide whether to give credit, what credit limit to set and what interest rate to charge. If the total score does not reach the lender's pass mark, the lender may turn down the credit application, offer to lend a smaller amount, or charge a higher rate of interest. People with a high credit score usually gain easy access to credit on good terms. Lenders sometimes refer to them as 'prime' customers. People with a low credit score tend not have access to mainstream credit facilities. This is usually because of damaged credit histories (which may include adverse County Court judgments, bankruptcy or poor credit repayment histories). Lenders sometimes refer to customers with low credit scores as 'sub-prime' or 'non-standard'.
Distributor	A company which sells **PPI** alongside its own credit product.
Exclusion period	The specified number of days between when a policy was purchased and when the customer can make a claim.
FLA	Finance and Leasing Association.
FOS	Financial Ombudsman Service.
FSA	Financial Services Authority. Independent non-governmental body which regulates the financial services industry in the UK.
GfK NOP	GfK NOP, a market research company. Conducted the **PPI** customer survey on behalf of the **CC** in February and March 2008 and the **retail PPI** customer survey on behalf of the **CC** in March 2010.
GWP	Gross written **premium**. The total amount of **premium** a customer is required to pay for an insurance policy written during the year; the total amount of **premium**s expected to be received by an **underwriter** over the life of the policy. This figure is expressed before deductions (ie gross) of reinsurance. This contrasts with premium earned, the amount of premium that a company has

earned by providing insurance against various risks during the year.

H Hospitalization cover.

ICOB Insurance Conduct of Business. A set of rules produced by the **FSA** which were replaced by *Insurance: New Conduct of Business Sourcebook* (ICOBS) in January 2008.

ICOBS *Insurance: New Conduct of Business Sourcebook*. A set of rules produced by the **FSA** for the conduct of insurance business.

IFA Independent financial adviser. A professional who offers unbiased advice on financial matters to their clients and recommends suitable financial products from the whole of the market.

Impairment A charge to a lender's profit and loss account in relation to outstanding loans (including mortgages and balances outstanding on credit cards) to customers. The charge forms part of bad debt expense. As defined in 'IFRS 9—Impairment of Assets', it is calculated as the amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.

Income Protection Income protection insurance. Provides protection in the event that one has to provide care for a spouse, partner, parent or child full time; hospitalization; accident; sickness (disability); and involuntary unemployment.

Insurer See **underwriter**.

Intermediary A third party through whom consumers identify a suitable type of **PPI** policy, whether with or without an associated credit product. Examples of intermediaries are **broker**s and **IFA**s. **Price comparison website**s are not **intermediaries** for the purposes of this report.

IPT Insurance **premium** tax.

Judgment Competition Appeal Tribunal judgment published 16 October 2009.

L Life cover. Insurance cover which pays out if the insured person dies.

LA Life assurance. Insurance paid to named beneficiaries when the insured person dies.

Marketing materials Include communications of a promotional nature in a form easily read by a customer or a potential customer.

Merchandise cover Insurance for the purpose of protecting the goods purchased, usually against loss or damage. Also known as purchase protection insurance.

Modelling consultation **PPI** remittal consultation document on the modelling approach, 4 March 2010.

MPPI	First-charge mortgage **PPI**.
Non-advised sale	A sale where no personal recommendation as to the suitability of the product is made to the customer.
OFT	Office of Fair Trading.
Overall consultation	PPI Remittal: The Competition Commission's approach to reconsidering the point-of-sale prohibition as part of its remedies package, 11 December 2009.
PA	Personal accident insurance.
Penetration rate	The proportion of customers taking out the underlying credit product who also take out **PPI**.
Personal accident insurance	Provides a lump sum in the event of an accident which results in permanent loss of limbs or permanent disability within the term of the policy. Some policies also include life insurance and hospitalization cover.
PLPPI	Unsecured personal loan **PPI**.
Point of sale	The point at which credit is sold to the consumer.
POSP	Point-of-sale prohibition.
PPI	Payment protection insurance. Insurance for the purpose of protecting a borrower's ability to maintain credit repayments in the event that the borrower becomes unable to maintain the repayments due to accident and/or sickness and/or unemployment and, under some policies, death.
PPI providers	**Distributors**, **intermediaries** and stand-alone providers which distribute **PPI** policies.
Premium	The amount paid or payable, often in instalments, for an insurance policy. Can be paid as an **annual premium**, **single premium** or **regular premium**.
Price comparison website	A person or organization which, as its primary business, gathers and presents to consumers and potential consumers price and/or non-price information about financial products from many different providers in order that consumers can compare the price and/or non-price features to determine which product would be suitable for their needs. A price comparison site may provide a means for consumers to contact the providers of the financial products in order to conclude a contract, but does not sell its own financial products to the consumer.
Regular premium	A series of payments of the premium made on a continuing basis and at regular intervals, usually monthly, over the term of the **PPI** policy.
Retail credit/retail finance	Any kind of loan, deferment of repayment of any loan or of interest on any loan, guarantee or indemnity, and any other kind of accommodation or facility in the nature of credit granted to a natural

person not acting in the course of a trade, business or profession. Includes non-car hire purchase and catalogue purchases. Excludes store cards.

Retail PPI	**PPI** which insures repayment of a retail credit account.
S	Sickness cover.
Short-term IP	Short-term income protection. A contract of insurance which provides a pre-agreed amount paid directly to the policyholder in the event that the policyholder experiences involuntary unemployment or incapacity as a result of accident or sickness and which: *(a)* is written for a term which is less than five years and not pre-determined by any term of the credit; and *(b)* can be terminated by the **insurer**; and *(c)* is not exempt from **IPT**.
Single premium	A single payment, made up front, whereby the insurer is paid the full price for taking out a **PPI** policy in one lump sum (as opposed to receiving a **regular premium** each month).
SMPPI	Second-charge mortgage or secured loan **PPI**.
Stand-alone PPI	**PPI** that is not sold alongside an underlying credit product.
Stand-alone provider	A company which provides stand-alone **PPI**.
Super-complaint	As defined in section 11(1) of the **Act**, a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. **Citizens Advice** is a designated consumer body for the purposes of section 11 of the **Act**. In this capacity, **Citizens Advice** made a super-complaint about **PPI** to the **OFT** which led to this investigation into the **PPI** market.
Take-up rate	Proportion of loans sold with **PPI** to total loans, either by volume (number) or value.
Tribunal	Competition Appeal Tribunal.
U	Unemployment cover.
Underwriter	A company which provides insurance, agreeing to take responsibility for paying certain costs in specified circumstances.
Waterbed effect	Where firms make profits in secondary markets, and prices in the primary market affect sales of secondary products, firms have an incentive to discount the price of their primary market products in order to increase sales of the secondary product. This is known as a waterbed effect.

Glossary of company names

Abbey	Formerly Abbey National plc, now part of the **Santander** Group.
Alliance & Leicester	Formerly Alliance & Leicester plc, now part of the **Santander** Group.
Aviva	Aviva plc.
AXA	AXA UK plc.
Barclays	Barclays Bank PLC.
British Insurance	British Insurance Ltd.
Capital One	Capital One Bank Europe plc.
Cardif Pinnacle	Pinnacle Insurance plc.
Cattles	Cattles plc.
Churchill	Churchill Insurance Company Ltd.
Co-operative Bank	Subsidiary of Co-operative Financial Services (CFS).
CYB	Clydesdale and Yorkshire Bank, part of the National Australia Group.
Egg	Egg Banking plc.
Express Gifts	Express Gifts Ltd.
FGH	Freemans Grattan Holdings, formerly known as **Otto**.
Genworth	Genworth Financial Inc.
GMAC	GMAC Insurance.
HBOS	HBOS plc.
HSBC	HSBC Bank plc.
JD Williams	JD Williams & Company Limited.
LBG	Lloyds Banking Group plc.
Legal & General	Legal & General Group plc; includes Legal & General Mortgages and Legal & General Partnership Services Ltd.
Lloyds TSB	Lloyds TSB Group plc, renamed Lloyds Banking Group plc on 19 January 2009, following the acquisition of HBOS plc.
London General Insurance	London General Insurance Company Limited.
MBNA	MBNA Europe Bank Ltd.

Nationwide	Nationwide Building Society.
NHI Services Ltd	NHI Services Ltd.
Northern Rock	Northern Rock plc.
Otto	Otto UK Home Shopping Group of Companies.
Paymentcare	Paymentcare Ltd.
Paymentshield	Paymentshield Ltd.
POFS	Post Office Financial Services.
Prudential	Prudential plc.
RBSG	The Royal Bank of Scotland Group.
Santander	Santander Group, owner of **Alliance & Leicester** and **Abbey**.
SDGFS	Shop Direct Group Financial Services.