

Response from the Association of Finance Brokers to OFT PPI market study – emerging issues

Introduction

This response is submitted by the Association of Finance Brokers (AFB). AFB is the trade association representing intermediaries operating in the secured loan industry. Our members arrange payment protection insurance (PPI) for their customers alongside secured loans.

We are pleased that OFT has chosen to remain in close dialogue with the industry throughout the progress of the market study. The publication of this paper allows the industry to consider the issues identified and respond accordingly.

In addition to this written response, we would also refer to our informal discussions with OFT during the market study, in particular those surrounding the role of the intermediary and the sales process for PPI in the secured loans market.

We have restricted our comments in this response only to those areas where we feel we can usefully contribute in terms of the effects on our members and their customers.

We are also pleased to see that OFT has identified and separated the different PPI markets by way of the type of credit the contracts are sold alongside. This is reflective of the different sales processes and issues within each market. However, we do have some concerns over the terminology used to describe the different distribution channels within each of these markets, and the lack of sector-specific data. To achieve the best outcome for consumers, it is important to pinpoint where concerns exist within each part of the market.

The use of the term 'distributor' in this report appears to refer to both client-facing intermediaries and lenders who distribute PPI either directly to consumers or through tied agents. In the secured loans market each of these distribution channels have different issues to address and it would be helpful for the industry if the findings of the study could be presented in a manner which would identify to which distribution channels these are applicable.

It would also be helpful for the industry if the issues could be identified in terms of the two different types of sales processes for PPI: advised and non-advised. There may be instances where specific issues (either of a regulatory nature or otherwise) are only applicable or are more detrimental to consumers during only one of the two sales processes. Identifying the issues in this manner could also feed more meaningfully into the Financial Services Authority review of the insurance regulatory regime in the UK, of which PPI will be part.

Product design issues

Currently, most PPI policies sold alongside secured loans bundle together different elements of cover, such as accident, sickness and unemployment, or unemployment and hospitalisation. Bundling PPI in this way can disadvantage consumers where they are not eligible to claim on certain elements of the policy. For instance, some unemployment benefits will not be available to the self-employed or contract workers. Unbundling these elements would allow consumers to choose the most appropriate payment protection cover based on their needs, circumstances and preferences.

Claims data

The market and consumers would benefit from greater information on claims. There is a lack of availability of such data for PPI within the intermediary community. For example, it would be helpful for both consumers and intermediaries to have better information about the most common reasons for which claims are rejected and accepted. This information can then be used to feed into customer-facing product literature to deliver greater transparency and clarity for consumers when considering PPI.

High commission rates, PPI prices and 'cross subsidy'

The report highlights cross-subsidy as an issue. We accept that this exists in the market and that changes need to be made in this area. Whilst we acknowledge the rationale behind de-linking PPI from the loan, there needs to be careful consideration of the complex issues involved. AFB is willing to play a full and active part in any discussions on this issue as it is of primary concern to our members. We need to ensure that any move towards de-linking is beneficial for consumers and practicable and workable for the industry.

Whilst secured loans continue to be linked to a particular PPI contract (either explicitly, or implicitly by the commercial terms offered to intermediaries from lenders) the commissions earned through PPI contracts will continue to help support the cost of the advice received by consumers from intermediaries on secured loans. Whilst we understand the principles of de-linking, it is important to recognise that this would lead to a change in remuneration structures for intermediary firms who offer secured loans. How this would ultimately affect consumers will depend on the commercial terms which lenders are prepared to offer to secured loan intermediaries and customers in a de-linked market. For example, a possible impact is that intermediaries may have to charge higher fees to provide the same level of service, and/or loan interest rates offered to consumers may increase.

Whilst PPI continues to be linked to secured loans, there will be little competitive price pressure on PPI contracts in this market. Whilst de-linked market would serve to increase pressure on providers to deliver PPI contracts which are competitively priced, we must also recognise that de-linking needs careful consideration and has disadvantages.

Transparency

In the secured loan market, there are also issues of transparency, both for intermediaries and consumers. The work involved in arranging a secured loan means that the upfront costs are significant for intermediaries. Consumers will not necessarily be aware of these costs or that they are incurred regardless of whether or not the transaction completes. Greater transparency of services and charges will help address the issues of cross-subsidy and high commission rates for PPI.

PPI is sold and not bought

PPI products can play a useful role in sustainable home ownership, by assisting borrowers through short-term financial difficulties incurred through illness or unemployment. The reputation of PPI has been damaged by the recent adverse publicity surrounding the product, leading to a reduction in consumer confidence in PPI. This imbalance needs to be addressed. Consumers need access to PPI products which they can have confidence in, both in terms of the sales and claims handling processes.

The perception amongst consumers that it is difficult to make a successful claim on PPI contracts needs addressing. Clearer information on claims could be used in product literature to help manage customer's expectations and improve their understanding of the nature of the cover provided.

Portability of contracts

We are aware that consumers encounter difficulties where they wish to switch the provider of the associated credit and take their PPI contract with them.

Headline APR rates

The report indicates that OFT believe this issue to be common-place. The credit advertising rules address this issue by requiring a typical APR to be displayed under certain circumstances. OFT has published guidance on compliance with the regulations, and the industry would benefit if this was more widely promoted, particularly amongst smaller firms, and more easily accessible in terms of the positioning of the material within the OFT website and communication to all firms holding a consumer credit licence.

For the advertising regulations to deliver a successful outcome, the market must be effectively policed. Where a breach of these regulations has occurred, consideration must be given to the use of enforcement powers where appropriate and communicating the outcome of such enforcement action to the industry.

PPI automatically included in quotes

The statistics included in this report do not refer to the secured lending industry, however we would still like to comment. As PPI can offer valuable protection, consumers benefit from an awareness of the product. Where appropriate, customers should be provided with comparable quotes, both with and without the cost of PPI.

Consumer perception that taking out PPI helps the application for credit

The FSA's ICOB rules require firms to disclose whether PPI is compulsory on the statement of price document. It is unclear from the report whether this is an issue of non-compliance with these rules or whether the rules are not effective in this market.

Lack of competitive pressure from alternative products

Other protection products available are not directly comparable to PPI. Income protection is given as an example, however this does not generally provide unemployment benefits and the monthly premium costs are significantly more than PPI.

Those who are older, have impaired health, or are in a higher risk occupations, will generally be subject to increased premiums. Other protection products are usually subject to medical underwriting at outset of the contract, and there is often a time-delay in putting the protection in place. The cost of underwriting does lead to increased premiums on these products when compared to PPI. That said, there are advantages to individual underwriting before the policy is put on risk – the customer has a greater level of certainty over the outcome of a claim. It may be that providers of PPI would wish to consider offering an up-front underwriting model to help build consumer confidence through greater certainty of successful claims.

The effect of the internet

Whilst the internet can be a useful research tool, when consumers come to purchase financial products they often choose to rely on the services of a professional. The intermediary market has taken advantage of the internet as a way of attracting and informing consumers, whilst recognising that most consumers greatly value face-to-face advice when they reach the final purchase stage.