



Association of Finance Brokers

Response to the OFT report on the market study of payment protection insurance

This response is submitted on behalf of the Association of Finance Brokers (AFB). AFB is the trade association representing intermediaries operating in the secured loan industry. In the secured personal loans market, intermediaries are by far the largest distribution channel – in 2004, intermediaries were responsible for approximately £3 billion of the £4.6 billion advanced. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel of lenders to meet the individual consumer's loan requirements. Our members also provide access to associated protection products such as payment protection insurance.

We welcome the opportunity to comment on the proposed decision to refer the payment protection insurance market to the Competition Commission for a market investigation. We have restricted our comments to those areas which we did not discuss in detail in our response to the 'emerging issues' paper, and those areas where we feel it may be useful for us to provide further details at the present time.

We share the OFT's concerns about how consumers buy PPI, their understanding of the product, and the quality of information available to them. We are keen to see that the PPI market works for consumers and delivers good value products which are supported by good quality product literature.

The changing face of the secured loans market

The secured loans market has experienced rapid growth over recent years. Intermediaries have fuelled competition and new lenders are entering the market, offering more innovative and flexible loan products. The wide choice of products available has led to a greater demand from consumers to access the services of intermediaries who act on their behalf in sourcing the most suitable loan product to meet consumer's individual needs.

PPI in the secured loans market

Historically, secured loans have been particularly attractive to consumers who have an adverse credit history, or those who are looking to consolidate unsecured debt in order to reduce their monthly outgoings. Many consumers with an adverse credit history will use a secured loan to consolidate debts or raise further monies. A secured loan can provide additional borrowing in a way which does not jeopardise the interest rate previously obtained on their first-charge mortgage prior to experiencing financial difficulties or other circumstances which have led to an adverse credit history.

PPI exists to support the consumer in being able to meet loan repayments in the event of their losing their primary source of income. Consumers who are securing previously unsecured debt, or who have experienced financial difficulties in the past will often wish to

use PPI to ensure that their home is not placed at risk in the event of unemployment or sickness. Purchasing PPI by way of single premium has been beneficial for those consumers who wish to fix the price of their cover, and/or those who do not wish to have the additional worry of maintaining premiums for PPI on a monthly basis. Many single premium PPI policies which are currently available in the secured loans market also contain additional benefits such as life insurance and/or hospitalisation benefits.

Single premium contracts have been preferred over regular premiums by many consumers and lenders. This is because the protection is guaranteed and it eradicates the risk that customers might cancel their regular contract if finances come under pressure but before arriving at the point where they can claim. E.g. reduced income from loss of overtime prior to redundancy. The use of single premiums and control over the benefits has also given lenders some comfort that their bad debt ratios will be mitigated. This has the consequence of keeping loan interest rates relatively low.

Barriers to consumer choice for single premium PPI in the secured loan market

The legislative requirements of the Consumer Credit Act have led to unintended consequences for consumers who choose to purchase single premium PPI. Lenders in the secured loan market are restricted by the effects of Section 75 of the Consumer Credit Act 1974. These provisions make a lender liable for breaches of contract or misrepresentation in relation to PPI contracts where they are funded by the proceeds of the loan. A lender can mitigate its liability under these provisions by retaining control over the suppliers of any single premium PPI contract which is to be funded by the loan proceeds, and therefore, to some extent, satisfy themselves that the supplier will act in a way which reduces the risks of a liability under Section 75. This creates a barrier to secured loan consumers who wish to shop around for single premium PPI and impacts on the ability of the intermediary to act independently of the lender in recommending a PPI provider.

Pricing of PPI

The pricing of PPI is to a large extent controlled by the insurer and any distributors involved in the chain between the insurer and the consumer. In the secured loans market, most PPI sold is linked to the associated loan product, due to the restraints caused by Section 75. Whilst the intermediary may receive a commission for the sale of PPI, the lender in conjunction with the insurer is responsible for the pricing of the contract. Intermediaries in the secured loan market do not have a direct influence on the cost of single premium PPI arranged alongside the loan or the ability to seek out better terms for their customers on single premium products.

The high penetration levels of single premium PPI, in combination with the barriers to choice created by Section 75, have led to cross-subsidy in the secured loan market. Premiums for single premium PPI are used by some lenders to reduce the interest rate charged on secured loans, therefore consumers who choose not to purchase PPI have the cost of their loans subsidised by those who choose to take PPI. Whilst this might be seen by some as unfair, the cost of the loan and the interest rate offered is clear to the consumer.

Delivering good value for consumers

In order for PPI products to provide good value for consumers, they must deliver the expected cover at a competitive price. The AFB acknowledges that there appears to be a

wide variation in the price being charged for what appears to be similar cover and supports greater transparency. Consumer's understanding of the cover provided by PPI can be raised through the improvement of product literature, such as policy summaries and policy documents. Better claims information would enable customers to put the cover offered by PPI into context: for instance, claims data could be used on policy summaries to demonstrate the most frequent reasons for claims and under what circumstances claims are likely to be declined. This level of transparency would further improve a consumer's ability to make an informed decision when purchasing PPI.

We are concerned that declining PPI penetration rates could increase bad debt levels and therefore the number of repossessions. A further negative impact would be the possibility of lenders increasing interest rates to compensate, thereby disadvantaging all consumers.

Consumer education

The increasing volume and value of secured loans being taken out via an intermediary shows that consumers greatly value the services of intermediaries in the secured loans market. Intermediaries are able to use their market knowledge to compare loans and PPI products and provide information and advice. We are working with other industry trade bodies to further aid consumer understanding through the development of a guide which is designed to help consumers make informed decisions on PPI early on in the buying process.

Product design

We support the undertakings made by some insurers regarding proportionate refunds for customers who cancel single premium PPI before the end of the contract. We would like to see these undertakings become standard industry practice.

As we discussed in our response to the emerging issues paper, we feel that consumers would benefit from unbundling of PPI products, enabling them to purchase those elements of cover which best suit their needs and circumstances.

Management Information

The industry and consumers would benefit from the publication of data on PPI. We would like FSA to publish the data it collects through its regulatory reporting requirements, such as sales and complaints data for PPI. We would also be pleased to see insurers publish more information about PPI claims, in particular the most common reasons which claims are denied and accepted. This data can be used to improve consumer confidence and identify and analyse trends and risks.

AFB View

Progress has been seen since the first FSA thematic review to improve refunds, enhance product literature, review sales scripts and increase levels of training and monitoring to ensure adherence to agreed procedures. New consumer guides are being produced. Product manufacturers are beginning to introduce revised types of PPI product.

A referral to the Competition Commission has the potential to slow this innovation as the manufacturing side of the industry stops to await publication of the result. Change needs to

be driven by the insurers and lenders as in the current market the intermediary can have limited influence on product design and pricing. However, we acknowledge the issues from a consumer perspective and endorse the need for change.

Resolution of the CCA Section 75 issues would be helpful as we believe there are circumstances where single premium PPI is appropriate for certain consumers.

We do not believe the referral is helpful at this point and consider that the industry can make the necessary advances under the supervision of the FSA and the OFT.