Association of Finance Brokers' response to CP10/6 - The assessment and redress of payment protection insurance complaints

The Association of Finance Brokers (AFB) is the trade association that represents intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Membership of the AFB is voluntary and on a corporate basis.

AFB was established to promote the views of secured loans brokers operating in the UK. We seek to raise standards in our sector in order to better meet the needs of consumers and build confidence in the industry. Our aim is to work constructively with the Treasury, the Office of Fair Trading (OFT), as well as the FSA, the government and EU policymakers. In doing so, we aim to promote the interests of the industry in a constructive way that connects regulators and policymakers with the "front line" of the secured loans market.

AFB welcomes the opportunity to respond to FSA's consultation paper on the assessment and redress of payment protection insurance complaints

Introduction

This submission should be considered in conjunction with AFB's presentation to FSA, which took place on 14 April 2010. The AFB Board is grateful for the opportunity afforded by the FSA to allow industry representatives to personally present their views. This submission is made in addition to those already made on this subject.

FSA needs to take note of the fundamental differences between the secured loan sales process and other loan processes and their associated PPI transactions. The current Consultation Paper does not sufficiently differentiate between these markets and as a result a sub-optimal outcome is threatened. This will bring about a competitive distortion in the marketplace which has not been considered and the resulting guidance should be reviewed accordingly. Failure to do so will result in significant consumer detriment.

New challenges

<u>The secured loan sales process</u>

The secured loan process is distinctly different from other loan sales processes. The secured loans sales process provides significantly more consumer protection than other loan processes, the level of disclosure is far greater, with extensive documentation being provided to consumers, and this provides certainly more documentation than most other PPI transactions (such as for unsecured or credit cards sales). Unsecured sales in vertically integrated firms are effectively a one

stage sales process whereby the consumer would exit the transaction with the sales process completed.

We do not believe that FSA's proposals have been developed in full cognisance of greater legal protections offered to consumers in the secured loans market. Secured loan sales are required, under the Consumer Credit Act 1974, to provide a consideration period to the consumer. In these sales the consumer receives effectively two 8 day consideration periods to review the documentation, and consider the sales process and products that they had discussed. They are able to contact the business within this period with any questions about the product. The business is forbidden from contacting the consumer direct themselves. The very reason for OFT implementing a consideration period was to remove the potential for high pressure loan sales taking place, and provide the key benefit of the customer having periods to consider the PPI offered. The consequence of this is that the average time to process a secured loan application, from start to finish is 40 days.

Furthermore, before the payment takes place it is industry practice for lenders to undertake a security call with the consumer to clarify that they understood the transaction was being completed, ascertaining that they knew they were taking out PPI and understood this, before releasing the funds.

We do not believe these differences in process, the greater consumer protection afforded and the resulting consumer awareness of the products bought, have been fully taken into consideration by FSA in its previous work. The very set up of the secured loans sales process is fundamentally different to other PPI transactions.

We would be deeply concerned if FSA were to cluster together secured and unsecured lending into a common-market view. The differences between these markets are significant and failure to address their differences, through appropriate regulatory action, would be anti-competitive.

<u>Acting within regulatory principles and under supervision</u>

AFB member firms were visited in the period 2005 to 2008 as part of FSA's thematic reviews and ARROW visits. These reviews resulted in FSA reviewing the products offered and the sales processes followed. Whilst there were FSA thematic reports issued, the follow-up letters to individual firms gave them comfort that the FSA was allowing these firms to continue selling single premium PPI under their existing sales processes.

It is clear that AFB members firms were regarded by their supervisors as acting within both the prevailing regulatory rules and according to the FSA's principles. We are greatly concerned that for FSA to now take a different view exposes firms to retrospective regulation which is entirely at odds with previous statements and the principles of good regulation. No industry can support regulation that is inconsistent and it is of the gravest concern that FSA now seems to be introducing hindsight regulation.

AFB member firms were concerned about the product construction of some secured loan and PPI products, so much so that they raised these concerns with both FSA and the individual lenders. However, although these concerns were raised, both FSA and the major lenders did not find sufficient problems with the products to withdraw them, alter their construction, or require broker firms to materially change their sales processes or require remedial action.

In addition it is material that brokers were raising concerns with the lenders who were responsible for manufacturing and marketing their own single premium PPI products. The brokers received assurances from these organisations that, as subsidiaries of large bank lenders, they were better resourced to have conducted full and appropriate due diligence on their products and so the brokers fears were mis-placed. The lenders' opinion was that their product was compliant and capable of being sold in support of the loans they were offering. These major lenders were clear that their product was appropriate and suitable and was approved through their product approval and compliance processes. It was inappropriate for small intermediary firms to question their compliance judgements.

The lender in funding the premium and being manufacturer of the product, was always fully aware of the borrower's circumstances, both personal and financial. As regulated firms they must have responsibility under the FSA principles of acting with integrity and treating customers fairly. FSA's comments on responsible lending were well known through this period and so this gave intermediaries further comfort that the lending organisations were acting in good faith.

In addition to this broker firms were being targeted on PPI cross-sale penetration rates as this both protected the risk element of the lenders book and provided them with the profitability required on this product to support the depressed interest rates being offered – as fact acknowledged by the Competition Commission in its review of the industry.

Broking firms wanting to reduce their exposure to risk in this market would have suffered from the risk of first mover detriment and they would undoubtedly have been subject to sanction by the lender community through the likely withdrawal of agencies and therefore this would have been commercially impossible for any executive proposing that in a broking firm.

In that AFB member firms were tied in to agency contracts with lenders and these agencies were based on minimum penetration rates for PPI sales being achieved. We consider that in undertaking its work in this market, FSA would have been aware of the way in which these sales relationships were set up but they did not find it sufficient of an issue to raise it with AFB member firms or with the lenders, so far as we are aware.

The influence of FOS data on FSA guidance

FOS data has been fundamental in not only generating FSA's review of PPI complaint handling and redress but also in contributing to FSA's own conclusions in the review. However, the reasons for FOS' decision on cases does not seem to have been sufficiently investigated by FSA. Instead FSA has relied on simply the basic statistical information that has been submitted.

FOS has consistently overturned our member's decisions on cases, on what are effectively product related issues. AFB members have rarely lost cases based on sale related complaints.

The majority of our members sold secured loans that were either redeemed or refinanced within three to four years of them being sold. As such it is unreasonable and unfair for FOS to simply look at the term of the loan and compare it to the term of the PPI product. This is the case as the loan was often structured over an extended term to assist consumer cash flow and as a result of assessing affordability. What needs to be considered is not only the demands and needs of the consumer but also the general term that these secured loans are generally held for. This is a significantly material difference to other parts of the loan and/or PPI landscape, which we consider has not been adequately reflected in considerations to date.

FOS' overturn rates have significantly changed on two separate occasions in the period 2005 to 2009. This resulted in member's complaint overturn rates significantly increasing. However, this is contrary to what should be expected. During the period under review, the PPI product itself had not changed in its key components, risks and exclusions. Little was done in improving product literature. However, we would expect that as complaints occurred, businesses would have reviewed their sales standards and applied any remedies to their sales processes. However, the increase in overturn rates would imply that the standard of sales decreased rather then increased. This seems unlikely and AFB member firms have shown that this is not the case. FSA reviewed and provided positive commentary on their sales process during ARROW and PPI thematic visits. What is more likely to be the case is that a fundamental change occurred at FOS in the way in which it considered and reviewed complaints. It appears that in response to the increasing number of complaints it was receiving, the FOS sought to take a different approach as it learned more, particularly about the nature of activity in the unsecured and credit card markets. This increase in complaint numbers was directly in relation to growing Claims Management Company (CMC) activity within the sector.

The shift in FOS' approach in considering these cases effectively made it impossible for CMCs to lose the cases they brought to FOS. This led to the cyclical effect of more CMCs actively pushing more cases to FOS. Thereby creating more PPI complaints, increasing FOS's workload and complaints data.

<u>The combined loan and PPI product design</u>

FSA has given little consideration to the design of these products. These products were designed to be a combined loan and PPI product. PPI being sold in conjunction with the loan product allowed lower interest rates to be applied to these loans. The pressure that lenders placed on intermediaries to make combined loan and PPI sales to consumers has not been addressed by FSA. Where an intermediary objected to such sales targets and penetration rates being placed upon them, or refuse to make PPI sales, they would have quickly seen their agencies removed. From a commercial prospective such a decision would not have been viable for most AFB members and given that both FSA and lenders dispelled AFB members concerns about the PPI product, members proceeded in the belief that they were in a regulatory safe harbour.

Lenders and insurers were responsible for the design of these products and this should be considered by FSA when applying its guidance to the industry. In line with FSA's principles on firms acting with integrity the organisations through the value chain should be accountable for the products failings. It is unfair that the lender who has been fully responsible of the decision to lend the money and fund the premium for their won product takes no responsibility for the sale. AFB considers that the FSA should provide clear guidance that lenders should be fully considered in complaints in order to ascertain if they were complicit in any fault. Additionally, in arriving at any consumer compensation, the parties should pay in proportion to the benefit they received from the sale of the product. It is not good regulation to allow those who have benefited from a transaction that should not have taken place to profit.

Desired outcomes

1. Give due recognition to the fact that the secured loan market is different to the unsecured market. AFB would be delighted to work with FSA to identify a workable solution that is practical, recognising the differences between the sectors and supports the regulator's objectives, while ensuring the competitive balance within the market. We recommend that secured loan brokers are removed from the current consultation process and we work with FSA to provide more appropriate guidance for this sector of the industry. Secured loan and PPI sale processes are so very different to the unsecured and credit card PPI sales processes and therefore requires another approach.

2. The complex design of these combined loan and PPI products should result in lenders and insurers being proportionally responsible for their contribution to this flawed product coming to market.

Lenders and insurers should contribute to the compensation bill in a proportionate manner. The differences in the intermediated sales process should be acknowledged in FSA guidance. Brokers have not benefited from the full premiums in the same way as those in a vertically intergraded firm. FSA current guidance does not take into account BERR's Regulators' Compliance Code. Which state that:

- *3.2 Regulators should keep under review their regulatory activities and interventions with a view to considering the extent to which it would be appropriate to remove or reduce the regulatory burdens they impose.*

- *3.3 Regulators should consider the impact that their regulatory interventions may have on small regulated entities, using reasonable endeavours to ensure that the burdens of their interventions fall fairly and proportionately on such entities, by giving consideration to the size of the regulated entities and the nature of their activities.*

As such, the redress guidance should acknowledge that if an intermediated sale is shown to be mis-sold then all those responsible in the value chain for bringing the product to market should proportionately contribute to the redress.

Guidance for the secured loan sector also needs to more closely reflect that, whilst there may have been elements of a policy that were not appropriate, the nature of the secured loan sales process makes it likely that the customer was aware of the product and its benefits and is now complaining as a result of proactive activity by CMC's, not a self motivated concern over their product. Accordingly, a more proportionate approach to redress based on the customer's actual complaint, not general misgivings over the product construction would be appropriate.

<u>Other considerations</u>

Some member firms are considering joint/individual legal action should secured loan brokers be required to carry out the current requirements as set out in CP10/06.

The current proposals in CP10/6 could put all secured loan brokers that sold single premium payment protection insurance out of business and limit access to compensation for legitimate complainants. The compensation route through FSCS is significantly more difficult than through an operating firm and then through FOS, if required. It could also serve to bring any that do survive further financial distress through compensation scheme cost allocation.

AFB
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