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The Inquiry Secretary (PPI market inquiry)
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Dear Sirs,

We are writing in response to your request for evidence regarding your investigation into the supply of payment protection insurance (PPI) in the UK.

We are qualified to comment on this topic because we are an independent business consultancy that specialises in retail financial services and our directors have relevant, long and wide experience of the market. The directors have, in the past, held responsibility for unsecured, secured and mortgage lending and the associated insurance in The Woolwich and subsequently Barclays Bank and more recently in a specialist sub prime secured lender. We have also completed several assignments for clients on the regulatory aspects of PPI in the last twelve months. On this basis we believe that we are able to provide an informed but independent view.

Summary

Our evidence comprises both observations and matters which we feel need careful thought and consideration, away from some of the current emotive publicity in the media. It is highly likely that you will receive many submissions on the topics of pricing, commissions and eligibility so we have restricted our submission to subjects other than these. We would however be more than happy to give our views on these areas if they would be of value to you.

Underlying premise

We have based all of our comments on the fundamental premise that protection of the ability to repay personal liabilities when financial circumstances change adversely, in the majority of cases, constitutes good financial advice.

The sales process

The recent actions by the FSA have highlighted that some distributors have not been following a sales process for PPI which treats customers fairly. These failures include not clearly offering customers a choice on whether to take out PPI when applying for a loan or mortgage. They also included failures to identify customer needs with exclusions meaning that a claim under a policy would be invalid. At times there is a fine line between making a strong recommendation to customers and giving them the impression that there is no choice other than to take the PPI cover and we agree with the view that some distributors have at times gone over that line.

The sales process is presumably a matter for the FSA but we feel that your work may cover the issues of choice available to customers at the point of sale. Whilst we agree that opening up competition in this market is laudable, our concern is that many customers view PPI cover as an option on their borrowing facility. By offering them too many options they are likely to consider the product as being too complex and decide that it is simpler for them not to take any cover at all.

We believe that your deliberations should be against the backdrop of the following:

- In response to customer demand and growing use of technology application processes for unsecured, secured or mortgage borrowing are being simplified and commoditised and these markets are very competitive,
- Increased complexity in the PPI element of the overall sales process as a result of increasing choice may not be perceived as customer friendly and could have the very unfortunate outcome of reducing PPI take up for the wrong reasons (as described above),
- Generally, obtaining credit is merely a route to acquisition of a personal asset – such as a home or car
- Lenders and brokers sell PPI because they sell loans and/or mortgages. Our experience and instinct tell us that very few borrowers would think to buy PPI

on a standalone basis. We believe that there is a parallel here to products such as stain protection for upholstered furniture where retailers tend to offer one option and purchases are usually made at the point of sale.

Market integration

Some lenders buy products from the wholesale PPI market. They have the opportunity to select best of breed products for their borrowers, if they wish, albeit that there may be fixed term, exclusive distribution arrangements with risk carriers which will limit choice during the term of the distribution agreement.

We contrast this with vertically integrated bank assurance type arrangements – often supported by an offshore captive insurance company. We find it difficult to see that there is an opportunity for any realistic benchmarking against best of breed in these circumstances, particularly in respect of policy terms and pricing.

We firmly believe that market features and controls differ between these two groups and that your work should recognise these important differences. We think greater danger lies in selling self manufactured policies on an exclusive basis, one of the chief reasons being that there is less opportunity to externally benchmark product offerings. We believe that offering insurance through captive insurers is not conducive to the effective operation of competition in the UK PPI market.

Single premium products

The media appears to have taken against the concept of single premium PPI. In itself the concept is sound and we believe that problems have arisen due to product design and operation – these products have not always offered the most appropriate period of cover and have been inflexible should the insured need to amend or cancel the cover.

Our experience of the sub prime mortgages and loans market has shown that single premium products are very appropriate for particular borrower types – namely those who have irregular cash flows where mortgage/loan repayments are erratic and therefore the likelihood of maintaining regular monthly premiums for the cover is low and the propensity for lapse is high. Furthermore, there is the important point that taking out cover for a specified period of years locks in certainty in terms of cover,

terms and price. We would therefore not agree with the populist view that single premium PPI is per se a bad product.

For unsecured loans the term of the PPI policy is usually matched to the contractual term of the loan – at least for loans with a contractual duration of up to 5 years. However for secured loans the PPI cover is usually for a period of 5 years (though this can vary) which bears little relationship to either the contractual life of the loan or to the experience life of the loan. We would argue that one feature of single premium product design should be that the PPI cover should be related to the likely experience life of the loan rather than for an arbitrary period. We have borrowed the term ‘experience life’ from the insurance industry and use it to mean the actual term of the loan or mortgage rather than its contractual term. Increased competition in the loans and mortgages markets has reduced experience lives but we have seen only limited evidence of any change to the term covered for single premium PPI policies. This has been further affected because of the inflexibility of insurers when the loans/mortgages covered by the PPI policy terminate early and before the end of the PPI cover period and generally no pro rata refund of premiums is forthcoming.

We are aware that at least one lender has developed a hybrid product which combines the features of single premium and monthly premium PPI. This is a development that should be encouraged if there is to be any intervention in the market. We believe that several major PPI carriers have looked at this product as an option.

Other factors to consider

There are three further factors that we believe you should consider where inquiring into the market.

Firstly it is current custom and practice for the benefits under a PPI policy to be assigned to the lender who has arranged the cover. Whilst it could be argued that borrowers can be trusted to make payments to the lender in the event that they have a successful claim on their PPI policy, direct payment to the lender does remove any temptation to divert the benefits away from repaying the loan or mortgage. In addition, any mortgage interest benefits payable by the Department of Work and Pensions are paid directly to a lender rather than via the borrower. We would therefore argue that there is a need for consistency. A whole of market approach to

PPI will make the initial arrangement of assignment much more difficult, if not impossible, and is likely to add significantly to lenders costs. In turn these extra costs are likely to be passed on to customers in the form of higher interest rates or application fees. Furthermore, failure to assign could create the situation where borrowers in arrears get further into arrears should PPI claim benefits not be applied to the mortgage/loan for which they were intended, thus defeating the rationale for taking out the cover in the first place.

We also feel that many of the media comments about poor value are being made against the background of a benign economic environment. Claims experience should be looked at over a reasonable economic cycle. We do not believe that short term comparison of claims experience between different general insurance products is very helpful either for the purposes of understanding market dynamics or for aiding customer insight/understanding.

Finally we believe that a strong relationship between a lender and a PPI insurer can benefit claimants. There is the benefit that a strong relationship between the distributor and insurer can secure good terms through buying power. Additionally, in the right circumstances, the lender/distributor can use its negotiating strength to support a consistent approach to claims overall or support a claim individually. We see this feature being diluted, or possibly disappearing altogether, if there is a whole of market approach. By 'whole of market' we mean that the products are offered from all possible suppliers or from a panel substantially covering all product options.

Conclusion

We believe that the case for or against the effect of competition in the PPI market as it stands is not a clear cut as the media would have us believe and that other important factors should be considered. There is however the opportunity for the products to be made more transparent for the man on the street who is less financially sophisticated.

We deplore the assumptive sales techniques which do not offer the 'no cover' option when taking out a loan but equally we do believe that the underlying need to cover against unforeseen financial disaster is sound financial planning. On this basis the making of strong recommendations, in the right circumstances, is good financial advice. We have explained the issues as far as imposing a whole of market

requirement on distributors is concerned but we are worried about lenders who arrange PPI exclusively through captive insurers. This reduces the opportunity for best of breed to emerge.

We have not commented on pricing, commission levels or eligibility criteria. We do feel that there is scope for retail pricing to fall and for commissions to take some of this strain. However we can see dangers in using other general insurance markets as benchmarks – not least because the PPI market has been operating in a benign economic environment and should there be a shock to the system the risk carriers should have the financial strength to both satisfy valid claims and have the incentive to continue trading in the market. Certainly we would not envisage similar systemic shocks in either the motor or buildings insurance markets.

We do hope you have found this submission useful and would be happy to either amplify the points made or discuss the topic further.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Simon Woolcott', written in a cursive style.

Simon Woolcott - BA (Hons) FCMA

Director

on behalf of the directors of Marchwood Associates Limited