

## The Protection Racket: Turning the screw on the pedlars of payment protection insurance

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One of the most starkly visible developments during 2008 has been the regulatory attention given to the sale of Payment Protection Insurance ("PPI"). Of the total fines imposed by the Financial Services Authority (the "FSA") in 2008, the £10 million derived from PPI cases, including the blockbuster £7 million fine imposed on Alliance & Leicester, comprised the largest proportion.

The FSA is not the only regulator with PPI in its sights. The Competition Commission (the "Commission") recently announced a package of measures designed to inject competition into the PPI industry, including a ban on selling PPI within seven days of the sale of a credit product. These measures will be brought into force by October 2010.

This article looks at the continuing menace of PPI mis-selling, the FSA's enforcement crackdown, and the legislative changes introduced by the Commission. Finally, we set out a checklist of issues that firms should turn their minds to when selling PPI.

### The persistency of the PPI problem

Since 14 January 2005 the FSA has regulated the sale and administration of non-investment insurance policies, including PPI policies. Upon taking on this responsibility, the FSA quickly initiated a thematic review of PPI. This resulted in the FSA's identification and heavy criticism of PPI mis-selling in its reports in November 2005,<sup>1</sup> October 2006,<sup>2</sup> and September 2007.<sup>3</sup>

Has four years of regulation and thematic review by the FSA made a difference to PPI selling practices? If it has, then the effects have yet to become clearly visible. Its latest report sets out the results of its "mystery shopper" exercise, and its disappointment at what it has seen. It has identified continuing routine and systematic malpractice in a number of dimensions of the PPI sales process. The FSA's main

concern was general reliance by firms on documentation to explain costs and exclusions, and a failure to provide an oral explanation of these. Specifically:

- 1 Very few customers were informed orally that the cost of the PPI would be added to the loan as a single premium and that interest would be charged on the premium;
- 2 Only half of the customers were informed orally about the key limitations and exclusions of the PPI; and
- 3 Many customers were not informed orally of the monthly and total cost of their PPI. At the worst performing firms, very few customers were given adequate information on the cost of their policy.<sup>4</sup>

The FSA is understandably concerned that despite its hard work in recent years, the fines that it has imposed, and the press coverage that the topic has received, there is still a widespread PPI mis-selling problem. Consequently, the FSA has now announced that it is "escalating" its regulatory intervention in the area, although what form that intervention will take is not yet clear.

It is not just the FSA that has identified the continuing nature of the problem. In response to a complaint by the Citizens Advice Bureau, the Commission last year embarked upon its own study into PPI mis-selling. It made a number of provisional findings, including an estimate that, as a result of insufficient competition in the PPI selling process, UK customers are overcharged for PPI by over £1.4 billion.<sup>5</sup> Finally, the Financial Ombudsman Service (the "FOS") has said that, in the last year, there has been a significant increase in the volume of PPI-related complaints received both by firms and by the FOS itself.

### The FSA's scalps

The FSA has repeatedly made it clear that mis-selling of PPI is an enforcement priority. Although the effects may have yet to trickle down into the practices and psyche of firms selling

<sup>1</sup> [http://www.fsa.gov.uk/pubs/other/ppi\\_thematic\\_report.pdf](http://www.fsa.gov.uk/pubs/other/ppi_thematic_report.pdf)

<sup>2</sup> [http://www.fsa.gov.uk/pubs/other/ppi\\_thematic.pdf](http://www.fsa.gov.uk/pubs/other/ppi_thematic.pdf)

<sup>3</sup> [http://www.fsa.gov.uk/pubs/other/ppi\\_thematic\\_update.pdf](http://www.fsa.gov.uk/pubs/other/ppi_thematic_update.pdf)

<sup>4</sup> FSA Press Release - FSA/PN/112/2008 - 30 September 2008

[http://www.fsa.gov.uk/pages/Library/Other\\_publications/Miscellaneous/2008/ppi\\_update.shtml](http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2008/ppi_update.shtml)

<sup>5</sup> [http://www.competition-commission.org.uk/Inquiries/ref2007/ppi/pdf/prov\\_find\\_report.pdf](http://www.competition-commission.org.uk/Inquiries/ref2007/ppi/pdf/prov_find_report.pdf)

PPI, the FSA has made good its promise. Over the last year, the FSA has launched a major crackdown on the mis-selling of PPI, and has obtained some significant scalps:

- 1 **Egg Banking plc** - Fined £721,000 for breaches of Principles 3 and 6 and of the requirements of ICOB (then in force). The FSA identified failings in approximately 40% of Egg's sales of credit card PPI. In particular, the regulator was concerned that the firm directed its sales staff to use "objection handling" techniques to persuade customers who had initially turned down the offer of PPI on their credit cards to take the insurance;<sup>6</sup>
- 2 **Alliance and Leicester plc** - Fined a record £7 million for breaches of Principles 3,6,7 and 9. The FSA identified a general failure by the firm's advisers to give customers details of the cost of PPI, failure to properly consider whether customers needed PPI, and failure to make it sufficiently clear that PPI was optional. In fact, the firm put pressure on customers where they queried the inclusion of PPI in their quotation or challenged advisers' recommendations;<sup>7</sup>
- 3 **Liverpool Victoria Banking Services Ltd** - Fined £840,000 for breaches of Principles 3, 6, and 7. The FSA found that LVBS added the cost of PPI to the quotation without the customer asking for it. If customers realised they did not have to buy the cover and objected to it, LVBS put pressure on them to take the PPI. When speaking to customers LVBS did not explain that the cost of the single premium PPI was added to the loan and that as a result customers paid additional interest on the PPI premium for the life of the loan. LVBS also provided inadequate information to its telephone customers about the features, exclusions and limitations of PPI and often provided information that was unclear, unfair or misleading; and<sup>8</sup>
- 4 **HFC Bank Ltd** - Fined £1,085,000 for breaches of Principles 3 and 9, and requirements of SYSC and ICOB. The FSA identified that HFC's procedures did not require advisers in its branch network to gather or analyse sufficient information about customers' circumstances when considering the suitability of PPI. HFC also did not require advisers to explain fully why they recommended a particular policy or identify to customers any demands and needs which the policy would not meet.<sup>9</sup>

Even from the four cases cited above, the pattern of mis-selling is relatively clear, as is the FSA's willingness to impose stinging fines on those that are in breach of Principles, rules or other requirements.

The FSA has used other weapons in its armoury against PPI mis-selling. First, it has revised the conduct of business rules on PPI. Since July 2008, the new Insurance Conduct of Business Sourcebook ("ICOB") has provided beefed up protections for customers in PPI sales. In particular, there are more onerous obligations on firms selling PPI regarding disclosure and explanation of information, ensuring that the customer is eligible for the product, and ensuring that the product is suitable for the particular customer.<sup>10</sup>

Second, the FSA has taken direct action to engage with and educate consumers. For example, it has established a new section on its consumer website that is dedicated to PPI, and is designed to enable customers to compare the products available in the market.<sup>11</sup> Again, these changes are only relatively recent, so the FSA hopes that their effects on PPI selling practices will begin to become visible this year.

### The Commission's changes

The Commission published its final report on PPI sales on 29 January 2009.<sup>12</sup> It concluded that the vast majority of the UK's PPI policies are sold at the same time as the customer takes out the loan or other credit product. The "point-of-sale" advantage means that firms face little or no competition for PPI, and are consequently charging persistently high prices. The report announced that the following legislative changes are necessary in order to enable consumers to benefit from lower prices and better choice:

- 1 The prohibition of the sale of PPI within seven days of the sale of the credit product. The exception to this is where the customer contacts the credit provider 24 hours after the sale of the credit product and requests the PPI product from them;
- 2 The prohibition of "single-premium" policies. Instead, premiums can be charged monthly or annually, pro-rata rebates must be made where the customer decides to terminate the policy, but no charges can be levied on a customer for costs arising from the set-up or early termination of a PPI policy;
- 3 A requirement on all distributors and intermediaries offering PPI to provide customers with a "personal PPI quote" which clearly states the cost of the PPI policy individually and when added to the credit product. While the credit provider may provide this quote at the point of sale of the credit product, it must not sell the PPI until seven days after providing the quote;
- 4 A requirement on all PPI providers to provide certain information and messages in PPI marketing material,

<sup>6</sup> <http://www.fsa.gov.uk/pubs/final/egg.pdf>

<sup>7</sup> [http://www.fsa.gov.uk/pubs/final/alliance\\_leicester.pdf](http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf)

<sup>8</sup> [http://www.fsa.gov.uk/pubs/final/liverpool\\_victoria.pdf](http://www.fsa.gov.uk/pubs/final/liverpool_victoria.pdf)

<sup>9</sup> [http://www.fsa.gov.uk/pubs/final/hfc\\_bank.pdf](http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf)

<sup>10</sup> <http://fsahandbook.info/FSA/html/handbook/ICOB>

<sup>11</sup> <http://www.fsa.gov.uk/tables/bespoke/PPI>

<sup>12</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2009/542ppi.htm](http://www.competition-commission.org.uk/rep_pub/reports/2009/542ppi.htm)

including the price of their PPI product, expressed in a common format of monthly cost per £100 of monthly benefit, and that PPI is optional and available from other providers;

- 5 A requirement on all PPI providers to provide an annual statement to PPI customers, including information similar to that provided in the personal PPI quote; and
- 6 A requirement on all PPI providers to provide certain information on PPI policies to the FSA and to the Office of Fair Trading.

The Commission expects the information requirements to be in force by April 2010, and the remainder of the measures to come into force by October 2010.

## Checklist

We would recommend that any lender that sells PPI institutes an approach to PPI sales that is not only compliant with the rules, but is founded on the simple TCF premise: has the customer been treated fairly? More specifically, we would recommend that the lender requires each adviser to go through the following basic three step process when deciding whether to sell a customer PPI:

- 1 Have I complied with the Principles for Business? In particular:

Principle 6 - Customers' interests - Have I paid due regard to the interests of the customer and treated him fairly?

Principle 7 - Communications with clients - Have I paid due regard to the information needs of the client, and communicated information to him in a way which is clear, fair and not misleading?

Principle 8 - Conflicts of interest - Have I ensured that I have not put the interests of the firm, or another person, above the interests of the customer?

Principle 9 - Customers: Relationships of Trust - Have I taken reasonable care to ensure that my advice is suitable?

- 2 Have I complied with all of the applicable ICOBS rules? In particular, have I ensured that I have complied with all of the additional requirements applicable to PPI sales, including the following:

ICOBS 4.2 - Information about the firm, its services, and remuneration;

ICOBS 5.1 - Eligibility to claim benefits;

ICOBS 5.2 - Statements of Demands and Needs;

ICOBS 5.3 - Suitability of advised sales; and

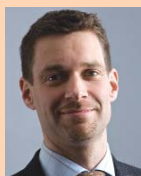
ICOBS 6.4 - Pre- and Post-Contract Information and Explanation.

- 3 Once the customer has put the phone down or walks out of the door, do I feel as though I have treated him fairly?

If the advisor cannot answer in the affirmative to all of the above questions, then he must not sell the PPI to the customer.

We look forward to assisting our clients in ensuring that they comply with their obligations when selling PPI, thus avoiding the wrath of the FSA.

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