

**The Association of Mortgage Intermediaries
Response to the Office of Fair Trading (OFT) Payment Protection Insurance
Market Study: Emerging Issues**

This response is from the Association of Mortgage Intermediaries (AMI). AMI currently represents over 70% of all mortgage intermediaries in the UK.

We are pleased to see that OFT is giving the industry the opportunity to provide comments on the study. In addition to this written response, we would also refer to our informal discussions with OFT on this work, in particular those surrounding the PPI market as it relates to our members and the market study in general.

We recognise the general issues raised in the report and OFT's concerns, and we will be making some general comments on these. However, we will focus our comments on the area our members are primarily involved in – the mortgage payment protection insurance (MPPI) sector. In adopting a broad-brush definition of PPI there is a danger that all products are judged to be the same, whereas the PPI market includes a wide range of PPI product features and the sales processes can be very different for each sector of the market. We are therefore pleased to see the paper examines the issues by retail market sector and that first charge mortgage PPI is separated from credit card, unsecured loan PPI, secured loan PPI and store card PPI.

We also note that the issues and concerns raised with MPPI appear to be less severe than in other sectors. MPPI is a distinct product with a different sales process to other PPI products. The role of the intermediary within the MPPI sector is crucial – the intermediary works in the best interest of his or her client. The fact that MPPI is also delinked from the mortgage means there is a greater transparency around the sale of PPI.

We would like to see clarity of terminology addressed in further reports. 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 mortgage market each of these distribution channels has 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 which distribution channels these are applicable to.

It is also disappointing to note that no distinction is made between the different types of intermediary firm and also that there is no differentiation between advised and non-advised sales. Without this distinction, the report cannot properly reflect the current market structure or the different practices within the market.

Emerging issues

13.1 Claims ratios

We cannot comment on the claims ratio and profitability of insurers, however we would like to see more claims information made publicly available. It would be useful for consumers to have information made available within customer-facing product literature for PPI. In particular greater transparency for consumers on the circumstances under which claims are or are not successful. There is also a need for improvement in policy

documentation such as policy summaries and policy documents to indicate clearly the circumstances and conditions covered and where a claim would never be successful .

13.2 High commission rates

In terms of the percentages quoted, we would agree that commission levels on PPI products in general seem high and in some cases are unjustifiable. However, in relation to first charge mortgages, these commission rates do not result in large profits for intermediaries. Paragraph 13.3 of the report reveals that PPI repayments for a £100k 20-year mortgage were £32 per month for the cheapest ASU policy and £45 for the most expensive. The median commission rate quoted in 13.2 is 35% for first charge mortgages. This would mean the intermediary receives a flat rate commission, at the different ends of the scale, of between £11.40 and £15.75 per month. These amounts are not initially commensurate with the significant upfront costs to intermediaries in arranging this PPI, yet over time they will be. There may be an argument for commission structures to better reflect the upfront costs in order to ensure consumers have access to professional advice should they choose to seek it, and that the adviser is remunerated at the time the service is provided.

As the study outlines, we cannot overlook the fact that PPI as a product is sold and not bought. The role of the intermediary is vitally important. It is the intermediary that sources the product, produces the regulatory paperwork and accepts the responsibility and liability for the sale. The commission received in monetary terms for an advised sale of MPPI does not make this business hugely profitable for the intermediary.

The concerns surrounding commission levels also need to be considered alongside those of transparency for consumers in a market which is not subject to compulsory commission disclosure as required for other financial services products. There may be a case for considering mandatory commission disclosure (and commission equivalents for direct sales) for PPI products, although this would need to be considered carefully in light of the short length of time for which sales of PPI have been subject to FSA regulation and the wider implications of introducing disclosure into the general insurance market.

13.3 Differing PPI prices

We are pleased to see the report highlights the less extreme differences between the cost of MPPI and other PPI products. Council of Mortgage Lenders' figures for the percentage of MPPI policies arranged through intermediaries show an increase over the last few years. In 2003 this figure was 19%, in 2004 21% and the last figures we have for H1 2005 is 23%. The increased level of intermediary involvement in the MPPI sector has clearly driven competition and therefore we are seeing less price differential in comparison to other PPI products and distribution channels.

13.5 Cross-subsidy issue

Given that, in the MPPI market, the product is generally de-linked from the loan, we do not consider cross-subsidy to be an issue in this sector. We would like to see other sectors of the PPI market move towards a model which does not subsidise credit interest rates with PPI premiums.

13.6 PPI is a product which is sold not bought

It may well be fair to say that customers do not go out with the intention of buying MPPI but this may be because they are not aware of the cover provided and the reasons why it may be suitable for them. An independent intermediary will be able to explain the benefits of PPI in the context of other protection products, and source a PPI contract which meets the customer's particular circumstances.

We do have concerns around the adverse publicity focused on PPI in general. We do not want MPPI to become a stigmatised product. We have already witnessed a fall in the numbers of MPPI policies arranged and this may well be due to the contagion from the negative attention PPI as a whole has generated. This is not in the consumers' interest given the valuable role PPI can play in sustainable home ownership.

The need for improved MPPI policies, which can be recommended and bought with confidence, is increasing as the property and employment markets cannot be assumed to remain stable. MPPI can be a valuable means of protection for consumers, often only being seen to have value when economic conditions are uncertain.

The publication of clearer, better quality information on MPPI policies will help consumers to feel confident and fully informed. AMI supports a move to produce a consumer guide on PPI.

13.7 Consumers do not tend to shop around for PPI

Independent intermediaries exist to shop around for their clients, sourcing the most suitable policy from those available. The nature of the intermediary's role in the MPPI sector cannot be under-estimated. The better competition that exists in the first charge mortgage PPI sector is evidence of the role independent intermediaries can play.

13.8 PPI is complex and can be confusing

AMI has been involved in the CML's baseline specification work producing minimum core requirements for MPPI. Minimum core definitions and features, common to all products in the market, will work towards providing consumers with a level of confidence about the product they are purchasing. Providers can of course go beyond the baseline specification and we are keen that they should continue to bring innovative PPI products to the market. Consumers would also benefit from a focus on consistent, industry-agreed terminology similar to the industry-defined definitions used by critical illness insurers.

Currently, most PPI policies bundle together different elements of cover, typically accident, sickness and unemployment. 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. Some providers have already made unbundled products available, however we would like to see this as an option for all PPI contracts.

13.11 Lack of switching

We accept that it is difficult for customers to switch MPPI and this is an issue that needs to be addressed. At present there is a lack of switching because consumers do not have the option to move MPPI contracts when they change their mortgage provider. We

would like to see free-standing policies that are portable, enabling cover to be maintained in the event that the associated mortgage is transferred to another lender.

13.17 PPI automatically included in quotes

As PPI can offer valuable protection, consumers benefit from an awareness of the product. However, except where PPI is compulsory alongside a particular loan (or other item of credit), customers should be provided with comparable quotes, both with and without the cost of PPI. We would be very surprised if the figure quoted in the report – 40% automatically including PPI in the quote for the loan – was the case in the mortgage intermediary channel. It would be helpful for the industry to have information split by distribution channel, that is between sales made directly by lenders and those made by independent intermediaries, to evidence the difference in practices.

13.18 Poor information on product details

Consumers benefit from the availability of clear information on financial products. We agree that this is an area where improvements should be made. We would refer to our earlier response on claims information and a consumer guide.

13.21 Lack of marketing/promotion of PPI

As discussed earlier in our response to 13.2, PPI is not hugely profitable for mortgage intermediaries. Therefore, mortgage intermediaries are unlikely to receive value from advertising or producing bespoke promotional materials for PPI.

13.23 Belief that taking out the 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. We feel the 27% figure quoted should be broken down by sector in order to pinpoint where this is a concern. If other retail sector PPI products were clearly delinked it would help address this particular consumer perception.

13.26 Competitive pressure on prices

As mentioned earlier it would be helpful for OFT to clarify what is meant by the term 'distributor' in reference to the comment that 'distributor profitability is sizeable'. We would argue this is not the case in the independent intermediary sector where the costs of arranging PPI contracts in compliance with the regulatory rules mean that on average profits for PPI business are not excessive.

13.27 'Alternative products' do not appear to provide competitive pressure

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 can be 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, although we do acknowledge the reverse position, that younger people in good health and low-risk occupations, can get better value from other protection products. Other protection products are usually subject to medical underwriting at the 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.

While there may be a good percentage of intermediaries in the mortgage market that will routinely look at different types of protection contracts, in other sectors this may not be the case. We would be keen to see intermediaries taking a wider view of the products currently available.

13.28 Point of sale advantage

The fact that the point of sale advantage appears weaker in the MPPI sector is an example of the positive impact de-linking can have. We feel that other sectors would benefit from a move towards a de-linked model for PPI and associated credit.

13.32 The internet does not appear to have opened up the sector

The internet is not a panacea. Consumers tend to use the internet for research purposes and opt for independent intermediary advice to access the market and obtain advice on the transaction.

The role of the intermediary in the MPPI sector is a crucial benefit that other sectors do not enjoy. A good intermediary is the champion of the consumer and stands shoulder to shoulder with their client. Their ability to access the entire market and assess the suitability of their client for a specific MPPI product has clearly had a positive influence in the MPPI sector. Other retail PPI sectors would benefit from the experience of the MPPI market, although we acknowledge there is still room for improvements via unbundling, greater and clearer customer information, commission transparency, and through increased publication of claim statistics and case studies.