



Financial Services Authority

# The sale of payment protection insurance – results of thematic work

November 2005

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# Executive Summary

1. This report sets out our findings on the level of compliance with our rules by firms selling payment protection insurance (PPI) with credit arrangements (including revolving credit, unsecured loans and prime and sub-prime mortgages and other secured loans). Our findings are based on supervision visits to 45 firms. We looked at the systems these firms had in place to achieve compliant selling practices. We also commissioned a market research company, GfK NOP, to carry out 52 ‘mystery shops’ across 19 firms to look at what happens in practice.
2. As PPI is a secondary purchase there is little shopping around by consumers in most sections of the market although in some sections of the prime mortgage market brokers may shop around on behalf of customers. In addition, PPI is a relatively complex insurance product and is often sold to vulnerable customers. As a result of this and the poor levels of compliance set out in this report, the sale of PPI poses a high risk to our consumer protection objective.
3. The purpose of this report is to feed back our detailed findings, including examples of compliant and non-compliant practices, so that firms understand the compliance problems we found and the urgent action they may need to take to address these problems. We plan to undertake another round of thematic work early next financial year to assess whether levels of compliance have improved. We found particularly serious problems in some firms and will be investigating these firms further with a view to possible enforcement action.

## Visit findings

4. The 45 firms represent a very small sample of the total number of firms authorised by us to sell PPI. However, as we found the same issues in most firms in the sample we believe this supports our conclusion that poor compliance levels exist in some areas of the market.

5. Our visit findings suggest that the 15 firms in our sample selling regular premium PPI in the prime mortgage sector generally had better levels of compliance in this aspect of their business compared to the other sectors (revolving credit, unsecured lending and sub-prime mortgages/secured loans) and so they posed a lower risk. Because of this, the majority of the visit findings in this report relate to the 30 firms operating in these other sectors.
6. Our key findings on the 30 other firms are as follows:
  - **The sale of PPI by these firms poses a high overall risk.** The practices of the majority of the 30 firms posed a risk to our consumer protection objective. This was because of various aspects of their selling practices and/or their lack of proper compliance controls as set out in this report.
  - **Risk of inappropriate sales.** Around half of the firms failed to take reasonable steps to ensure that customers do not buy policies they cannot claim on or which provide only very limited cover. In a few firms, the high PPI penetration rates we found (70% and above) caused concern because it seemed unlikely that such high percentages of customers could realistically claim for benefits under all sections of the policy. This is because of the eligibility requirements that apply. (See paras 4.3-4.9.)
  - **There were inadequate controls in place for non-advised sales which could lead to firms providing advice when they did not intend to.** In about half of the firms selling on a non-advised basis the information they provided to customers – and/or the lack of controls to ensure sales staff did not give advice – led us to question whether the firms were in fact advising customers and failing to comply with our suitability rules. (See paras 4.13-4.14.)
  - **Advice on PPI was often likely to be of poor quality.** Most firms selling on an advised basis did not have systems in place to assess suitability adequately. We were particularly concerned about the failure to properly assess whether PPI is needed by the customer and the lack of consideration of the cost of the policy. We were also concerned about the presumption by firms in the sub-prime mortgage/secured lending market that single premium, as opposed to regular premium, policies are suitable. These firms did not sufficiently consider the aspects of single premium policies that do not meet customers' costs and flexibility needs. In line with these findings, the documents (statement of demands and needs) most firms gave customers about the advice they had received were not helpful. They were too generalised and lacking in customer-specific information. (See paras 4.15-4.19.)
  - **The level and structure of inducements and targets for sales staff could encourage mis-selling in some of the small- and medium-sized firms.** Around two-fifths of the small- and medium-sized firms we visited fell into this category and most of these had a lack of effective controls in place to mitigate this risk. (See paras 4.20-4.21.)

- **Most firms were unlikely to pressurise customers into buying PPI.** We were only concerned about the sales techniques used in a small minority of firms in terms of pressurising customers. There was no evidence to suggest that firms were implying that PPI was a compulsory purchase. However, in some cases the firm automatically included PPI in the initial loan quote, without making it clear at the initial stage that PPI was optional. (See paras 4.22-4.24.)
  - **Firms relied on product documents they gave the customer at the expense of explaining the policy to the customer orally.** The majority of the firms selling by telephone were not giving the customer sufficient information on exclusions. We were also concerned that in face-to-face sales there was more emphasis on the benefits and little on the limitations or exclusions in the policy in the oral descriptions given to customers. (See paras 5.1-5.5.)
  - **Product and price disclosure by firms selling single premium policies gave us particular cause for concern.** Some firms failed to comply with our price disclosure rules for single premium contracts by not disclosing the amount of interest that is payable on the premium. Others did disclose this, but in a way that disregarded our *Principles for Businesses* by making it insufficiently prominent or clear to the customer. We were also concerned that the majority of firms selling single premium policies did not give the customer sufficient information on the lack of refunds or the fact that refunds would not be on a pro-rata basis if the customer cancelled the policy after the statutory cancellation period. Where firms sold both single and regular premium policies, we were concerned in most cases that the comparisons they made were misleading in favour of single premium policies. (See paras 5.6-5.13.)
  - **Training and competence of sales staff was not sufficient in many cases.** We found shortcomings in around half of the firms we visited. (See Chapter 6.)
  - **Compliance monitoring was of variable quality and was very poor in some cases.** In two-fifths of the firms we visited there were serious shortcomings in the monitoring of sales staff. In particular, there was a lack of risk-based monitoring of sales staff in many firms. (See Chapter 7.)
7. Finally, although we did not specifically look at the way in which firms design PPI contracts as part of this study, our findings suggest that compliant and fair selling practices are made all the more difficult because of the way in which PPI contracts are designed (see Chapter 3). We plan to undertake further work in relation to the Unfair Terms in Consumer Contracts Regulations 1999 and single premium PPI policies that provide no refund when cancelled early (see para 5.9).

## Mystery shopping

8. The mystery shopping results are broadly consistent with the visit findings, although, because of the sample sizes, we have not looked at the prime mortgage sector separately. Key findings from the mystery shopping exercise are:
- **Risk of inappropriate sales** – some of the eligibility checks carried out on the shoppers missed out key questions. For example, shoppers were asked about their employment status (i.e. temporary, permanent etc) in only 33 of the 52 mystery shops.
  - **Concerns about the quality of advice** – in only 17 of the 31 advised mystery shops was the shopper asked about their existing insurance cover, despite this being explicitly required by our rules.
  - **Little evidence of pressure selling** – in only two of the 52 mystery shops did the shopper feel pressurised into taking out PPI.
  - **Lack of explanation of exclusions and limitations** – in only 26 mystery shops did the sales person explain the exclusions and limitations to the policy, which can be contrasted with 47 mystery shops in which the sales person explained what the policy covered. Furthermore, in only five out of the 13 face-to-face shops was the shopper's attention drawn to the importance of reading the Policy Summary, despite this being explicitly required by our rules.
  - **Lack of understanding about the nature of single premium policies** – of the 24 mystery shops that we identified as involving the sale of single premium PPI, in only one case was the shopper made aware that the premium would be added to their loan. In most other cases, the shopper's perception, based on what the firm had told them, was that the policy was regular premium.

# 1 Our approach

- 1.1 We carried out supervision visits to a range of firms and commissioned a market research company, GfK NOP, to carry out mystery shopping.

## **Supervision visits**

- 1.2 Between May and August 2005, we visited 45 firms selling PPI across a wide range of sectors – banks, building societies, car dealers, catalogue companies, mortgage brokers, credit brokers and retailers. The firms ranged in size from sole traders to major high street banks. Table 1 gives a breakdown of the supervision visit sample by type of sector. Where our findings differ between sectors we have made this clear. Where firms sold PPI in several sectors, we generally only focused on their selling practices in a specific sector. However, in many of the small- and medium-sized firms that were carrying out both prime and sub-prime mortgage business we looked at the sale of PPI in relation to both aspects of their business. Those firms that did both prime and sub-prime mortgage business or secured and unsecured loans have been allocated to a sector based on their predominant type of business in Table 1 and throughout this report.

**Table 1: Sample of firms for supervision visits**

| Sector  | Number of firms |
|---|-----------------|
| Revolving credit – credit cards, store cards and catalogues | 6*              |
| Unsecured personal loans                                    | 12*             |
| Mortgages: prime (mainly first charge)                      | 15              |
| Mortgages and secured loans: sub-prime                      | 13              |

\* one firm we looked at sold PPI with both credit cards and unsecured loans.

- 1.3 Depending on the size of the firm and the nature of its business, the visits involved interviews with senior management, compliance staff and sales staff. We analysed information we received from the firm before each visit, including examples of the documentation given to customers. In some cases, we obtained further information after the visits.
- 1.4 During these visits, we focused on assessing firms' compliance with:
- the *Insurance: Conduct of Business sourcebook* (ICOB);
  - the training and competence rules;
  - the rules on systems and controls; and
  - the rules set out in the *Principles for Businesses*, particularly Principle 6, which requires that 'a firm must pay due regard to the interests of its customers and treat them fairly'.
- 1.5 These visits primarily assessed the inputs by firms to meet our rules (i.e. their systems for compliance) rather than the outputs (i.e. whether actual sales were compliant). Based on our visit findings, we have assessed these inputs and judged whether they are likely to result in a poor outcome for customers.

### **Mystery shopping**

- 1.6 GfK NOP carried out 78 mystery shops across firms selling PPI with credit or store cards, unsecured personal loans, mortgages and secured loans between August and October 2005. Of these, we excluded 26 shops from the analysis in this report for various reasons – for example, because the shopper was declined credit or because they got a quote for credit but it did not include a PPI quote. To ensure that firms had adequate opportunity to comply with all our rules relating to PPI, this report is based on the remaining 52 mystery shops across 19 firms that were all taken to a stage where a PPI quote was given and the PPI contract could be concluded. When shopping for credit and store cards, the mystery shopper actually took out the credit or store card. In the other shops they did not proceed with the sale, but asked for all the paperwork. Table 2 gives a breakdown of the mystery shopping sample used in this report.

**Table 2: Mystery shopping sample**

| Sector  | Number of firms |
|---|-----------------|
| Revolving credit – credit cards and store cards | 14              |
| Unsecured personal loans                        | 17              |
| Remortgages and secured loans                   | 21              |



1.7 The shoppers used the following scenarios:

- 24 shoppers had a pre-existing medical condition;
- eight shoppers were on a temporary contract;
- 23 shoppers already had existing protection insurance in place such as income protection, critical illness, life cover or other payment protection; and
- eight shoppers followed none of the above scenarios.

Eleven shoppers followed more than one scenario (e.g. they were in temporary employment with a pre-existing medical condition).

### **About this report**

1.8 In each chapter, we set out the results of our visits, including examples of good and poor compliance we found and the mystery shopping results where relevant. Where we describe a particular practice as ‘good practice’ that does not mean (except where explicitly required by our rules) that we necessarily expect all firms to adopt that practice. The examples given are merely ways some of the firms included in this study complied with our requirements. Examples of good practice may also be linked to the context of the particular firms they are taken from – adopting the examples given in this report does not mean that firms will necessarily comply with all of our requirements. Although we have tried to provide examples that could apply to a wide range of firms, it is for firms and their senior management to ensure that they comply with our rules, taking into account their particular circumstances.

# 2 Overall findings

- 2.1 From our visits, the sale of regular premium PPI with prime mortgages stands out as different from the other sectors. In general, we found that compliance tended to be better in this sector compared to the other sectors. From this, we have concluded that PPI selling practices in this sector do not represent a high risk to our regulatory objectives.
- 2.2 As already mentioned, we generally focused on the activities of individual firms in one particular area of their business. As such, it cannot be assumed that the relatively good level of compliance in a firm's prime mortgage business permeated that firm's PPI business in other sectors (i.e. with unsecured loans or credit/store cards). The exception to this is a few firms in our sample who were predominantly selling prime mortgages but also doing sub-prime business. For these, we found the good levels of compliance for their prime business also applied to their sub-prime business.
- 2.3 The 15 firms selling regular premium policies in the prime mortgage sector (which included a bank, a building society and 13 mortgage brokers) shared a number of common characteristics:
  - where they operated on an advised basis (which most of these firms did) they completed a full factfind on the mortgage and the customer's protection arrangements;
  - staff were generally more familiar with FSA regulation compared to the other sectors;
  - they had good training and competence schemes in place (with a couple of exceptions);
  - most offered a range of protection products, in addition to PPI, such as term assurance, critical illness cover and income protection and they generally demonstrated a reasonable understanding of the role of these different types of product;

- all of the brokers (as opposed to the two lenders) selected the PPI provider themselves rather than selling PPI provided by a particular lender and most stated that they selected their chosen provider on the basis of value for money for the customer and the quality of administration the provider offered;
- their PPI penetration rates were generally much lower compared to the other sectors; and
- they generally demonstrated good levels of compliance with our rules, with a few exceptions.

2.4 The practices of most of the 30 other firms posed a risk to our consumer protection objective because of various aspects of their selling practices and/or their lack of proper compliance controls. Given this difference between the prime mortgage sector and the other sectors, all the remaining findings in this report relating to our visits refer to the 30 firms outside the prime mortgage sector.

# 3 Product design and selection

## Product design

3.1 Our work on Treating Customers Fairly<sup>1</sup> has noted the importance of firms designing products that meet customers' needs. Although we did not look at the way in which firms design PPI contracts as part of this study, our findings suggest that compliant and fair selling practices are made all the more difficult because of the way PPI contracts are designed. Specifically:

- the complexity and range of exclusions makes it difficult for sales staff to adequately explain the cover; for the Policy Summary to give a fair but understandable picture of what cover is provided; and for customers to assess what they are buying;
- the complexity and range of eligibility criteria can make it difficult for sales staff to check that the customer is eligible to claim on all sections of a policy before it is sold;
- the nature of single premium contracts can make it difficult for firms selling such contracts to ensure that the customer has a reasonable understanding of the implications – for example, that the premium is added to the loan and interest is charged on it and the implications of cancelling the loan early;
- adding complex cover, such as critical illness cover – in addition to the basic accident, sickness, unemployment and life cover – makes the contract more complex to sell properly without competent sales staff who understand the limitations of such cover; and
- providing add-ons, such as critical illness cover and hospitalisation benefit, may lead to firms selling PPI to all customers (regardless of whether they are eligible for the core accident, sickness and unemployment benefit) and not making it clear to those customers who do not qualify for the main benefit that they are only eligible to claim under certain limited sections of the policy.

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<sup>1</sup> Treating Customers Fairly – building on progress, July 2005.

- 3.2 In short, the more complexity that firms build into PPI policies the more difficult it is for firms selling these policies to do so in a fully compliant manner.
- 3.3 As mentioned, the reports we have published on Treating Customers Fairly have suggested that product providers should consider their target market when designing products and consider how products meet their customers' needs and expectations. The Citizens Advice Bureau<sup>2</sup> has heavily criticised PPI product design and, as noted above, we have concerns about the implications of product design for compliant sales practices. So the industry may wish to consider whether it is time to develop new products that meet these concerns.

### **Product selection**

- 3.4 It is also the case that some of the small- and medium-sized intermediaries we visited operating in the sub-prime mortgage/secured lending and unsecured lending sectors did not have any role in selecting the type of PPI contract they sold. Instead, the lender they placed business with selected the PPI contract that the intermediary then offered alongside the loan on an optional basis. We came across several cases where the lender had selected a single premium policy when the intermediary considered regular premium policies would have been more appropriate for its customer base. However, the intermediary claimed that it did not have any alternative but to sell the PPI policy the lender selected.
- 3.5 Firms selling PPI are responsible under our rules for the sale of the policy. So if they consider the single premium PPI policies offered by the lenders they use are not suitable for their customers, they must not recommend such policies.

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2 Protection Racket – CAB evidence on the cost and effectiveness of payment protection insurance, September 2005.

# 4 Selling practices

4.1 This chapter covers our findings on the following matters:

- risk of inappropriate sales;
- non-advised sales;
- the quality of the suitability assessment carried out by firms when giving advice;
- the statement of demands and needs provided to customers;
- inducements and sales targets; and
- sales techniques.

4.2 Our Financial Promotions Department has also undertaken some work in this area and will be reporting any findings in due course.

## **Risk of inappropriate sales**

4.3 For all sales, whether advised or non-advised, a particular concern is that customers are being sold policies they cannot claim on or which provide only partial cover.

4.4 Principle 6 requires firms to pay due regard to the interests of their customers and treat them fairly. Principle 7 requires firms to pay due regard to the information needs of their customers, and all communications with customers to be clear, fair and not misleading. Principle 3 is also relevant, in that it says a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Our SYSC manual backs this up by requiring firms to have appropriate systems and controls in place for their business. In particular, SYSC 3.2.6R says that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system.

- 4.5 To comply with these rules, we believe that a firm should take reasonable steps to ensure that customers do not buy policies under which they are ineligible to claim benefits. This applies to both advised and non-advised sales.
- 4.6 It is up to firms themselves to decide how they comply. However, the simplest way of doing this is to make an eligibility check. If the firm does not speak to customers directly, it could ask the customer to complete an application form fulfilling the same purpose. If parts of the cover apply, but others do not, this should be made clear to the customer so they can take an informed decision on whether to buy the cover. If the firm cannot reasonably perform an eligibility check, the customer can nonetheless reasonably expect to be given clear and balanced information that they can use to make an informed decision.
- 4.7 In advised sales, our rules (ICOB 4.3) specifically require the suitability assessment to take into account the relevance of any exclusions and limitations. The firm must also tell the customer if the policy does not meet all their demands and needs. For instance, the customer might not be eligible to claim on parts of the policy because they only work part-time and so the accident, sickness and unemployment cover would not apply, whereas the critical illness cover might apply. In these cases, the policy may not be suitable for the customer and the firm should not recommend it.

### *Visit findings*

- 4.8 In around half of the 30 firms, the checks in place to ensure that the customer was eligible to claim on the policy were inadequate. We saw evidence during the course of our visits that the requirement to check eligibility was not always followed or even understood by sales staff. Also, some sales scripts we reviewed did not cover all the eligibility conditions relating to the policy being sold.

#### **Example of poor eligibility checking**

When reviewing the sales files of a small motor dealer, we came across a case where a five-year single premium policy with an age limit of 65 had been sold to a retired 68-year-old man. Not only was he ineligible to claim on the policy, the fact that he was retired meant that most of the benefits were not relevant to him. Following our visit, the firm arranged to cancel the policy and the customer received a full refund.

- 4.9 In some instances the penetration rates we found seemed very high. For example, we found penetration rates of 70% or more in a few firms. These high rates are a cause for concern since it seems unlikely that such high percentages of customers could realistically claim for benefits under all sections of the policy. This is because of the eligibility requirements that apply.

### *Mystery shopping*

- 4.10 Different policies have different eligibility criteria and it was not possible to match the eligibility checks carried out in each of the mystery shops to the actual conditions applying to each policy. Nevertheless, we were able to look at the extent to which the mystery shoppers were asked about eligibility criteria that are common across most (but not all) PPI policies. Of the 52 shops:
- 49 checked the shopper's age;
  - 45 checked whether the shopper was employed or not;
  - only 38 checked whether the shopper worked full or part time; and
  - only 33 checked the shopper's employment status (i.e. permanent, temporary etc).
- 4.11 PPI contracts often exclude those on temporary contracts from unemployment cover, or else apply conditions to those on fixed-term contracts. So we were interested in seeing whether this was picked up in the shops and pointed out to the shopper. Of the eight shops conducted by shoppers who were on a temporary contract:
- five were told without prompting whether or not they would be covered;
  - a further two were told whether or not they would be covered when they prompted the sales person on this; and
  - in one shop the shopper was not told the position even when they prompted the sales person.
- 4.12 We were also interested to see how firms dealt with the exclusion for pre-existing medical conditions. In only 11 of the 52 shops was the shopper asked whether they had a pre-existing medical condition. Of the 24 shops conducted by a shopper with a pre-existing medical condition:
- in only ten shops was the shopper told by the sales person unprompted whether or not the condition would be covered by the policy;
  - in a further ten shops, the shopper was told about this when they prompted the sales person;
  - in three shops, the shopper was not told whether or not the condition would be covered, even when they prompted the sales person about it; and
  - one shopper was not told and did not prompt the sales person, as further details were to be posted.



## Non-advised sales

### *Visit findings*

- 4.13 Half of the 30 firms we visited claimed that they were selling PPI on a non-advised basis. On further discussion, however, some of the smaller firms were confused about whether they were operating on an advised or non-advised basis. In around half of the firms that were selling on a non-advised basis the information they provided to customers – and/or the lack of controls to ensure that sales staff did not give advice – led us to question whether the firms were in fact advising customers and failing to comply with our suitability rules. In addition, a few of these firms did not disclose to customers whether or not they were providing advice as is required under our rules.

|  |
|--|
| <b>Example of a sales script used by a firm which claimed it was selling on a non-advised basis, but which is likely to amount to giving advice</b>  |
| A sales script used by a firm selling secured loans stated: 'we do not offer advice but will provide you with information on accident, sickness, unemployment and life cover from a single insurer from which you will be able to decide whether to proceed.' However, later in the script it goes on to state: 'if the client is unsure about payment protection then you can tell them that <b>we strongly recommend that you consider taking out PPI</b> '. |

- 4.14 In some cases firms sought to control this risk by requiring the use of full sales scripts. However, in other cases firms only partially scripted the sale, allowing sales staff to adopt a conversational approach, or had no script at all. Clearly, such approaches carry greater risks that staff will end up giving advice than fully scripting sales. Risks remain even where the sale is fully scripted. For example, during a visit to a firm's call centre that was supposedly operating on a non-advised basis, a sales person strayed way beyond the script that he should have been following in his efforts to persuade the customer to purchase PPI that she clearly did not want or need.

## Suitability

- 4.15 If a firm makes a personal recommendation to the customer to take out a particular PPI contract, our rules require the firm to ensure that the recommendation is suitable for the customer. If it is clear that the PPI policy that the firm is selling will not meet all the customer's requirements, then the firm may still be able to recommend that the customer takes out the PPI contract (providing the product is suitable). However, it must make clear to the customer those requirements that will not be met. For example, the firm might sell the customer a sub-prime mortgage on the basis that when their credit history improves they are likely to re-mortgage. If the firm recommends a single premium PPI policy which provides low refunds on early cancellation, it should make it clear that this limitation of the policy might not meet the customer's need for flexibility. Such sales could be unsuitable and in breach of our rules (ICOB 4.3.1R) even where such a warning is given.

### *Visit findings*

- 4.16 Half of the 30 firms were selling on an advised basis. There seemed to be little difference in the approach these firms took, compared to those selling on a non-advised basis, in terms of the factors taken into account in assessing whether the product was appropriate for the customer. The factors taken into account to assess suitability varied across firms, but most firms did not assess the suitability of PPI adequately.
- 4.17 In particular, we found the following shortcomings in firms' suitability assessments:
- The price of PPI was not adequately taken into account in all cases. In some cases, the sales adviser assessed the suitability of the product for the customer before calculating any insurance premium. This is contrary to our rules, which require the firm to take the contract's price into account as part of the suitability assessment when this is relevant to the customer's demands and needs. And it is difficult to envisage a situation where a customer seeking credit would not regard the cost of insurance as an important factor.
  - A proper assessment of whether the customer actually needed PPI was not undertaken. In particular, we found that firms did not fully consider the customer's existing insurance and did not assess the benefits provided by the customer's employer in terms of accident, sickness and life cover.
  - In some firms, there was a lack of assessment of pre-existing medical conditions and the implications of these for the customer's ability to claim under the sickness section of the policy.
  - In some instances, there was a lack of due consideration of the customer's demands and needs when firms were selling single premium policies. For example, we consider that many customers arranging credit (particularly those in the sub-prime market) are likely to be cost-sensitive or need flexibility (or often both). If this is the case, those factors must be taken into account when assessing the suitability of a policy. Nevertheless, we found firms recommending single premium policies to such customers. This was despite the relative expense and inflexibility of these policies compared with regular premium policies and without having systems in place for explaining to customers that their cost and flexibility needs had not been met.

### *Mystery shopping*

- 4.18 Despite our suitability rules requiring firms to check whether customers have any existing insurance cover that is relevant, in only 17 out of the 31 advised shops was the shopper asked about any existing insurance cover.

## Statement of demands and needs

### *Visit findings*

- 4.19 In around two-thirds of the firms selling on an advised basis, the statement of demands and needs was too generalised and lacking in customer-specific information to be of use to customers. In some cases, it appeared that firms were simply using the statement of demands and needs to list product features.

#### **Example of a non-compliant demands and needs statement for an advised sale**

I have recommended this policy because:

- It provides payment protection for Mrs X.
- It provides life insurance for Mrs X.

#### **What we would expect a compliant demands and needs statement for an advised sale to cover**

- **The customer's demands and needs (ICOB 4.4.1R(1)(a))** – for example, this should include the adviser's assessment of whether the customer has other insurance in place that affects their needs, including employer benefits; the need for future flexibility if relevant, and so on.
- **Reasons for recommending the particular PPI contract (ICOB 4.4.1R(1)(c))** – this should set out why the particular contract is suitable based on that particular customer's needs. For example, it should explain why the recommendation is suitable based on the costs of the contract if relevant (ICOB 4.3.6R(2)) and in the light of the exclusions and limitations of the contract (ICOB 4.3.6R(3)).
- **Demands and needs not met by the recommended contract** – the statement of demands and needs is the record that firms must keep to demonstrate that they have made a suitable recommendation (ICOB 4.4.5G). So firms should also consider recording the demands and needs of the customer that are not met by the personal recommendation (ICOB 4.3.1R(3)(b)). For example, if the customer has a need for future flexibility, firms may wish to explain the constraints on this (e.g. the lack of refunds available or refunds not being made on a pro-rata basis).

## Inducements and sales targets

- 4.20 In our work on Treating Customers Fairly we have said that a failure to manage and control the risks inherent in particular remuneration structures can threaten the firm's ability to treat its customers fairly. Our rules also require firms not to give or accept inducements if these are likely to conflict to a material extent with the duty the firm owes its customers (ICOB 2.3.2R).

### *Visit findings*

- 4.21 The commission rates paid to firms selling PPI can be very high in some cases – we found examples of rates as high as 80% of premiums. In around two-fifths of the small- and medium-sized firms we visited, we considered the commission and incentive structures and targets for individual sales staff could encourage the mis-selling of PPI. And most of these firms lacked effective controls to mitigate this risk.

| Inducements and sales targets – practices that can help firms comply   | Inducements and sales targets – practices that may create risks if not appropriately managed   |
|--|--|
| <ul style="list-style-type: none"> <li>Balanced incentive structures based on a scorecard of measures.</li> <li>In one firm the senior management recognised the potential for commission bias in the choice between single and regular premium policies. They were considering equalising commission levels to remove the potential for this.</li> <li>Telesales staff did not get bonuses if they did not conduct calls to an appropriate standard.</li> <li>Commission clawed back if policy is cancelled.</li> </ul> | <ul style="list-style-type: none"> <li>Pay structures for sales staff that reward quantity only and not quality.</li> <li>Large part of salary being made up of bonuses relating to sales (including PPI) – for example, sales targets that can more than double a sales adviser's basic salary.</li> <li>Sales staff receiving a much larger incentive for selling PPI than the associated loan.</li> <li>Tiered commission arrangements to encourage high-volume sales.</li> <li>Commission paid to sales staff favoured single premium over regular premium PPI when firm was offering both types of contract to customers. In some cases, staff received no commission if they sold the regular premium option.</li> <li>Commission structures where there is no clawback if the policy is cancelled.</li> <li>Senior management and compliance staff not being aware of incentives in place to sell PPI.</li> </ul> |

**Example of an incentive structure which we believe could increase the risks of non-compliant sales if not appropriately managed**

In one medium-size firm selling secured loans, sales staff were incentivised by a £20 bonus per PPI sale and the bonus structure on PPI and the loan could double their basic salary. In addition, targets of 50% PPI penetration were set for each member of staff for the award of these bonuses. Individuals failing to meet this target were not awarded any bonuses and were described as having 'a training need.' Furthermore, there was no clawback of the bonus if the customer subsequently cancelled the policy.

## Sales techniques

### *Visit findings*

- 4.22 In a small minority of firms we were concerned that their sales techniques could strongly encourage customers to take out PPI when they did not really want it. In some small firms we were concerned that the potential for pressure selling exists where sales staff take the paperwork to the customer's home and get them to sign up to the PPI and the loan during the home visit. This gives the customer little time to fully consider the paperwork.
- 4.23 We did not find any evidence from our visits to suggest that firms attempted to give customers the impression that taking out PPI would be compulsory to guarantee they were accepted for the credit product. However, given our findings on inducements and sales targets there may be a risk of this. All the large firms we visited gave the customer the option of having their quotations for credit with or without the cost of PPI. Two of these firms had changed

their practices very recently to do this. However, most small- and medium-sized firms did not do this. In a few cases the initial loan quote always included PPI and at the initial quote stage it was not made clear that PPI was optional. Nevertheless, in all of the firms we visited we were told it was made clear in the sales process that PPI was optional.

- 4.24 We found some firms called customers if they cancelled a policy to find out why. We accept that this can provide useful management information. However, firms should put controls in place to ensure that customers are treated fairly, including not being unfairly pressurised into keeping the policy. This is particularly the case if the original sales team makes the follow-up call and their bonuses depend on policies not being cancelled.

#### *Mystery shopping*

- 4.25 In line with our visit findings the mystery shopping found little evidence of pressure selling – in only two out of the 52 shops did the shopper feel pressurised into taking out PPI. And in the majority of mystery shops (46 shops) the shoppers were under the impression that PPI was optional even if they were not explicitly told this.

# 5 Product and price information

## General

5.1 Most of the firms we visited, with a few exceptions, were giving the product and price disclosures required under our rules. However, in some firms there were issues with the content not being fully compliant or with the clarity and timeliness of the disclosure. We found the following general problems:

- An over-reliance on product documentation given to the customer at the expense of explaining the policy to the customer orally.
- Poor quality presentation. Although the content requirements of our rules may have been met, the information was often presented as small print and the layout would not encourage the customer to read it. In many cases, this could breach our ‘clear, fair and not misleading’ rule, which relates to the presentation of information as well as to the content. This is consistent with the findings from our review of Policy Summaries.

## Exclusions

### *Visit findings*

5.2 For telephone sales our rules require the customer to be told about all significant or unusual exclusions or limitations over the telephone before they decide to buy the contract. Of the 20 firms we visited which were selling over the telephone, the majority of firms were giving the customer insufficient or no information on exclusions. Typically, the telesales operator would give one example of a significant exclusion (often pre-existing medical conditions) and rely on the customer reading the Policy Summary for the full list of significant or unusual exclusions. In other cases, exclusions would only be mentioned if the customer asked about them.

- 5.3 For face-to-face sales, our rules do not require customers to be given information on exclusions orally. Instead, they must be given a copy of the Policy Summary that sets these out in good time before they decide to buy the policy. The firm must also tell the customer about the importance of reading the exclusions section of the Policy Summary. Although firms are not required to disclose exclusions orally in face-to-face sales, it is important that the customer gets balanced information on the coverage of the policy in order for firms to comply with the ‘clear, fair and not misleading’ rule. So, if sales staff explain the benefits of the policy, they should counterbalance this with some explanation of the significant or unusual exclusions. We were concerned that nearly half of the firms we visited that were selling on a face-to-face basis were not providing the customer with balanced information on the exclusions as well as the benefits.

### *Mystery shopping*

- 5.4 In line with the visit findings, more information was given on what the policy covered than the limitations and exclusions in the mystery shops. For example, out of the 52 shops, shoppers were told about:
- what the policy covered in 47 shops; and
  - the limitations and exclusions to the policy in only 26 shops.
- 5.5 Despite the heavy reliance that seems to be placed on customers reading documents when PPI is sold, the shoppers were not always told to read them:
- the shoppers were only encouraged to read the policy document before signing in 28 out of the 52 shops; and
  - in the 13 face-to-face shops, only five shoppers were told about the importance of reading the Policy Summary, despite our rules requiring firms to do this.

### **Price disclosure for single premium policies**

- 5.6 For single premium PPI our rules require firms to give the customer the total premium, the amount of interest payable on the premium and the total amount (i.e. premium plus interest) as monetary amounts where possible (ICOB 5.5.14R). This information should be presented in a way that is clear, fair and not misleading and should usually be given ‘in good time’ before the contract is concluded. Guidance in ICOB says that ‘in good time’ means that firms need to decide the point in the sales process when the information is most useful to the customer in deciding whether a contract meets his needs (ICOB 5.2.13G).

### *Visit findings*

- 5.7 We found that all large firms and most small firms we visited selling single premium PPI were giving the correct information in terms of premium, interest and the total amount payable. Most medium-sized firms were failing to correctly disclose information, as they did not disclose the amount of interest that was payable on the PPI premium. However, some of those firms that were disclosing the correct information were not fully complying with our rules. In these cases the information was not clear but mixed in with other financial information on the loan in a confusing way. In some firms, it was not given ‘in good time’ but at the last minute before signing the contract.

#### **Example of clear and compliant price disclosure for single premium PPI**

**Premium** – The single premium payable is £\_\_\_\_\_, including Insurance Premium Tax (IPT) of £\_\_\_\_\_.

**Adding the premium to your loan** – If required, this premium can be added to the balance of your loan. However, you should note that in doing so, interest will become payable on this premium over the full term of the loan, or until the loan is repaid. If you maintain the loan for its full term, and it remains on its initial interest rate, the amount of interest payable would be £\_\_\_\_\_. This is in addition to the cost of the premium itself and so could potentially bring the total cost of this policy to £\_\_\_\_\_.

Where you have selected this option the premium has been included in your credit agreement and is reflected accordingly in your monthly repayment.

### *Mystery shopping*

- 5.8 From the documents obtained from the mystery shops, it was not always straightforward for our staff to determine whether the PPI was on a single or regular premium basis. This means that customers would be unlikely to understand the documentation. Where we did not obtain relevant documents about the price of PPI, we had to make an assumption about whether the policy was single or regular premium based on our knowledge of the firm and the type of product being sold. Of the 24 shops that we identified as involving the sale of single premium PPI, in only one case was the shopper made aware that a single premium was being added to their loan. (This does not take into account what they might have found out had they read the policy documents.) In most other cases, the shopper’s perception, based on what the firm told them, was that the policy was a regular premium.



## Information on refunds when single premium policies are cancelled

### *Visit findings*

- 5.9 Typically, if a single premium PPI policy is cancelled outside the statutory cancellation period, the customer does not get a pro-rata refund. At five of the firms that we visited, we came across PPI contracts that provided for no refund upon early cancellation. This is a significant limitation of a policy and should be drawn to the customer's attention in the Policy Summary. Some contract clauses provide no option for continuing cover and no refund when the customer repays the linked credit product early. We consider such nil refund clauses may be unfair under the Unfair Terms in Consumer Contracts Regulations 1999. We will be asking the insurers concerned to justify their use of such terms in their single premium PPI policy documents.
- 5.10 In most other cases, the amount refunded was so unfavourable to the customer that we would have expected it to be drawn to the customer's attention as a significant limitation of the policy and included in the Policy Summary. This disclosure should have been done in a way that meets the requirement on firms to treat their customers fairly (Principle 6) and to provide information in a way which is clear, fair and not misleading (Principle 7 and ICOB 2.2.3R). This is especially an issue where it is likely that the consumer may terminate their loan early and is also an issue where PPI is sold with hire purchase agreements (see para 5.12). This should be considered as part of the suitability assessment in an advised sale where flexibility is part of the customer's needs.
- 5.11 Of the 24 firms we visited selling single premium contracts, customers were not given the level of information we would expect on the position on refunds by around four-fifths of these firms. In some cases where we questioned sales staff, they did not understand the position on refunds or even that they were selling customers single, rather than regular, premium policies. This was particularly an issue in many of the motor dealers we visited.
- 5.12 This is of particular concern where single premium PPI is sold alongside hire purchase agreements (such as those used for car loans). This is because under the Consumer Credit Act the customer is free to end the hire purchase credit agreement after making 50% of payments and returning the goods. However, the customer will still owe money on the PPI premium and associated credit because of the way in which refunds are calculated on these policies. The documents that some motor dealers were providing to customers did not make clear that the cancellation provisions applying to the hire purchase agreement would not apply to the PPI loan.

|  |
|--|
| <b>Example of sales staff with insufficient product knowledge</b>  |
| On a visit to a motor dealer selling single premium PPI we asked the financial adviser what would happen if the customer decided to terminate the PPI single premium policy early. He incorrectly told us that the customer was free to walk away from the contract and would not have to make any further monthly payments. In fact, the customer would owe money on the PPI premium and the loan taken out to finance it. Indeed, upon further questioning, it became clear that he did not realise that the PPI policies he was selling were single premium financed by means of a loan rather than regular premium policies. |

### **Misleading comparisons between single and regular premium policies**

- 5.13 Eleven of the 30 firms offered the customer a ‘choice’ of single or regular premium PPI. All these firms were in the sub-prime mortgage and secured lending market. In the majority of firms this ‘choice’ was notional because of the heavy emphasis given to single premium policies in the sale. We were concerned that four-fifths of these firms were giving customers biased information in favour of single premium policies when a regular premium policy may have been more suitable. For instance, some of these firms were spreading the cost of, say, a five-year PPI contract over a 25-year mortgage term. They were then comparing the resulting monthly payments with the monthly payments on a regular premium contract.

# 6 Training and competence

- 6.1 We found shortcomings in the training provided to sales staff in around half of the 30 firms we visited. All the large firms we visited had formal training programmes in place. However, we considered that some aspects of these were inadequate in providing sufficient product and compliance knowledge to sales staff, particularly telesales staff. In many of the small- and medium-sized firms, training on PPI was inadequate. In the main, training focused on the primary product, with PPI being covered only very superficially. For example, it was typical for sales staff in these firms to have had ‘a few hours’ training on PPI. Another example was a firm in which sales staff simply recalled getting a memo about FSA regulation and nothing more. Other examples of what we found are set out in the table below.
- 6.2 The quality of ongoing supervision and monitoring of staff was also variable, and it was unsatisfactory in nearly half of the 30 firms we visited.

| Training and competence – good practices that can help firms comply   | Training and competence – Bad practices that can lead to non-compliance  |
|---|--|
| <ul style="list-style-type: none"> <li>• Use of competency-based assessments using short computer-based training tests that must be completed before staff can sell PPI, where they are carried out in a controlled environment.</li> <li>• In several motor dealerships the contracts for most staff had been changed to prohibit them from selling insurance, with all PPI sales being channelled through the financial adviser who had received training on PPI.</li> <li>• Six-monthly training sessions with a competency exam at the end.</li> <li>• Comprehensive training records kept for individual staff.</li> </ul> | <ul style="list-style-type: none"> <li>• Training of individuals not documented. In firms where staff are giving advice this is not compliant with our rules.</li> </ul> |
| <p><b>Example of a good training and competence scheme</b></p> <p>Before the start of FSA regulation the company arranged for sales staff to have 1.5 days training on ICOB followed by an assessment, which carried a 90% pass mark. An annual refresher course was also being developed. In addition, every week the firm gave staff a one-hour education update that included regulatory, compliance and product development issues. Monthly meetings with individual sales staff were held to discuss personal performance, including compliance. These were documented and all training was logged.</p>                    |  |

# 7 System and controls

## **Compliance monitoring**

- 7.1 Our SYSC manual requires firms to have appropriate systems and controls in place for their business. In particular, SYSC 3.2.6R says that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system.
- 7.2 Our visits showed that compliance monitoring of PPI sales was of variable quality. In two-fifths of the 30 firms we visited there were serious shortcomings.
- 7.3 It was common for firms to combine regulatory compliance monitoring of sales staff with monitoring sales performance. They did not see the potential conflict between the two when the same supervisors were responsible for both matters and so did not have systems in place to mitigate this risk. In addition, in some small firms the staff responsible for supervising sales had limited knowledge of PPI policies and compliance issues. So they were not in a good position to judge whether sales being made complied with our rules.
- 7.4 The use of information technology to enhance controls also varied greatly in terms of scope and effectiveness. But it was generally under-used by the firms that had computer systems in place to process the credit application and PPI policy.
- 7.5 The extent and use of management information to identify potential systems and controls problems varied greatly in large firms and was generally poor or non-existent in medium-sized and smaller firms. Many small- and medium-sized firms received no management information about cancellations, complaints or claims from insurers or lenders on PPI policies they had sold. Some suggested that they were unlikely to be successful in getting this information if they requested it from insurers or lenders based on their past experience. Examples of what we found are set out below.

| Examples of practice that can help firms comply  | Examples of bad practice or practice that may increase the risk of non-compliance without other appropriate controls   |
|--|--|
| <b>Compliance monitoring</b>   |  |
| <ul style="list-style-type: none"> <li>• Individual staff graded according to the level of perceived risk they represent. In one firm, staff graded as high risk demonstrably received more monitoring attention.</li> <li>• In one firm each successful sales call was checked by a supervisor (on a live basis with the customer) to ensure the customer was fully aware of what they were purchasing.</li> <li>• One firm checked the suitability of all sales by its advisers, and for trainees the factfind was reviewed by the compliance department before the sale was completed.</li> </ul> | <ul style="list-style-type: none"> <li>• No observations undertaken of sales staff, even those who had only been with the company for a short time.</li> <li>• Lack of risk-based monitoring, with particularly high penetration rates not impacting on the level of monitoring of individual sales staff.</li> <li>• Monitoring that did take place was primarily to assess the effectiveness of sales techniques rather than regulatory compliance.</li> <li>• Inadequate sampling of sales – for example, ratios were as low as one sales call per month per member of staff in one firm and another firm was planning on a ratio of only two sales a year.</li> <li>• No compliance controls over sales visits made to the customer's home.</li> </ul> |
| <b>Use of management information (MI) and information technology (IT)</b>  |  |
| <ul style="list-style-type: none"> <li>• Intelligent use of MI to identify compliance issues.</li> <li>• Contacting customers to find out why they have cancelled PPI policies and using this information to improve products or processes where necessary (although see para 4.24 regarding the need to ensure that customers are not unfairly pressurised).</li> <li>• Root cause analysis of cancellations and complaints assessed by senior management.</li> </ul>   | <ul style="list-style-type: none"> <li>• Focus by Boards on sales figures rather than MI on the quality of the sale.</li> <li>• MI collected on an ad hoc and reactive basis responding to problems only when they had crystallised.</li> <li>• Even where MI is collected, some firms do not use it to identify compliance issues.</li> <li>• Firms not fully exploiting their IT resource to validate compliance – for example, not building in eligibility checks for PPI into systems so that they automatically reject customers that would be unable to claim under the policies.</li> </ul>   |

## Systems for refunds on cancelled policies

- 7.6 There have been problems in the past with some major banks not having proper systems in place to ensure that if a single premium policy is cancelled early the customer receives a refund in line with what the contract states. All large firms we visited had addressed this problem and had systems in place that would proactively give the customer a refund if they cancelled the contract. We did not cover this in our visits to other firms, but we would expect all firms to ensure that they have systems in place enabling them to meet their obligations under PPI policies.

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