Consultation Paper

10/6 ★★★

Financial Services Authority

The assessment and redress of Payment Protection Insurance complaints

Feedback on CP09/23 and further consultation

March 2010

Financial Services Authority

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This Consultation Paper gives feedback on the responses to CP09/23 (which proposed, among other things, Handbook guidance on the assessment and redress of PPI complaints) and further consults until 22 April 2010.

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1 Overview

Why are we issuing this Consultation Paper (CP)?

1.1 In CP09/23 we:

- consulted on Handbook guidance concerning the fair assessment and, where appropriate, redress of PPI complaints;
- consulted on a Handbook rule requiring the re-assessment of all previously rejected PPI complaints made since January 2005; and
- stated that where a firm has identified (from root cause analysis of complaints or other sources) failings in its PPI sales practices, we would see it as appropriate (from Treating Customers Fairly considerations under Principle 6) for that firm to consider the position of non-complainant consumers who may also have suffered detriment from such failings, including considering 'whether a wider redress programme is called for'.

1.2 At the same time as CP09/23 we published an 'open letter' to the industry, detailing common failings in PPI sales practices.

1.3 We have had extensive pro-active engagement with the industry and consumer groups before CP09/23 and after, and we have listened intently to all views.

1.4 Responses to CP09/23 from consumer representatives have been very supportive. Industry responses have been very critical, in particular arguing that the combined effect of our proposed guidance and rule, our statements about root cause analysis and non-complainants, and our open letter, taken together, will have a very significant adverse impact on the industry.

1.5 We have considered carefully all the responses received, including the detailed criticisms. We recognise that the costs (and benefits) and wider industry impact implied by our proposals is significantly higher than we set out in CP09/23.

1.6 Given the public importance of the issues, we are now consulting for a further six weeks on the whole package – that is, proposed Handbook guidance on PPI complaint handling, and our statements on root cause analysis and non-complainants, in light of our open letter and its recast list of common PPI sales failings, and our estimates of the costs and wider financial impact. This consultation exercise will allow us, among other things, to further test and debate our revised assessment of the whole package's costs and benefits and wider industry impact.

1.7 We remain minded to consider that our package is a fair, proportionate and appropriate one which is needed to improve consumer outcomes. However, we have not completed our deliberations and remain prepared to consider all views. Consultees are asked to make any new points and need not repeat arguments already made in responses to CP09/23.

1.8 We are not, however, including in this further consultation the rejected PPI complaint review rule we had proposed in CP09/23. We will now wait until after our powers have been clarified under the new Financial Services Bill currently before Parliament before deciding how to proceed concerning this element.

Background

1.9 Our proposals in CP09/23 stemmed from our concerns about weaknesses in PPI selling practices and our serious concerns about the fairness with which firms had assessed the rising number of consumer complaints about PPI sales. We anticipated that the proposals would lead firms to:

- treat PPI complaints more fairly and consistently, thereby benefiting consumers (and reducing the current heavy burden of cases on the Financial Ombudsman Service); and
- deliver fairer outcomes to consumers who may have been mis-sold PPI but not complained.

1.10 The current proposed package should be seen in the context of our wider strategy and work concerning PPI sales which includes:

- several major firms delivering appropriate past business reviews of face to face sales of single premium PPI sold alongside unsecured personal loans;
- our pursuing targeted sales assessment work in the credit card and second charge mortgage PPI markets; and
- our examining the new generation of protection products now being developed to supplant PPI, and the risks that these may bring.

Outcome of our consultation

1.11 We received 51 responses to CP09/23. In Annex 6 we list those respondents who did not ask for their responses to remain confidential.

1.12 Responses from consumer representatives expressed strong support for our proposals (and expressed no objections to the open letter), in particular welcoming:

- our proposed guidance on PPI complaint handling as fair, relevant and practical, and likely to lead to a fairer outcome for PPI complainants;
- our proposed rejected complaint review rule as likely to bring a fairer outcome to many PPI complainants who had potentially not received a fair outcome from their initial complaint;
- our proposed 'comparative redress' approach, including the scope it would give many complainants for maintaining their PPI cover, if they so wished; and
- our statements on firms' obligations to consider the position of non-complainant consumers who may have suffered detriment from PPI sales failings.

1.13 Responses from industry were almost exclusively negative about our proposals arguing that we had:

- not demonstrated that there was a genuine problem around PPI sales or around PPI complaint handling (having inappropriately and retrospectively raised our expectations of what was required at the point of sale);
- proposed a solution concerning PPI complaint handling that was not appropriate or proportionate;
- not assessed accurately (underestimated ie) the costs of our proposed solution concerning PPI complaints;
- made inappropriate statements about firms' obligations concerning non-complainants who may have been mis-sold PPI;
- not set out the redress costs potentially implied by our statements concerning non-complainants - which industry submit to be very large;
- not assessed accurately (ie underestimated) the wider prudential impact on industry of the costs from our measures;

and that we had:

- proposed guidance on PPI complaint handling that:
  - was not balanced about the assessment of evidence;
  - contained flawed presumptions about how the consumer would have acted if a sales failing by the firm had not occurred;
  - took inappropriate and unworkable approaches to redressing upheld complaints, including setting an inappropriate referent regular premium price;
  - had an impractically short implementation period; and

- conducted an inadequate consultation on our proposals and the open letter.

1.14 Some industry responses queried the lawfulness of our proposals, including whether we had the power to make the rejected complaint review rule.

1.15 In formulating our original proposals, and revising our package of measures now, we have carefully evaluated the potential impact on the industry, and the interests of consumers.

1.16 In some important areas we have addressed the concerns of the industry where we consider that these were well founded:

- We have increased the proposed referent regular premium price for all firms to use (when assessing redress and maintaining insurance cover under our proposed 'comparative approach' to redress) from £6 to £9 per £100 of benefit.
- We have now set out a menu of different ways in which firms can fairly implement the comparative approach to redress and, in particular, the maintenance of cover on a new regular premium basis (which is an important element of that approach for relevant complainants who wish it). This menu enables all types of firms to deliver the comparative approach. We have also now provided worked examples and illustrations concerning this menu.
- We have made some adjustments to the draft Handbook guidance to make the meaning and workings of the 'presumptions' about consumer actions clearer, and to clarify some of the points about fair evidential assessment that had been of concern to firms.
- We have revised our cost-benefit analysis (CBA) of the proposed complaint handling guidance, and in light of concerns about its cost to *particular* sectors of the PPI market we have given separate headline redress figures for complaints about each of the main types of PPI.
- We have now set out the costs that may arise from some firms potentially redressing mis-sold non-complainants.
- We now propose to give industry more time to implement the measures, when finalised, than we had in CP09/23.
- We have recast our description of the failings in the open letter to align more closely with our principles and rules, to avoid the misunderstandings (that were evident from industry responses) around the previous formulation, and to make it clearer to firms how such failings have arisen.

Who should read this CP?

1.17 This CP will be of interest to firms currently or previously active in the sale of PPI. It will also be of interest to relevant trade and consumer bodies.

Consumers

1.18 This CP will be of interest to consumers who have complained about a sale of a PPI policy, or are considering doing so, and to third parties representing them.

Structure of this CP

1.19 This CP discusses the main points we received in response to CP09/23, and sets out our view of these points, and any revisions we are making in response.

- Chapter 2 discusses detailed industry criticisms of the rationale for, and scope and costs of our package, and sets out our views and further consultation questions in response.
- Chapter 3 discusses detailed industry criticisms of our proposed complaint handling guidance, and sets out our views and further consultation questions in response.
- Chapter 4 highlights key revisions to our CBA of the draft Handbook guidance, outlines key aspects of our estimate of the wider impact of our package of measures (in particular from some firms' potential reviews of non-complainants' sales), and asks specific questions about these matters.
- Chapter 5 discusses criticisms of the previous approach to consultation and implementation and discusses next steps, including proposed implementation dates.
- Annex 1 sets out the Market failure analysis of relevant aspects of the PPI market.
- Annex 2 sets out our CBA of the revised draft Handbook guidance on PPI complaint handling.
- Annex 3 sets out other costs and benefits of our measures.
- Annex 4 provides a compatibility statement.
- Annex 5 lists the non-confidential respondents to CP09/23.
- Annex 6 lists the questions consulted on.
- Appendix 1 contains the revised draft Handbook guidance.
- Appendix 2 contains draft material, including examples, supporting the revised draft Handbook guidance.
- Appendix 3 contains our open letter and a re-cast version of the appendix to it listing common PPI sales failings.

Next steps

1.20 The consultation period ends on 22 April 2010, which we consider sufficient time to identify and raise any new points about the whole package and the revisions to it described in this CP. We will pro-actively engage with stakeholders during this consultation period.

2 The rationale, scope and costs of our package of measures

Introduction

2.1 This chapter discusses the responses we received concerning the rationale, scope and costs and benefits of the package of measures in CP09/23. Responses from the consumer side supported the package of measures as necessary, appropriate and proportionate (see paragraph 1.12). However, most industry responses argued that we had:

A not demonstrated that there was a genuine problem around PPI sales or around PPI complaint handling;

B proposed a solution concerning PPI complaint handling that was not appropriate or proportionate;

C not assessed accurately (ie underestimated) the costs of our solution concerning PPI complaints;

D made inappropriate statements about firms' obligations concerning non-complainants who may have been mis-sold PPI;

E not set out the redress costs potentially implied by our statements concerning non-complainants – which industry submit to be very large;

F not assessed accurately (ie underestimated) the prudential impact on industry of the costs from our overall package of measures.

We discuss these lines of criticism in turn.

A Is there a problem around PPI sales and PPI sales complaints handling?

Rising PPI complaint volumes are not indicative of a PPI sales problem

2.2 Some responses from industry argued that the rise in PPI complaints does not stem from problems with the sale of PPI, but merely reflects 'opportunism' by many consumers, encouraged by websites and claims management companies, in the wake of various statements on PPI by public bodies. As one response put it, the rising number of complaints is 'not in any sense an indicator of corresponding levels of dissatisfaction or of inherent faults in PPI products or sales'.

2.3 Some industry responses argued more specifically that there was no evidence to suggest poor selling of the *particular kind of PPI* that they mainly sold.

Our response

We accept that, in principle, a large and growing number of complaints does not *necessarily* indicate a problem with the underlying product or its sale. However, in the case of PPI we do not consider it plausible to think there is no link between complaint volumes and underlying sales problems.

We have gathered evidence of weaknesses in sales practices in all the main PPI sub-markets reported on in our previous thematic statements. The visits our PPI team and supervisors conducted covered over 200 firms. We rated more than a third of the firms in this sample as high or medium-high risk (and gave this rating to nearly half of those selling unsecured or second charge loan PPI).

Out of this work, and supporting mystery shopping exercises, we brought 23 enforcement cases across *all* PPI types.

Type of PPI	Enforcement cases	Total fines
Unsecured personal loan PPI	3	£8,925,000
Second charge mortgage PPI	1	£455,000
Credit card PPI	2	£896,000
Retail credit PPI	2	£880,000
First charge mortgage PPI	5	£308,000
Car loan PPI	7	£175,700
Insurance Premium PPI	1	£770,000
Other PPI	2	£224,000

Dialogue and correspondence with firms and trade bodies about their views of sales standards has only strengthened our view that there is an underlying problem with many firms' PPI selling practices, across all PPI types,[1] and that rising PPI complaint numbers *are* symptomatic of this problem.

We would also note that PPI complaint volumes had already risen significantly from 2006 onwards, *before* claims management companies (CMCs) became heavily involved. Monthly CMC-represented PPI complaints only began to outnumber non-CMC ones during 2009.[2] To that extent, CMCs appear to have been *responding* to dissatisfaction concerning PPI sales, not creating it. The Citizens Advice Bureau's response to our consultation argued that, in its experience, PPI sales complaints were

1 The one exception to this is regular premium first charge mortgage PPI, where we have had fewer concerns about selling practices. Where we identified risks in, or enforced against, brokers' selling of first charge mortgage PPI, our concerns mainly stemmed from their selling of single premium policies of this type, and our thematic reports explicitly flagged the selling of regular premium PPI of this type as of lower risk. See response after para 2.15 for the implications of this for the scope of our proposals.

2 In November 2009, we sent two data requests to the 18 firms from whom we already received detailed submissions on PPI sales, and to all other firms which had responded to CP 23/09. The first of these asked firms to list the 'volume of annual complaints received 2005-2009' subdivided by 'received from customers' and 'received from CMCs'. The firms contacted represented over 80% of PPI sales by Gross Written Premium.

increasing because growing numbers of people were suffering unemployment or illness in the current difficult economic climate, some of whom were then claiming unsuccessfully on their policy and, feeling let down, complaining about its sale.

Our view remains that there are genuine weaknesses in sales practices across nearly all types of PPI, and that much of the large volume of PPI complaints about such sales reflects sincere consumer dissatisfaction, not opportunism (which is not to say that dissatisfaction necessarily means there was a mis-sale).

The FSA perception of a PPI sales and complaint handling problem rests on an inappropriate view of sales standards

2.4 Responses from consumer representatives did not raise concerns about our view of sales standards or about the open letter and the common sales failings it lists. However, many industry responses were critical in a number of ways of our view of failings in sales of PPI and the criticisms are set out here with our response. Firstly there were objections that we had not included the statement of failings in CP09/23.

Our response

We published the open letter as a list of the common PPI sales failings we had identified in our extensive thematic work, mystery shopping and enforcement actions since 2005, and from other sources, and we took the view that this did not require consultation. In CP09/23 we did, however, propose guidance that, in assessing PPI complaints, firms should take into account relevant materials published by us, which clearly includes the open letter.

We in fact received a number of industry responses to CP09/23 which commented on the open letter in detail raising many issues.

We have carefully considered these responses and whether we should revise the open letter in the light of them. (This is discussed further below.)

2.5 Many industry responses argue that we only now perceive weaknesses in PPI sales practices, and significant failings in the handling of PPI sales complaints, because we have inappropriately and retrospectively raised our expectations of what was required at the point of sale, not least as implied by the failings listed in the appendix to our open letter.

2.6 It was also put forward on behalf of the industry that the common failings described in the open letter do not represent contraventions of 'standards' actually applicable to historic or current PPI sales as they either:

- do not reflect the requirements set out in ICOB or ICOBS (or, where relevant, regimes in place before January 2005); and/or
- were not 'reasonably predictable' at the time under our Principles for Businesses, in the absence of any thematic statements to this effect (and the fact that many firms' sales practices were subject to our supervision, and we failed to raise these issues bilaterally with them as part of this).

Our response

Our view remains that we have not introduced any new requirements on firms, and that the failings we have set out are neither retrospective nor inappropriate.

We disagree that the failings set out in the open letter reflect standards that were not reasonably predictable under the Principles or that for them to be so would require us to raise them in a thematic statement or during supervision. (In any event, as set out in our Enforcement guide, it would be wrong to think of 'reasonable predictability' as a legal test to be met when deciding whether there has been a breach of our rules, such as might lead to disciplinary action by us against a firm).

In some cases the failings identified in the open letter arise out of a breach of an FSA rule in ICOB or ICOBS. In other cases the failings, in our view, constitute a breach of our Principles for Businesses, which have applied to this sector since January 2005.

In particular:

- Principle 6 provides that a firm 'must pay due regard to the interests of its customers and treat them fairly'; and
- Principle 7 provides that a firm 'must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading'.

It has always been clear, and we formally state in our Handbook (PRIN 1.1), that:

- our Principles are rules that must be complied with alongside other rules which apply to the business in question;
- while some of the rules and guidance in the Handbook deal with the bearing of the Principles on particular circumstances, the Principles are also designed as a general statement of regulatory requirements applicable in situations in which there is no need for guidance; and
- accordingly, our other rules and guidance 'should not be viewed as exhausting the implications of the Principles themselves'.

So, for example, the fact that there is a specific requirement in a rule for a written disclosure to be made at a particular time does not exhaust the requirement under the Principle for that communication to be clear, fair and not misleading. Similarly, it does not exhaust the requirement to pay due regard to the information needs of clients (though, of course, a disclosure made under the rule may in particular circumstances be enough to meet those needs).

2.7 Industry responses criticised what was seen as the retrospective and unduly prescriptive thrust of the failings concerning disclosure (and in particular oral disclosure) of various elements of information at the point of sale.

Our response

What we have done in the appendix to the open letter is to bring to firms' attention unacceptable outcomes that we have observed, notably several matters that we have found to be commonly not disclosed.

We have repeatedly reminded firms of our expectations concerning PPI sales in many speeches, thematic reports and other publications over recent years. Failings leading to enforcement actions against firms are also detailed in the Final Notices for these actions. We have also been clear in our statements about Treating Customers Fairly. There has been no change in our substantive view that not disclosing the matters covered by the failings amounts to a compliance failure and that this is not a retrospective view or amounting to the introduction of 'new standards'.

However, we have carefully considered the industry criticisms of the way the failings in the open letter were expressed, and considered whether we should revise our description of the failings in light of those criticisms.

As we have made clear in the past, our aim is to focus more clearly on the outcomes we as regulators want to achieve, leaving more of the judgement calls on how to achieve those outcomes to the senior management of firms.

In the PPI context, this means that firms must consider how to communicate information to customers in a manner that is fair, clear and not misleading in accordance with Principle 7.

Having assessed very carefully the responses about the way in which (in the appendix to the open letter) we have described common point of sale failings for PPI sales, we think that the key points are that:

- Principle 7 requires information to be communicated in a way that is clear, fair and not misleading. Despite this, we have found that firms have commonly not been communicating the necessary information at a time and in a way that allows it to be taken into account by the customer in their decision-taking.
- In sales that were primarily conducted orally, we have regarded it as a failing only to provide important information in writing, rather than to communicate it during the sales discussion.
- In the context of a sale conducted primarily orally, the most obvious way for a firm to meet the requirement to provide the disclosure in a fair way is to make it orally. However, in our work we have not found there to be a failing if a firm was able to meet the requirement in some other fair way, such as drawing the customer's attention to the particular information on a computer screen or in writing and allowing the customer a reasonable opportunity to consider it.

There has been no change in our basic views. We are persuaded that, because of the misunderstandings around the previous formulation, and taking into account comments received, we should recast our description of some of the failings. Our aim was to make it clearer to firms how our failings have arisen, for example under the Principles. How we did this was by aligning our description of the failings more closely with our principles and rules. (So, for example, we now describe many of the disclosure failings in terms not of the ‘oral presentation’ of the relevant matters, but of their disclosure in a way that was clear, fair and not misleading).

Appendix 3 contains the open letter and the recast appendix to it (apart from updating the opening paragraph). We see no need to change the open letter itself, and for the avoidance of doubt, this means that our view remains that the general principles of fair conduct when selling PPI before 14 January 2005 have much in common with our standards after this date.

Some other amendments have been made to the letter to reflect comments received and our own views on how best to convey the common failings.

- The failing regarding disclosure of the cooling off period has been amended to reflect the fact that the position is slightly different under ICOBS.
- The failing regarding the steps that need to be taken to establish a customer’s demands and needs has been amended to describe the steps less prescriptively.
- The failing regarding the costs of a policy exceeding the benefits under it has been expressed more accurately and precisely.
- We have removed the separate description of the failing relating to cumulative cost of regular premium policies, which is now sufficiently encompassed within the stated failings about price disclosure.

We have also clarified the failing concerning non-disclosure of non pro rata refund cancellation terms. While we would ordinarily expect firms to have disclosed this information to customers, firms might fairly have concluded that such disclosure was not necessary in particular circumstances. We would not expect such circumstances to be common, because this information should have been disclosed whenever there was a prospect at the point of sale that the customer would repay or refinance the loan before the end of the term of the policy. When considering whether disclosure should have been provided, it is important to take into account information on customers’ general behaviour and information on the particular customer of which the firm was aware (or ought reasonably to have been aware).

Finally, we have improved the clarity of the open letter through minor drafting changes.

2.8 Specific industry criticisms of the failings were as follows:

(i) That we were stating that there was a requirement since January 2005 for the oral disclosure of optionality, price (including premium), details of exclusions and limitations (and a variety of other information, including any potential review of premiums) and that this was an additional and unspecified requirement that is inconsistent with specific ICOB/ICOBS rules requiring only disclosure in writing.

Our response

As explained above, the fact that there is a specific requirement in a rule for a written disclosure to be made at a particular time does not exhaust the requirement under the Principles for disclosure in the context of the sale of PPI to be clear, fair and not misleading. Similarly, it does not exhaust the requirement to pay due regard to the information needs of clients. Firms should not assume that detailed rules (however comprehensive) embody the only obligations of firms towards customers and that they need not also comply with the Principles.

(ii) That we were stating that there was a requirement since January 2005 for the oral disclosure of refund terms and that there is no specific ICOB/ICOBS requirement to this effect, or any specific statement in our thematic work to this effect, and that it was directly in contradiction of a statement by Clive Briault on 29 March 2007).

Our response

The absence of a specific rule does not mean that there is not a requirement on firms to disclose refund terms, in order to satisfy the requirement under Principle 7 for information to be communicated in a way that is clear, fair and not misleading.

The obligation to pay due regard to a customer's information needs and communicate information in a clear, fair and not misleading way requires the firm to provide balanced information when making reference to a policy's main characteristics (whether orally or in writing). For example, if the firm described the benefits of the PPI orally, it should also have provided an adequate description of the significant disadvantageous features for the customer. A feature of many single premium PPI contracts is that a customer will not normally receive a pro rata refund (or even close to it) if cancelling early. As described above, we would ordinarily expect firms to have disclosed this information to customers in a way that is clear, fair and not misleading.

This issue has featured in recent enforcement cases against firms:

- In the Final Notice of the action against Liverpool Victoria Banking Services Limited (29 July 2008) it was noted (at paragraph 4.23) as one of the facts and matters by reason of which that firm had breached Principle 7 that 'The firm did not explain that if the customer cancelled the policy early, for example by taking out a further loan to extend or refinance the existing lending, that the customer would receive significantly less than a pro-rata refund of the PPI premium and interest.'
- In the Final Notice of the action against Alliance & Leicester plc (6 October 2008) it was noted at paragraph 2.3 as one of the failings identified by us that 'There was a general failure to provide details of the cost of PPI, to explain that it was a single premium added to the loan (with interest) and that, in the event of cancellation outside the statutory 30-day

period, the refund could be considerably less than a pro rata repayment of the premium.'

The statement by Clive Briault on 29 March 2007 said 'firms should consider whether they must draw the refund term to the customer's attention as a significant limitation of the policy in the policy summary – ICOB 5.5.R(5) – and in telephone sales – ICOB 5.3.6R(2)(a)(iv)'. This highlighted the importance of this information. It did not introduce any limitation on what the Principles required of firms.

iii) That we were stating that there was a requirement for firms, in order to establish customers' demands and needs, to have asked certain specific questions (including about any employer benefits, assets such as savings and investments, known pre-existing medical conditions and whether the customer's circumstances were likely to change); and that there were no specific rule requirements to this effect, and that what is expected of the firm in this respect ought to have regard to whether or not the answers to these questions were materially relevant to whether or not a policy was suitable (as opposed to whether a policy was the 'most' suitable, which is not something the industry feels it was required to consider).

Our response

There are specific rules requiring a firm, in an advised sale, not to recommend an insurance policy without taking reasonable steps to properly establish the customer's demands and needs.

These rules, and the Principle that a firm should take reasonable care to ensure suitability of advice mean that before recommending PPI the firm should enquire about matters such as: any existing means the customer already had of protecting the loan or which they could use to meet the repayments on the loan should this become necessary (including, for example, benefits from their employer, and assets such as savings and investments); whether the customer was aware of any pre-existing medical conditions that might be excluded under the policy; whether the policy would be affordable in light of the customer's income and outgoings; and whether the customer's circumstances were likely to change (including whether they might retire during the term of the policy).

iv) That we were stating that one of the issues for a firm to address when considering the suitability of a sale of a single premium policy was whether the term of the cover was less than the term of the credit agreement and the consequences of any mismatch, and that this had not been a requirement.

Our response

We identified a common failing of not disclosing to the customer that the term of the cover was shorter than the term of the credit agreement and the consequences of such mismatch. Our view is that failing to disclose such a mismatch and its financial consequences to the customer would not comply with the Principles. From the introduction of ICOBS 6.4.9R(3) this would also have been a breach of the rule.

v) That we were stating that one of the issues for a firm to address when considering the suitability of a sale of a single premium policy was whether the premium (and cost of the loan to pay for it) was likely to exceed the benefits payable under the policy cover, and that the cost of the loan is not relevant to benefits payable under the policy.

Our response

We have identified a common failing where the customer was sold a policy where the total cost of the policy (including any interest paid on the premium) would exceed the total possible benefits payable under the policy (other than benefits payable under life cover). That is, the policy is inevitably going to be a bad purchase for the customer. This would be a breach of the requirement under the Principles to treat customers fairly as well as the general requirement under ICOB to take reasonable steps to ensure a personal recommendation is suitable and under ICOBS to take reasonable care to ensure the suitability of advice. We have amended the open letter to give greater clarity in response to comments.

vi) That we were stating that one of the issues for a firm to address when considering the suitability of a sale of a single premium policy was whether there was a prospect that the customer would repay or refinance the loan before the end of policy and that this had not been a requirement; and that 'prospect' seems an extremely wide test, and that we were wrongly assuming that firms would have the relevant knowledge.

Our response

There are detailed rules under ICOB and ICOBS concerning the requirement to seek information about a customer's circumstances and objectives and their demands and needs which are applicable to this situation, as well as the requirement under the Principles to take reasonable care to ensure the suitability of advice. A single premium policy may not meet a customer's need for flexibility if a customer might repay or refinance the loan (or otherwise cancel the policy) before the end of its term. Advisors must take reasonable care to ensure that the policy was suitable for the customer's demands and needs taking into account all relevant factors.

vii) That we were stating that there was a requirement not to sell a policy where the cost of the loan and the premium is likely to exceed the benefits payable under the policy and that this had not been a requirement. It was said that this is the case for most insurance policies, and is the nature of insurance business – insurers gamble that premiums will exceed claims. In any event, the comparison seems unfair, the policy is taken out to cover the cost of the loan (not the premium as well, which forms a 'stand alone' element for these purposes).

Our response

As explained above, we have identified a common failing where the customer was sold a policy where the total cost of the policy (including any interest paid on the premium) would exceed the benefits payable under the policy (other than benefits payable under life cover). That is, the policy is inevitably going to be a bad purchase for the customer as an individual. This is not the same as saying that premiums should not exceed claims overall for an insurer. We have amended the open letter to give greater clarity in response to comments.

viii) That our view was that oral disclosure of any potential review of premiums was required; and that this would be a new requirement.

Our response

There are detailed rules under ICOB and ICOBS concerning the requirement to disclose details of the period for which a premium is valid and when it will be reviewed. A specific rule (under ICOBS) also requires that if a firm provides information orally during a sales dialogue with a customer on a main characteristic of a policy, it must do so for all the policy's main characteristics. However, the existence of detailed rules does not exhaust the requirement to act in accordance with the Principles when communicating information and it is a failing where a firm does not comply with them.

The FSA perception of wrongly rejected PPI complaints is inappropriately reliant on the decisions of the Financial Ombudsman Service (FOS)

2.9 There were several aspects to this industry criticism:

- the FSA has no right, as a separate public body, to attach weight to complaint decisions by the FOS;
- the frequency of the FOS's overturning of firms' rejections of PPI complaints is not out of line with that for other types of complaint;
- the PPI complaint decisions by the FOS are misconceived and its approach has not been consistent, changing significantly over time;[3]
- the FSA has not audited the PPI complaint decisions of the FOS; and
- the FSA should not attach weight to private discussions with the FOS that we do not then disclose to firms for their consideration.

Our response

We indicated in CP09/23 that our proposals stemmed from our serious concerns about the fairness with which firms have assessed consumer complaints about past PPI sales (which have significantly increased in recent times). We also indicated six broad sources of information that prompted those serious concerns. In summary:

3 Some industry responses said FOS overturns of PPI complaints had increased from 16% in 2006/07, to 45% in 2007/08, to 89% in 2008/09.

- our own findings about (over 200) firms' PPI sales practices;
- our own analysis of samples of PPI complaints decisions made by (three large) firms (which found poor results);
- our dialogue with firms and industry representatives about their approach to assessing PPI complaints;
- the large (and growing) number of PPI complaint referrals to the FOS;
- the significant difference in consumer outcomes between PPI complaints to firms and those referred to the FOS; and
- our discussions with the FOS about its dealings with some firms' complaint handling departments concerning PPI complaints.

So, information from the FOS about PPI complaints has certainly not been the only prompt to our concerns. But it has been an important one. The fourth and fifth aspects were formally emphasised by the FOS (along with its view that there was a widespread issue, that allowing consumers to bring individual complaints was not an appropriate solution and that a general solution was needed) in its public letter to us of July 2008 under the 'wider implications' framework,[4] which formally asked us to take its concerns into account.

The FOS is the statutory scheme established by parliament to resolve individual consumer complaints. Disputes about the decisions it makes are matters for it to resolve or ultimately the courts. The FOS is independent of the FSA, and must reach its own decisions on complaints, on the basis of what appears to it to be fair and reasonable, taking account of the law, the regulatory rules, codes and good industry practice at the time (which is not, we recognise, necessarily the same judgement as that we must generally make about firms' compliance with our requirements).

We consider it is right and appropriate for us to attach weight to the FOS's decisions when assessing firms' handling of complaints and fairness of behaviour more generally (and firms should have regard to FOS's decisions when handling relevent complaints – see DISP 1.4.2G).

We discussed with the FOS on several occasions the key themes that run through many of its PPI decisions, often in the context of the PPI working group.[5] That group also provided us with some examples of FOS decisions that firms did not agree with.

In the light of the representations from the industry we did consider the issues raised. Our view of the relevant regulatory standards and conduct which falls short of the standards (such as that set out in the open letter), and the FOS's conclusions about individual cases or about the circumstances where redress should be paid, are compatible. Whereas, there are a number of material differences between our

4 The Wider Implications Process aims to encourage effective co-operation and co-ordination between the ombudsman service, FSA and other relevant regulators (such as the OFT).

5 In the summer of 2008, the major trade associations suggested that an industry-led solution to concerns about PPI complaints might be possible. We supported the efforts of an industry-led group, with consumer representative input, to try to produce an effective industry code to improve PPI complaints-handling standards across the sector – see CP09/23 paras 2.10-2.11. The group met a number of times before and after CP09/23.

view and much of the industry's view of 'point of sale' conduct and consideration of consumer needs and circumstances. So to that extent, we remain confident that a significant proportion of industry's assessment of PPI complaints is likely to be genuinely problematic.

In year ending 31 March 2009, the outcome of PPI complaints changed in favour of the complainant as a result of the FOS's involvement (ie there was a change in favour of the consumer after referral to the FOS) in 89% of cases. This is *twice* the percentage for complaints about non-PPI insurance, investments or mortgages, and still significantly exceeds the high rate for cases concerning bank accounts and services (of around 60% – figures which themselves concern us). So, we remain of the view that the change rate at the FOS for PPI complaints is a clear outlier.

On the wider points about our discussions with the FOS, we would note that:

- FOS has had experience of dealing with thousands of individual complaints from customers about PPI over the past three years and direct experience of the way that firms have responded to those complaints. It is clearly relevant to our overall assessment of the regulatory position to obtain information from the FOS;
- we have a formal 'gateway' with the FOS which makes such exchanges in support of our respective functions entirely proper;[6]
- the thrust of these discussions with the FOS was mainly generic, about broad types of firms and their PPI complaint-handling behaviours; and
- the main points from these exchanges were outlined in CP09/23 and have been made by the FOS in numerous public forums attended by firms, and also in commentary and illustrative case study decisions on the dedicated PPI pages of the FOS website.

Concerning any shift in the FOS's PPI change rate, we received exactly the same explanation from the FOS (when we enquired on the point following consultation responses that raised it) as industry representatives have received from the FOS. Namely, that the shift in change rate simply reflects the shifting mix of PPI complaints to the FOS over time. That is, over time the case mix has shifted materially from being one predominatly relating to complaints about claims-related matters against insurers (where the change rate is much lower) to being dominated by complaints about the sale of the policy (where the change rate is much higher).

The FSA has insufficient evidence of its own concerning PPI complaint handling

2.10 Criticisms of our relationship with the FOS were accompanied in some industry responses by the further objection that we should only intervene in PPI complaints on the basis of our *own* evidence about firms' complaint handling, but had not done the work needed to gather such evidence.

6 The ombudsman service may provide information to the FSA and the OFT, subject to the subject's rights of privacy. Disclosure of confidential information by the FSA to the ombudsman service is subject to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001.

Our response

We conducted complaint file reviews of three large firms' PPI complaint handling, which found poor results. We viewed these results in light of: the more general evidence (discussed above) that was accumulating about poor sales standards; and the data and intelligence we had, from the FOS and elsewhere, which indicated poor PPI complaint handling by firms to be likely.

We also viewed these PPI complaint handling concerns in the context of our concerns about the fairness of firms' handling of complaints more generally (concerns that were themselves prompted by, for example, communications from the FOS, our own supervisory work, and our intensifying analysis of the complaints data reported to us by firms[7]).

We decided, after careful consideration, that it would not be the best use of resource, or in consumers' best interests, to conduct further firm specific evidence-gathering on PPI complaint handling at that stage. (Our decision also has to be seen in the wider context of the very considerable thematic and enforcement messages given, as well as the resource we had already expended on PPI more broadly (primarily on firms' selling practices), and the growing other demands upon our resource arising from the intensifying prudential difficulties that emerged through 2008.)

Therefore, we moved directly to discuss with industry and other stakeholders how improvements in PPI complaint handling might be achieved. But that dialogue, and supporting correspondence around it, did nothing to reassure us about firms' approaches to either PPI sales or the assessment of PPI sales complaints. Indeed, these discussions made us *more* concerned.

Such dialogue confirmed us in our view that the significant difference in consumer outcomes between PPI complaints to firms and those referred to the FOS probably meant that many of that majority of complainants who were complaining to firms about their PPI sales, but not persisting to FOS, were not getting fair outcomes from their complaints.

So, we remain of the view that our own firm specific evidence gathering on PPI complaint handling and the overall evidence clearly indicates a more or less general problem with PPI complaint handling.

Conclusion

2.11 We remain of the view that we have well-founded and adequately evidenced concerns about widespread weaknesses in PPI sales practices, and in PPI sales complaint handling, which have given rise to the risk of significant ongoing consumer detriment, and that we need to address these in order to protect consumers and meet our statutory objectives. This was the rationale for our original proposals and it remains the basis for the package we consult further on here.

7 We are currently conducting thematic work on banks' handling of non-PPI complaints, and will report publicly on it.

B Is our proposed solution concerning PPI complaint handling appropriate and proportionate?

The proposed rejected complaint review rule is not appropriate[8]

2.12 One line of industry criticism was that if a general review of the numerous previously rejected PPI complaints was required, then this was something that should legally be prescribed through an industry review under section 404 of the Financial Services and Markets Act 2000 (s404), which involves a number of significant prior process disciplines.[9]

Our response

We have given very careful thought to this point. As Parliament is considering whether to revise s404 and certain other of our relevant powers under the Financial Services Bill currently before it, we consider it more appropriate to defer further consideration of any rejected complaint review requirement until after our powers have been clarified.

Our 'one size fits all' proposals do not distinguish between 'good' and 'bad' firms, or between sales made before or after FSA regulation, or between different types of PPI.

2.13 Many responses from the industry argued that whatever our grounds for concern about PPI complaint handling, it was inappropriate and disproportionate to seek to remedy these through the means of Handbook requirements that would catch and impose administrative costs upon individual firms who may not themselves have been manifesting the kinds of behaviours (in selling or complaint handling) that led to our general concern. Instead, the solution, and in particular any review of rejected complaints,[10] should be confined to those firms for which the FSA has *specific* evidence that PPI had been mis-sold and complaints mis-handled.

2.14 Some industry responses argued that because the selling of general insurance by intermediaries only became a regulated activity in January 2005, our proposed guidance and rejected complaint review rule should not apply to complaints about PPI sold before that date. Some argued more specifically that our proposals would fall disproportionately on insurers, who, it was alleged, may have to pick up liabilities from sales made before January 2005 by brokers that were not members of the General Insurance Standards Council at the time of sale.

2.15 Another industry criticism of our proposed approach was that it inappropriately applied to complaints about all types of PPI and would be disproportionate in its effects for particular types of PPI that (variously):

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8 In CP09/23 we asked: Q5: *Do you agree that requiring the re-assessment of rejected PPI complaints against the proposed guidance is a fair and proportionate requirement?*

9 Section 404 provides for the establishment of schemes for reviewing past business where there is evidenced widespread or regular failure to comply with the FSA's rules and consumers are either experiencing, or have the potential to suffer, loss. A scheme must be authorised by the Treasury following an application from the FSA outlining the alleged failure. Treasury authorisation is to be granted by way of Parliamentary order.

10 In CP09/23 we asked: *Q6: Do you agree with the scope of the review rule?*

- were not single premium, so did not, for instance, share the product or market features of concern to the Competition Commission;
- had not been implicated by us in mis-selling or consumer detriment;
- had not given rise to many complaints (relative to policies sold) or to high firm rejection rates or a high FOS change rate (relative to complaints about other types of PPI);
- had large premiums, such that redress for individual upheld complaints about that type of PPI would be large, and so attract more complaints than other types of PPI and so inflate total redress costs for relevant firms;
- had small premiums, such that total redress arising from the proposed rejected complaints review rule would be modest, relative to the administrative costs incurred by relevant firms in conducting the review.

Our response

As noted above, we considered that the evidence indicated a more or less general problem in PPI complaint handling.

We did consider a firm-by-firm approach to improvement and remediation, targeted initially on those firms that appeared to be worst at PPI complaint handling, and embracing further evidence gathering, bilateral negotiations concerning the review of rejected complaints and improvement in handling new complaints going forward, and, potentially, enforcement referrals.

However, we concluded that such an approach would have left untouched, for a significant period of time at least, many other firms that were little or no better in their PPI complaint handling. Such an approach would not, therefore, have achieved in any reasonable timescale the improvement in outcomes for complainants more generally which seemed to us necessary.

In short, the more or less general problem in PPI complaint handling seemed to us to demand a more or less general solution that would deliver common and improved standards of PPI complaint handling across all industry sectors, make good the detriment to those past rejected complainants who had been mis-sold, and avoid further detriment to future complainants who may have been mis-sold.

We then considered carefully *which* general solution would be most appropriate.[11] We considered issuing a Dear CEO letter to firms, outlining our concerns about their complaint handling and asking them to reconsider their approach accordingly. However, in the present case, we considered that the extent of evidence, the number and variety of firms seemingly involved, and the potential extent of consumer detriment caused, demanded a more formal, specified and across the board approach.

We concluded that Handbook provisions were more suited to deliver this, and that their greater formality and detail would engender a more thoughtful and immediate

11 We also considered what our strategy should be in response to the wider problem concerning PPI sales practices, and how our approach to the complaint-handling problem would fit into that strategy – see paras 1.10 and 2.20.

response from all relevant firms, and so bring improved outcomes for more complainants sooner.

Concerning the proposed complaint handling guidance, we consider that a firm that has always sold PPI fairly, and/or handled PPI complaints fairly and consistently according to its existing obligations under DISP, will feel little impact or additional burden from our guidance, since the firm will typically tend to have relatively few PPI complaints and/or need to make relatively little adjustment to its PPI complaint handling approach. Therefore, notwithstanding the general application of the proposed Handbook guidance, we do not agree that it can reasonably be considered likely to have a disproportionate impact on 'good' firms.

Concerning the proposed rejected complaint review rule, and as we certainly bore in mind at the time we took our decision to propose it, we would remain open to an individual firm making a case that such a review would be unduly burdensome for it, or not serve the intended purpose in its case, such that the rule should be waived in its case, provided such waiver would not cause consumer detriment (see s178 of FSMA). This might be, for example where the firm could prove that it does not have a problem with PPI complaint handling, or that any such problem has already been identified and adequately remedied by it.

So we remain of the view that, in principle, proposed guidance on fair PPI complaint handling that applies to all firms, and a potential formal requirement upon all firms to review rejected PPI complaints, are appropriate responses.

Concerning complaints about PPI sales made before January 2005, we see no reason to carve these out from the scope of our proposed complaint handling guidance. This is because for nearly all banks and insurers, and for a majority of general insurance intermediaries, the existing DISP requirements for handling complaints already apply to new complaints about such pre-January 2005 sales. (We are not proposing any change to the definition of a complaint within the Handbook, or to which complaints are covered by DISP.) We have no cause to think that complaints about these earlier sales have been handled any better than those about later sales, and our open letter sets out our view that firms should have regard to the list of failings when considering complaints about pre-January 2005 sales. So it is entirely appropriate in the context of our rationale and concerns about poor PPI complaint handling that our proposed guidance on DISP does not carve out such complaints.

A decision about whether rejected complaints about pre-January 2005 sales would be included in any rejected complaint review requirement will now be for another day, and we will take into account then the responses already made on the point.

Whether an insurer bears any liability for a sale by another entity is a factual and contractual matter. Where there is a contractual or agency arrangement between the parties in the insurance chain, or an agency arises, or a consumer's losses were due to an act or omission of someone in the insurance chain other than the seller, liability may also fall, normally, jointly and severally on other parties. It is true that, in general, complaints about insurance sales made before January 2005 by brokers who were not members of GISC at that time do not fall within the scope of our

DISP requirements or the jurisdiction of the FOS. So consumers may have to seek a remedy against the broker through the courts.

We did consider, in light of industry responses, whether there was anything different about the various types of PPI or the way they were sold which would mean we ought to take different approaches towards complaints about those types.

Our *provisional* view is that these industry responses mostly did not make a persuasive case for excluding complaints about any particular PPI type from the proposed rejected complaint review rule.[12] The one exception is that we have had fewer concerns about the sales of regular premium first charge mortgage PPI, and that so far, the number of complaints about this PPI, and the proportion of them rejected by firms but overturned by the FOS, is relatively lower than for other PPI types. So we will monitor those figures, to consider whether rejected complaints about this type of PPI should be left out of any future rejected complaints review requirement.

In light of the industry's concerns about the costs of our proposed guidance to particular sectors of the PPI market, our revised CBA now estimates the separate headline costs for complaints about each of the main types of PPI (see Annex 2). We also consider the potential for these costs from the proposed guidance (in conjunction with costs potentially arising from the redress of non-complainants) to cause adverse prudential implications for particular sectors of the PPI market.

However, we see nothing in these figures (or in the industry's arguments more generally) which undermines, for any particular sector of the PPI market, our view in CP09/23 that the sum of redress is a *fairness driven transfer from mis-selling firms to mis-sold consumers*. If a particular type of PPI gives rise to relatively few complaints to relevant firms, and/or complaints about that type are already being fairly handled by firms according to their existing obligations under DISP, then those firms will feel little impact or additional burden from the proposed guidance when assessing complaints about that type of PPI.

So, we do not see it as necessary or appropriate to remove complaints about any type of PPI from our proposed guidance on handling new PPI complaints.

C Have we underestimated the costs of our proposed guidance on PPI complaint handling?

2.16 In CP09/23, our CBA estimated that our proposed complaint handling guidance would result in a transfer from firms to consumers of between £58m and £80m a year for around five years (£290mn-£400mn in total), in the form of increased redress for increased numbers of upheld new complaints.

2.17 Responses from consumers did not raise concerns over this CBA or the assumptions behind it. But industry responses made a number of criticisms, the overall thrust of

12 Provisional, because we are not finalising any rejected complaint review requirement here, so final decisions on what PPI types would be included in any such rejected complaints review will be for another day, and we will take into account then the responses already made on the point.

which was that we had significantly underestimated the cost to industry (some also questioned the benefits that we suggested our proposed guidance would bring).

Our response

We discuss and respond to these criticisms in detail in Chapter 4 (and in the revised CBA at Annex 2, with further cost-benefit information supplied in Annex 3). Here, however, we would note that we accept that the CBA in CP09/23 did substantially underestimate the additional costs (and benefits) of firms' complying with our proposed guidance. This was mainly due to something largely unconnected to our proposal, namely, the higher than assumed volume trends for PPI complaints (which became apparent after our original consultation).

Our revised CBA of the guidance, set out in Annex 2, shows additional costs to firms (from redress and administration) of **£700mn to £1.2bn** over five years.

Our view is that, taken on its own, this revised CBA estimate for compliance with the guidance, although significantly higher than the original estimate, would not undermine the justification we gave in our original CBA. That is, our rationale that the sum of redress is *a fairness driven transfer from mis-selling firms to mis-sold consumers* still applies, as the increase mainly reflects the costs of redressing a proportion of rising PPI complaint numbers. If we underestimated the size of the cost, we also underestimated the size of the fairness driven transfer to consumers.

However, we have considered this overall sum's potential to contribute (in conjunction with costs potentially arising from the redress of non-complainants) to adverse prudential implications for firms (see F below).

D Were our statements about firms' potential obligations concerning non-complainants appropriate?

2.18 In CP09/23, we said that:

Firms will also wish to consider their existing obligations under DISP (1.3.3R) concerning the root cause analysis of PPI complaints. That is, in addition to handling complaints fairly, firms should be assessing the common underlying causes of those complaints and correcting those causes. […] To that extent, root cause analysis of PPI complaints should be part of a wider reflection by firms on the full range of criticisms and concerns we have raised concerning PPI sales practices. We would expect firms to develop a clear conception and programme of the changes they intend to carry out in response. [...] In this context, we would see it as appropriate for a firm to consider whether a wider redress programme is called for, potentially including the pro-active redress of relevant PPI customers who have not complained where, for example, the firm becomes aware from complaints or otherwise that it had serious deficiencies in past sales practices, either in general or in a particular sales location or medium. […] This is another aspect we will take a close interest in over the coming period.

2.19 Most responses from consumer representatives welcomed these statements, but responses from industry objected that they amounted to our inappropriately seeking an industry-wide review of PPI sales ‘through the back door’, without the process disciplines of s404.

Our response

Our comments on firms’ obligation to consider the position of non-complainants potentially affected by weaknesses in PPI sales practices did not introduce new concepts specific to PPI. Firms should long have been aware of what we would expect them to do when trends have been identified through, for example, complaint handling and root cause analysis.

In June 2002, we stated[13] that, under the (then) complaints rules,[14] a firm should, in ensuring that it takes reasonable steps to handle complaints fairly, take a ‘*more positive approach*’ and use a complaint to:

‘check whether there is an underlying issue which prevents customers from getting a fair deal which needs to be put right…A firm may discover, for example, a systemic error or regulatory breach that disadvantages a number of past and existing customers… Investigation of a complaint by the Financial Ombudsman Service, although focused on one particular case, could also call into question a firm’s conduct in relation to a group of customers’.

We specifically highlighted a situation where a:

‘firm may be faced with decisions as to how it should approach the task of meeting the need to deal fairly with different classes of customers…even when it has received no complaints because it has identified the problem, rather than it coming to light through an external inquiry of some kind such as an Ombudsman investigation’.

We went on to state expressly that:

‘If something has gone wrong which affects a wide class of customers, a firm will wish to take appropriate and proportionate action to seek to put things right… When considering the interests of all consumers who might be affected there might be one class or group which the firm feels should be compensated but there are reasons why others should not be, or not to the same extent…In those circumstances, the firms could explore with the FSA how to put in place a programme of mitigation to provide appropriate redress to consumers affected, on a fair and equitable basis, without disadvantaging some at the expense of others. This could be in the form of an agreed rectification scheme, which might pro-actively compensate on an agreed basis of fair treatment, or there might be other means by which those concerned could be fairly compensated’.

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13 In the ‘Treating customers fairly: Progress Report’ publication http://www.fsa.gov.uk/pubs/discussion/dp7_progress-report.pdf

14 As at June 2002, DISP 1.2.22R provided that *a firm must put in place appropriate management controls and take reasonable steps to ensure that in complying with DISP 1.2.1R, it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems, as well as any specific problem identified by a complaint*. This rule was amended and set out in further detail in the current DISP 1.3.3R and 1.3.5G.

In December 2005, we expressly stated[15] that within the area of complaints handling, a key Treating Customers Fairly (TCF) risk would be:

‘Not acting when complaints may indicate a wider problem affecting a larger or similar group of customers’.

As such, a typical question that a firm would want to consider, to help identify whether it had sought to meet its TCF obligations, is:

‘how does the firm identify and remedy issues that may indicate a wider or recurring problem?’

In July 2007, we stated[16] that poor practice in decision-making included instances where a firm failed to record the basis of material decisions and had failed to justify:

‘why a firm had decided that a complaint trend did not have a wider impact’.

We also stated that a firm’s inclination to be fair and objective in its dealings with customers is:

‘evident not only through complaint handling itself, but also through analysing the root cause to identify improvements in processes and controls, and the willingness to undertake wider reviews where unfair consumer outcomes have been identified’.

In June 2008, we re-iterated these broad points for General Insurance Brokers,[17] when we stated that an example of good practice regarding such firms’ controls is where:

‘Complaints are regularly reviewed at senior management level and **root-cause analysis findings are acted on**’.

In general, therefore, if a firm is aware, from its complaints handling experience or otherwise, that there have been deficiencies in its past selling practices (or other behaviours), we would see it as appropriate (from Treating Customers Fairly considerations under Principle 6) for the firm to further consider the position of non-complainant consumers who may have suffered detriment from such failings. We would expect the firm to take fair and sensible decisions about whether, and what, action would be appropriate concerning this group of consumers. And it may then be appropriate for such own initiative action by the firm to include taking steps that potentially lead to the redress of the non-complaining consumers who have suffered detriment.

In the present specific context of PPI, we consider that each firm should analyse its PPI complaints, and other relevant sources of intelligence, including the failings listed in our open letter (see 3.4.1G of the proposed guidance), and consider whether it was likely to have recurring or systemic failings in its sales practices (including in specific areas or channels of its business). If the firm concludes this was likely, then we would expect that:

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15 ‘Examples of Key Risks, Indicators and Questions’ publication. http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/examples.pdf

16 ‘Treating customers fairly – culture’ publication http://www.fsa.gov.uk/pubs/other/tcf_culture.pdf

17 ‘Treating customers fairly: progress update’ publication http://www.fsa.gov.uk/pubs/other/tcf_progress.pdf

Where a firm identifies recurring or systemic problems in its sales practices for payment protection contracts (from its complaints or otherwise), it should consider whether it ought to act with regard to the position of customers who may have suffered detriment from, or been potentially disadvantaged by such problems but who have not complained and, if so, ensure that those customers are given a proper opportunity to obtain appropriate redress. In particular, the firm should:

(1) ascertain the scope and severity of the consumer detriment that might have arisen;

(2) consider whether it is fair and reasonable for the firm to undertake pro-actively a redress or remediation exercise which may include contacting customers who have not complained; and

(3) communicate the firm's conclusions on (1) and (2) to the FSA as soon as practicable.

Where the firm considers that no redress or remediation exercise is required it should give the FSA reasons for its conclusion.

Supervisory dialogue would then be likely to consider aspects of proportionality, in light of the nature of the PPI shortcomings identified, the number of consumers affected, the nature of the potential or actual detriment to them, and what might be appropriate steps by the firm in response.

We would anticipate bringing together and assessing all such reports from firms. Moreover, we would be likely to approach in due course firms from whom we had *not* received such reports. Firms should be under no illusion about the importance we place on their obligations in this regard, and their ability to demonstrate and justify to us the relevant actions they have taken, and in particular, not taken. Where they cannot do this, they can expect tough action from us.

Nonetheless, as our statements concern individual firms, and are conditional on the actions, findings and judgements of such individual firms, we cannot see that our statements can reasonably be construed as amounting to an 'industry-wide sales review through the back door'.

So we remain of the view that our statements are appropriate, in the context of Principle 6 and DISP 1.3.5G, and will not in any way penalise firms which have good and fair PPI sales standards.

However, limitations on our powers concerning most PPI sales made before 14 January 2005 (when general insurance selling by intermediaries became a regulated activity) mean we cannot necessarily expect most firms to consider in this way the position of non-complainants who were sold PPI before that date.

We invite comments on the appropriateness of our italicized statements above, and whether they should be made into Handbook guidance – see questions 4 and 5 below.

2.20 Some responses from the consumer perspective argued that, given the apparent extent of PPI point of sale failings and potential consumer detriment, the correct regulatory response *should* be a full industry wide review of past PPI sales under s 404 of FSMA, not least to ensure fairness for those who may not be aware or confident enough to complain.

Our response

We have considered this option, but currently consider that the most significant sales problems can be redressed more swiftly and proportionately through other means, in particular through:

- several major firms delivering appropriate past business reviews (PBRs), covering a significant proportion of face to face sales of unsecured personal loan PPI since January 2005, together with the PBRs agreed within the context of our enforcement actions against firms' PPI selling practices during 2008/09;
- our ongoing targeted sales assessment work in the credit card and second charge mortgage PPI markets;
- our intended actions to ensure individual firms take their obligations concerning non-complainants seriously; and
- the fair assessment of PPI complaints by firms, which our prposed guidance (and monitoring in support) will help ensure.

We consider that on average, more PPI complaints (relative to sales) will tend to be made to those firms more likely to have made non-compliant sales. To that extent, using such a complaints-led approach as a key part of our strategy is likely to be more onerous for such firms than for those whose sales tended to be more compliant, and so is a more targeted and proportionate response to poor sales practices than mandating to the whole market a full review of PPI sales. We note that financial services issues giving rise to complaints now receive more publicity than in the past, through for example the activity of consumer bodies and websites.

E What are the wider cost implications of our statements about non-complainants?

2.21 Some industry responses said that our statements concerning firms' obligations towards non-complainants, in conjunction with what firms have criticised as our retrospective and inappropriately high expectations about their PPI sales practices, imply a redress bill of tens of billions of pounds, which, moreover, we had not included in the CBA in CP09/23.

Our response

We remain of the view that, as any such review and redress is conditional on what individual firms themselves find and conclude, and as Principle 6 and the Handbook guidance (in DISP) on such matters already exists, none of this was a new 'proposal' needing its own CBA.

However, in light of the firm's concerns about the potential financial implications *if they were* to conduct such reviews, find mis-selling had been prevalent and decide to redress it, we have now set out our estimate of what we consider to be a realistic range for such potential redress to non-complainants – see Annex 3.

The headline figure is a one-off potential cost to industry (from redress and administration) of **£1bn-£3bn**.

This is a substantial figure, but a small fraction of the more extreme industry figures submitted to us. This is mainly because we:

- exclude from consideration most sales made before 14 January 2005; and
- consider it appropriate for any own-initiative review of PPI sales by a firm to proceed initially through consumer contact exercises and for only respondents' sales to be reviewed.

We ask for views on the appropriateness of these assumptions (see Chapter 4).

F Have we adequately assessed the prudential impact on industry of the costs from our overall package of measures?

2.22 Some industry responses argued that the costs to them implied by complying with our proposed complaint handling guidance, and/or our statements concerning firms' non-complainants, would individually or together have adverse impact on the financial stability of many firms and even whole sectors.

2.23 Some responses from brokers argued that our proposals would fall disproportionately on PPI brokers who were not lenders or insurers, since they had only taken a minority share of the policy premium in commission for selling the policy, but now stood liable for a sum of redress concerning an upheld complaint about that policy which amounts to much or all of such premium. These responses argued that this burden would put many such brokers out of business, and cast a burden on the Financial Services Compensation Scheme (FSCS).

2.24 Some broker responses further argued that this would be unfair to them because they feel they were required to achieve threshold PPI penetration rates to underpin lender profitability, and that there were product design and manufacturing flaws that brokers should not be held responsible for.

Our response

We accept that the two sets of costs (£700mn to £1.2bn over five years for complaints, and £1bn-£3bn. for non-complainants) are substantial.

As any particular (post January 2005) sale can only be in one cost pool or the other (ie a sale complaint, or else a sale not complained about but reviewed), more cases in one pool will mean fewer in the other. So the higher ends of each range are very unlikely to both occur.

The main prudential impacts we have identified concern specialist secured lenders and general insurance brokers.

Most specialist secured lenders (active in the market since 2005) are currently closed to new business, and so such costs will add pressure to their financial position. However, we don't consider this is likely to lead to adverse supply or competition effects (for relevant loans or PPI) for consumers.

Concerning brokers, the liability for redress is determined by the position at law. The redress for mis-sold PPI is akin to damages equivalent to the customer's losses, and whilst liability may sometimes fall jointly on several parties, as discussed above, it may often fall on the seller of the policy, even if he has earned little from the sale. This is one reason for our prudential requirements concerning professional indemnity insurance.

In any case, any failings by a product provider do not lessen the broker's own responsibilities to sell PPI in a fair and compliant way. Concerning the retail market more generally, we previously set out our views of product providers' and distributers' respective responsibilities,[18] and more recently we have signalled our intention to develop a regulatory approach that looks more deeply into product governance, design and oversight by provider firms,[19] and which may consider introducing a form of product regulation.[20]

There are around 7000 directly authorised general insurance intermediaries and around 16000 appointed representatives. We estimate that perhaps 5% to 10% or more may fail as a direct result of the cost impact from our measures. However, we don't consider this is likely to lead to adverse supply or competition effects for consumers.

Overall, it is possible, though unlikely, that some £160m of the redress costs described above may pass through to the FSCS and then on to its levy firms.

Notwithstanding these potential prudential impacts and our need to consider our different statutory objectives, we remain of the view that our proposed package remains appropriate and proportionate. If an individual firm were to raise the risk to us that providing redress to non-complainants would put them at risk of failure, we would need to discuss this with the firm concerned. However, we remain of the view that, taking into consideration the financial impact of our proposals including prudential risks to some firms, our priority is to ensure that consumers receive fair redress where this is appropriate because of mis-selling by firms.

Summary and Questions

2.25 In this chapter we have:

- considered a number of detailed industry criticisms of our proposals;
- set out our views in response, which reject most of those criticisms; and

18 See Policy Statement 07/11 (July 2007) 'Responsibilities of providers and distributors for the fair treatment of customers - Feedback on DP06/4.

19 http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0125_dw.shtml

20 http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0919_jp.shtml

- highlighted those aspects of the package we now intend to revise (or defer) in light of those few criticisms we consider to have some justification.

2.26 We now invite, and commit to consider, any formal representations (or other comments) that raise new points not made in response to the original consultation on the matters in this chapter. In particular, we ask:

Q1 Do you consider that, taken as a whole, our package of measures – the proposed complaint handling guidance as revised and supporting materials (chapter 3 and appendix 1 and 2), and our statements on root cause analysis and non-complainants (in this CP and CP09/23), in light of our open letter and its recast list of common PPI sales failings (appendix 3), and our estimates of the costs and wider financial impact on industry (chapter 4 and annexes 2 and 3) – is a justified, appropriate and proportionate response to a genuine problem of PPI sales and complaint handling (this chapter), whose costs are matched or exceeded by its benefits?

Q2 Do you agree that the open letter and its appendix, in the version attached (appendix 3), lists common PPI sales failings under the relevant FSA Principles and rules since 14 January 2005?

Q3 Do you agree that the general principles of fair conduct when selling PPI before 14 January 2005 have much in common with our standards after this date?

Q4 Do you agree that our statements about our expectations concerning firms' treatment of their PPI non-complainants are appropriate in the context of Principle 6 and DISP 1.3.5G? Do you think there are particular circumstances concerning PPI which mean it would be unreasonable for us to expect firms to act towards PPI non-complainants in the way we have set out in our statements?

Q5 Do you consider that it would be helpful for our statements about our expectations concerning firms' treatment of their PPI non-complainants to be added to our proposed Handbook guidance concerning PPI complaints?

3 The key contents of the revised draft Handbook text

Introduction

3.1 Our proposed Handbook guidance consisted of three main elements.

3.2 The first concerned how a firm should go about assessing a PPI complaint and relevant evidence in order to decide fairly whether there were failings in its behaviour towards the complainant during the sale.

3.3 The second concerned how a firm should determine fairly the way the complainant would have acted if a failing by the firm had not occurred. The proposed guidance indicated that: where any of several broadly specified types of failing had occurred, the firm should presume the complainant would not have bought the PPI they bought or any other ('the non-purchase presumption'); but that for single premium sales, if certain of the failings were the only ones to have occurred, the firm could presume that the complainant would have bought a regular premium policy instead ('the regular premium presumption').

3.4 Finally, the proposed guidance set out two broad approaches to calculating fair redress. One, involving the return of all the premium(s) paid by the complainant (plus interest), was proposed as a fair approach to redress for any upheld complaint.[21] The other was proposed as an alternative for those upheld complaints about a single premium sale where the complainant would have bought a regular premium policy instead. That second proposed approach would, in effect, put the customer in the position they would have been in if they had instead bought a regular premium policy. So it involves the return to the complainant of the *difference* between what they had paid towards the single premium and what they *would* have paid as regular premiums;[22] and in addition the offer by the firm to maintain the complainant's existing PPI cover until the policy's scheduled end (in return for regular premium payments from then on).

3.5 We further proposed, for the purposes of this alternative approach ('comparative redress') and to facilitate consistency and transparency in its application, a referent

21 The proposed guidance further said that where the complainant had a loan, part of which was to pay for single premium PPI, the firm should also reduce the loan balance, and thus future repayments, to a level reflecting the absence now of the single premium.

22 Again, see footnote 21.

regular premium price for firms to use when calculating redress and for the maintained cover going forward. Following our assessment of the policies available from July 2005, we proposed the referent price as £6 per £100 of benefit.

3.6 In light of these various proposals and considerations, we asked in CP09/23:

> Q4 Do you agree that the proposed guidance on the fair assessment of complaints and the evidence about them is relevant, helpful, reasonable and appropriate?
>
> Q1 Do you agree the proposed approach to the assessment and redress of PPI complaints is fair and balanced and will provide fairer outcomes for more consumers?
>
> Q2 Do you agree that the regular premium referent price we propose to stipulate is a reasonable one?

3.7 Some firms had expressed concern (in pre-consultation) that, being single premium policy suppliers, their systems were not set up to collect regular premiums. They suggested that instead, they could implement comparative redress by withholding from the redress owed to the complainant a sum sufficient to pay for the future regular premiums that would maintain the cover. So we also asked:

> Q3 Do you consider that this alternative approach to paying for future regular premium cover would be fair to relevant consumers and practicable?

3.8 This chapter discusses the responses we received to our questions, outlines the revised guidance we now propose and asks further questions.

The fair assessment of a PPI complaint and evidence about it

3.9 Responses from consumer representatives strongly welcomed this aspect of the guidance, feeling it would help get PPI complainants a fairer and more balanced hearing by firms. Most responses from the industry, however, were negative.

Balance

3.10 The main objection from the industry was that the overall effect of the guidance was unbalanced and unfair because it made it very difficult for firms to reject any PPI complaint, even where the firm felt it had acted quite correctly at point of sale. Three main critcisms were that:

- Our proposed guidance gives precedence to oral testimony from the consumer and discounts entirely the worth of documentary or other evidence from the firm. This makes it nearly impossible for a firm to defend a sale, especially where the complaint raises an issue that is necessarily more subjective (for example where the complainant now asserts they had 'felt pressured' into the purchase), or hard to prove either way (for example where the complainant says they were not told something at point of sale which they ought to have been).

- The guidance does not set out what a firm can reasonably expect of a consumer's substantiation of his complaint, so it 'reverses the burden of proof' away from the complainant, requiring firms to uphold complaints on the basis of any customer statement *unless* the firm had compelling evidence to the contrary, in the process undermining any sense of consumer responsibility for the sale.
- Even if the firm can defend the particular points made in the complaint, our proposed guidance requires the firm to consider all other possible aspects of the sale, significantly increasing the chances that some shortcoming will be identified and the complaint upheld, even where the original complaint may have been sketchy and generic.

Our response

Oral evidence

The guidance does not say that any consumer statement must be taken at face value and automatically believed. The guidance simply warns against the opposite tendency (which we are concerned many firms have been falling prey to). That is, treating oral testimony from the consumer as being of no relevance or evidential weight, and thus rejecting many complaints prematurely without having given them fair consideration. (Our Dear CEO letter on mortgage endowment complaint-handling warned against this previously.[23])

To this end, the proposed guidance merely stated, more specifically, that the firm should 'give appropriate weight to what the complainant says', recognise that 'oral evidence may be sufficient', 'assess the reliability of the complainant's account fairly', and take account of a complainant's 'limited ability fully to articulate their complaint or to explain their actions'.

We do not consider such guidance can reasonably be construed as requiring the endorsement of any and every consumer assertion, or as being biased against firms. So in the revised proposed guidance these aspects are retained substantially unchanged, though we have made some small amendments to make clearer the balanced nature of the guidance on these points. For example, the revised proposed guidance states 'The firm is not expected automatically to assume that there has been a breach or failing'.

Documentary evidence

The proposed guidance did not say that documentary evidence held by a firm was of no value or evidential weight. The guidance simply warned against the opposite tendency (which, again, we are concerned many firms have been falling prey to) of mechanistically regarding certain rather limited types of documentation as decisive, and of thus rejecting many complaints prematurely without having given them fair consideration. To this end, the proposed guidance indicated, for example, that the firm should not reject a complaint simply because the consumer signed certain

23 See: www.fsa.gov.uk/pubs/ceo/ceo_letter_4apr02.pdf

documentation. This does not amount to saying or implying that these aspects should have *no* weight in the consideration of the complaint, merely that they should not be the sole or predominant consideration.

We do not agree that this view undermines the requirements of signature and disclosure or the importance of consumer responsibility. Just because a consumer has signed a document does not of itself mean that they had not suffered from prior failings (for example, if the firm did not inform them about the relevant features of the policy in a 'fair, clear and not misleading' way). The circumstances surrounding the signature may be important (for example, if the customer was pressured into quickly signing the documentation without being given sufficient time to read and consider it).

It is *whether* such failings took place which the firm must consider and investigate fairly when assessing the complaint. This is consistent with both our own specific initiatives in other areas (for example against the inclusion of 'have read and understood' terms in contracts and other documentation) and our general views on consumer responsibility (see DP08/5 and FS09/2).

So, in the revised proposed guidance, we have kept these aspects substantially unchanged.

Specific evidence and general evidence

The proposed guidance did not dismiss the evidential weight of general documentation about the policy and its terms, or about sales processes, scripts or training. It urged the need for caution in assessing such material, stressing that as generic materials they necessarily tend to carry *less* weight than evidence which speaks specifically to the particular sale complained of and to what happened during it. We do not see that this offends balance or normal practice around settling disputes.

The specificity or otherwise of evidence must be read in the context of the wider guidance, including that about oral evidence. We are not saying that any oral statement about the sale is 'specific' and so must necessarily 'trump' (carry more weight than) any generic material held by the firm. Rather, the firm should assess – fairly and in good faith – the weight of the oral testimony as evidence specific to the sale, and any conflict it implies with the firm's own account and own (specific and general) evidence.

We have slightly amended this aspect of the revised proposed guidance concerning specific and general evidence (3.3.9G) to make our meaning clearer.

None of this is to deny that there may often be genuine practical difficulties in establishing what happened, particularly around some aspects of a sale that was conducted mainly orally, where it may be hard (without recordings) for either side to provide definitive evidence. In these kinds of cases, the firm simply must do its best to proceed in line with the specific considerations set out by the guidance to give *appropriate* weight and *balanced* consideration to all the available evidence.

Root cause analysis

The guidance on root cause analysis, which some responses criticised as being unbalanced against firms, is – similarly – simply seeking to make firms' consideration *less unbalanced*.

That is, we were concerned that many firms were: keen to attach great weight to generic material about their processes when they felt this vindicated their sales and allowed them to reject complaints; but often far less keen to attach any weight to generic evidence that potentially showed shortcomings in their sales practices and so had potential relevance to their assessment of what was likely to have happened in the particular sale being complained about, and of whether that complaint should be upheld.

Construing the scope of a complaint

Our proposed guidance said that firms should not take a narrow interpretation of the complaint as it happens to have been framed or expressed.

The fundamental point is that if a complainant alleges, in however broad terms, the mis-sale of the policy, then the firm should consider whether the policy was mis-sold. This does not mean that we expect the firm to re-assess *every* possible aspect of the sale in detail, regardless of what the complainant actually expressed dissatisfaction about. For example, if the complainant does not claim to have been pressured into a sale or to have not known they had been sold insurance at all, the firm need not necessarily focus on these aspects in its investigation (unless the firm has cause to believe this is necessary, given what it knows about its sales processes at the time and the outcomes of its root cause analysis, for example). However, the firm may well need to look into aspects that are not explicitly cited by the complainant.

For example, where the complainant alleges in broad terms that the policy sold to them was not suitable, or that important aspects were not adequately disclosed to them, then the firm may well have to consider whether it failed the consumer concerning any relevant aspect of suitability and/or disclosure. This is expected of the firm in order to comply with the complaint resolution rule DISP 1.4.1R and the application of the Principles and the requirement to treat customers fairly.

Interpreting the complaint as narrowly as possible to make it easier to reject may have the effect of encouraging claims management companies to allege every conceivable thing against the sale, further muddying the evidential waters.

In practice, the scope of the complaint should often become clearer once the firm has sought to clarify the nature of the complaint, including potentially through contact with the complainant, as the proposed guidance provides.

So, in the revised proposed guidance, we have left these parts substantially unchanged.

Burden of proof

In complaint handling generally, firms sometimes reject complaints with the argument that the 'burden of proof' is on the complainant and that they have not met it. This is often accompanied by an inappropriate expectation and insistence that the complainant make their case seemingly in a manner akin to that of 'legal pleadings'. However, our view is rather that the firm should investigate the complaint, collect information, assess the evidence and reach a conclusion, with all this done in a balanced and fair way. And that is what both the originally proposed and revised proposed guidance sets out in the specific context of PPI complaints.

Q6 Do you agree with our revised proposed guidance on the approach to considering evidence?

Disclosure

3.11 Some industry responses objected that:

- the parts of the proposed guidance concerning the assessment of the role of disclosure in the sale complained of were not clear in their expectations; and
- the proposed guidance more generally failed to differentiate appropriately between sales behaviour in an advised and non-advised context.

Our response

We have made some minor amendments to a number of the provisions in the revised proposed guidance to clarify our meaning and expectations in these respects.

Refinanced loans

3.12 A number of industry responses argued that the guidance appeared to require a firm to assess all PPI sales ever made by it to the complainant. This would be an unduly broad and onerous requirement and would take in sales of PPI on completely different credit products that were not relevant to the sale complained of, and may have taken place long before it.

Our response

The revised proposed guidance clarifies that our specific concern is where consumers refinance their personal loans and with each refinancing firms sell, and potentially mis-sell, a new single premium PPI policy – so that the consumer is soon bearing the cost (within their loan) of two or more previous single premium policies. We now make it clear that the seller should review the sales of *all the policies it sold to the customer in the course of this successive refinancing* (only), and take all of them into account, including their cumulative impact, when potentially redressing the consumer.

Q7 Do you agree with our revised proposed guidance in respect of re-financed loans?

Past claims

3.13 Some industry responses argued that where a customer had previously made a successful claim on the policy, it showed that they must have needed it and that it had been suitable for them. So, any subsequent complaint about its sale should be rejected.

Our response

We do not agree with this view. That someone successfully claimed on one part of the policy does not prove they had, for example, been appropriately informed of other aspects of the cover or exclusions, or of the price. For example, in the following plausible scenario, where:

- a consumer sought health cover because they were concerned their arthritis might undermine their ability to sustain employment;
- but the firm failed to make adequate disclosures about the exclusion from cover of pre-existing health conditions;
- the policyholder subsequently became unemployed *for quite different* reasons, as part of a wider redundancy, and claimed; and
- the firm paid that claim;

– it is only reasonable to conclude, given the consumer's original needs and priorities, that had the firm disclosed matters properly, the consumer would probably not have bought the policy (even though it turned out to bring some benefit to them). To that extent, their successful claim is not, of itself, a reasonable argument for saying they had not been mis-sold the policy.

As this example illustrates, all a successful claim is usually likely to show, in an evidential sense, is that the customer knew they had taken a contract of insurance and wasn't entirely ineligible under it.

The revised proposed guidance therefore warns firms not to attach exaggerated weight to a previous successful claim when considering the complaint.

This is only a point about the evidential weight of the paid claim. Our approach to *redress* allows that it may be fair for the firm to deduct the *financial* value of the previously paid claim from the redress owed for a mis-sale.

A slightly different point (raised in some responses) concerns consumers who have bought PPI several times before and made several successful claims. Our general point still holds, but clearly such repeat claiming *may* have relevance to considering the plausibility of certain things the consumer might assert in a subsequent complaint.

Limitation

3.14 Some responses asked about how time barring might work for PPI complaints and from when.

Our response

We are not proposing guidance on this aspect that is specific to PPI complaints. So time limits for these complaints will be the same as the time limits for complaints in general, as set out at DISP 2.8.2.

However, in our view, general media coverage of the PPI issue, including comments or publications by the FSA, would *not* be enough to have given a consumer the kind of specific 'constructive knowledge' (of a potential problem with, and potential financial loss from, the PPI policy sold to them) which is required to trigger the start of the three-year time limit within the DISP rules.

The rebuttable presumptions

3.15 Most responses from the industry were hostile, arguing variously that:

- the presumptions reflected a bias against the single premium PPI product and a retrospective attempt to 'ban' past sales of it by unwinding all those complained of;
- if we disliked the single premium product, we should say this outright, rather than maintain a polite fiction that each complaint about a single premium sale has to be considered on its individual merits; or if we did not in fact dislike it, then we should make it clear in our guidance how and in what circumstances a firm could fairly reject a complaint about the sale of a single premium policy;
- we had supplied no evidence for our presumptions about what consumers would have done without sales failings;
- such presumptions inappropriately shift the burden of proof on to the firm to show that the customer would still have bought a policy – whereas it should properly be for the complainant to show that they *would not have* bought the policy and had suffered financial loss from buying it; and
- the presumptions are not rebuttable in practice anyway, as the firm has no contemporary evidence from the time of the sale about the consumer's intentions or 'state of mind'.

3.16 More specifically, some industry responses argued variously that:

- *the non-purchase presumption* is flawed and disproportionate because it:
  - assumes the consumer would have made the categorical decision not to buy any PPI at all even where the firm's shortcoming is relatively minor (for example failing to disclose adequately all aspects of the cover and its exclusions); and
  - leaves no scope for settling the difficulties in ways more sensible and moderate than cancelling the policy and returning the full premium(s)[24] and consequently gives relevant complainants more redress than their loss or detriment warrants.
- *the regular premium presumption* is flawed because it:
  - over-estimates consumers' awareness of the (very few) stand-alone regular premium alternatives that were in the market and their inclination to have shopped around for and bought such alternatives; (the secured loan sector further argued that there was *no* standalone regular premium product

24 For example, some responses suggested maintaining the policy but setting aside, in the event of a claim, any non-disclosed exclusion; or maintaining the policy but paying some redress to the consumer to compensate for those aspects of cover they were being denied by the non-disclosed exclusion.

available for secured personal loans which provided the life cover element that single premium policies did);

- takes an uninformed risk in presuming that regular premium cover will be better and more suited to relevant consumers than their existing single premium cover; (for example the presumption gives insufficient weight to the value borrowers put on the comfort of having the policy paid for up-front through a single premium, or to the fact that regular premium contracts usually allow for the provider to vary the premium price or the cover); and
- gives insufficient weight, for example in its emphasis on the consumer's potential need for flexibility in cancellation, to the thought that designers have put in to creating a product for those consumers who might have variable income but were keen to maintain regular loan repayments and to rebuild their credit standing before re-financing more favourably.

3.17 There was also a widespread concern that we were expecting firms to reconsider the consumer's intentions even where there had been *no* sales shortcomings – that is, expecting firms to reconsider, even in compliant sales, whether the consumer had *really* wanted the product sold to them.

3.18 Responses from consumer representatives welcomed the proposed guidance on these aspects as fair and appropriate. But some did express concern that firms would seek to 'shoehorn' all upheld single premium complaints into the regular premium presumption (so as to pay out less redress), even where that wasn't fair or appropriate to the case at hand.

3.19 In particular, some responses felt our proposed guidance potentially made it too easy for firms to ascribe the alternative regular premium purchase to consumers who in reality did not want or need cover at all (for example because of their prime concern to minimise monthly outgoings on their loan). These responses concluded that the firm should always seek fresh information from the upheld complainant on their appetite for regular premium cover, and should only use the comparative approach to redress where the consumer confirms they would have wanted a regular premium policy before, had they been offered this during the original sale, and/or confirms that they want to retain their cover now on a regular premium basis.

Our response

General considerations

We only expect the firm to consider what else the consumer might have done *if and when* it has first identified that there were sales failings on its part, and we have amended the revised proposed guidance in this area to make this clear.

In March 2009 we wrote to the Competition Commission with our view on the appropriate target market for single premium PPI. But our guidance is not motivated by any broader agenda against the single premium product. We welcomed firms' decisions to stop selling single premium cover on unsecured loans in light of the Competition Commission findings, and because this seemed a sensible step for firms to take in light of the difficulties which they appeared often to have in selling it fairly in practice.

The need for an individual assessment of the particular sale and the complaint about it is no ‘polite fiction’ but an important safeguard of fairness for firms and complainants alike.

The proposed guidance indicated that even where there were sales failings, it remains open to the firm to provide evidence for rebutting the presumption and finding that the consumer would in any case have proceeded as they did. We would expect this evidence to be specific to that customer. We have recast the relevant parts of the guidance to make this clearer.

So, when a firm receives a PPI complaint, it should generally seek out relevant information concerning the individual sale and the complainant’s circumstances. This evidence is useful in two respects. It should assist a firm in assessing its own behaviour at point of sale, and in judging whether (given any particular sale failings identified) the relevant presumption should apply or whether there is clear and specific evidence which gives good reason to set aside the presumption as to what the complainant would have done in this particular case.

To that extent, and as is often the case with assessing complaints and remedies, the proper emphasis should be on what *a reasonable person* would probably have done in the *particular circumstances*.

Some responses challenged us more broadly to justify and ‘evidence’ the presumptions. These are questions about what consumers would have done in other circumstances in which events at point of sale had taken a different turn. This means they are hard to test empirically, and in that sense we do not have statistical evidence ‘proving’ them, nor do we think this is needed. We consider the presumptions we have set out are reasonable ones fully in the tradition of, and informed by, the kinds of judgements that courts and ombudsmen have long and often been making when assessing claims and the potential need to put the claimant back in the position ‘they would have been in’.

The non-purchase presumption

We do not consider any of the broad sales failings which the proposed guidance lists to be minor. We remain of the view that it is a reasonable and rational presumption that, without those failings, the consumer would not have bought the PPI they bought.

It is true that this presumption implies the same potential treatment of two scenarios which at first glance may appear somewhat different, namely:

- someone who was never eligible at all for cover; and
- someone who was eligible for cover under all the policy for some of the time or under some of the policy for all of the time.

We gave careful thought to whether we should take an approach that potentially differentiated between these scenarios. In particular, we considered whether we should take a different approach towards the second scenario in terms of what fair redress ought to look like.

However, we were not confident that such alternative approaches would be fair and appropriate in the context of the failings by the firm, or sufficiently in tune with the traditional and likely outcome of cases before the courts in such scenarios. As described above, our DISP rules put the onus on to firms to investigate complaints and assess fairly whether they should be upheld, rather than adopting an approach requiring consumers to prove causation. The failings underlying the second scenario remain, in our view, substantial flaws in the sales process. In essence our approach is simply to assess what the consumer would have done but for the firm's failing. We were not persuaded that there is a good reason to apply different approaches for these scenarios.

So, the revised proposed guidance retains the non-purchase presumption largely as we previously proposed. This means that even where some valid cover has been in place, if other parts had not and such exclusion had not been properly disclosed by the firm, then the firm should presume that the consumer would **not** have bought the PPI policy (unless there is good reason to set aside this presumption).

We have revised the proposed guidance to limit the presumptions' application to 'substantial flaws' in the sale. This will address concerns that the presumptions would apply irrespective of the nature of the failing.

The regular premium presumption

We do not claim to be able to prove that many single premium customers knew about the few stand-alone regular premium policies that were available, or that they would have been mainly disposed to buy them instead had firms better disclosed aspects of the single premium product that was actually sold to them.

Rather, we have considered the question as more one of: would a reasonable person, in the circumstances the particular complainant found themselves in, have wanted and needed and been willing to buy an alternative regular premium policy had they thought to investigate the available market more widely?

We believe this can reasonably be presumed to be true of a significant proportion of potentially upheld complainants, regardless of their individual market knowledge or dispositions to shop around. Conversely, we have not received convincing arguments from the industry that this is an intrinsically unreasonable presumption to make about how a 'reasonable consumer' generally might have acted.

Concerning secured personal loans for example, even if it is true that there was no standalone equivalent policy on a regular premium basis that provided life cover, the consumer could have bought such cover through regular premium mortgage PPI with a separate decreasing term assurance plan. So there was a non-single premium alternative available, even for a secured loan.

Also, the presumption does not suffer the disadvantage which some responses alleged, of a relevant consumer being moved from the 'safety' of a single premium policy to a regular premium policy whose premiums or terms may be varied. This is because, in fact, the underlying (single premium) policy is not cancelled or changed, but merely paid for differently, at a fixed regular premium price. So no additional variation of cover or premium is possible.

Overall, therefore, we still believe that the regular premium presumption is a reasonable one to make as the basis of redressing relevant complaints, and we have not substantively altered its logic in the revised proposed guidance, though we have slightly amended how it is presented.

Having decided that the regular premium presumption remains appropriate, the firm may make its relevant redress offer to the customer and (contrary to the views of some consumer representative responses) need not necessarily probe or press the consumer in every case to provide positive affirmation that they would have wanted regular premium cover.

As for the concern that firms may apply the regular premium approach too widely – including to complainants who in fact should not have had any PPI (for example because they cannot afford it) – we would stress that our guidance provides for several specific point-of-sale failings (for example pressurised selling techniques, or inadequate disclosure of material exclusions and eligibility criteria) for which the comparative redress approach is not appropriate. Also, our intended monitoring of firms' decisions and redress (see chapter 5) should help alert us to any firms that are not fair and consistent in their presumptions (or rebutting of the presumptions).

We have added to the revised proposed guidance another sales failing concerning single premium PPI (omitted from the original guidance by oversight) from which the regular premium presumption may follow appropriately, namely, the inadequate disclosure of the fact that the term of the cover was shorter than the term of the credit agreement and of the consequences of that mismatch.

We have also, for reasons of consistency, brought the description of the breaches and failings more in line with the drafting of the open letter (see Appendix 3).

We accept that the regular premium presumption, and the comparative approach to redress that rests on it, may prove in practice to be somewhat broad-brush in outcome for some individual complaints. But we consider this to be a necessary and reasonable consequence of our efforts to establish a workable but fair approach that resolves the large-scale 'wider implications' issue that firms' poor handling of PPI complaints has given rise to.

Q8 Do you agree with the revised proposed guidance on determining the effect of a breach or failing? Do you agree that it is appropriate to have both presumptions or should either of them not be included?

Q9 Do you agree with the list of significant flaws that lead the firm to presume that the customer would not have bought the PPI? Do you think that any of these should be removed or amended and/or lead to a different presumption, or that the presumption should apply for all sales flaws identified in the open letter?

The fair assessment of redress for upheld PPI complaints

3.20 Responses from consumer representatives broadly supported the proposals concerning the calculation of redress. Responses from industry, however, were (mainly) negative. Here we present the main criticisms together (addressing some of them individually), before setting out our overall response and outlining the revised proposed guidance on redress.

Requiring the return of full premiums for many upheld complaints is disproportionate

3.21 We disagree with this view, which we discussed above in the context of the non-purchase presumption. We consider that the full return of premiums and termination of the contract is in line with the general approach taken by the courts, for example where a PPI policy has been purchased in reliance on a misrepresentation, or where a party to an insurance transaction fails to satisfy the duty of utmost good faith.

The FSA should not be taking the comparative approach to redress at all

3.22 Some responses (from firms and consumer representatives) felt the comparative redress approach was mis-conceived because it did not correspond to a remedy a court would prescribe.

3.23 Other responses didn't object to the logic of the comparative approach, but did object to our setting, as part of that approach, a single referent price for the regular premium policy redress comparison and maintained cover. This amounted to us inappropriately 'price fixing' and thereby distorting the market.

The referent price is wrong

3.24 Most industry responses argued that £6 per £100 of benefit was too low, and therefore unfair to firms, because:

- for the backward-looking premium comparison and redress calculation, the policy we had mainly based it on:
  - did not have the same level or quality of cover as many other of the policies sold, which were therefore more expensive;
  - included a premium variation clause so did not 'price in' the longer term underwriting risks of single premium policies; and
  - was distributed by a low cost means (internet and non-advised), so that its price did not reflect the costs other firms had incurred in distributing their PPI differently.

- for the complainant's cover being maintained, the proposed referent price did not:
  - reflect current market prices for cover;
  - reflect the current underwriting costs of cover, still less the commission payments still owed potentially to the original intermediary or the margin expected by the lender or insurer; or
  - provide any remuneration for the administrative costs that firms felt they would incur in altering premiums to the new regular basis and in adjusting the level of repayment on the underlying loan.

3.25 The second charge mortgage secured loan sector argued that the price was especially inappropriate and inadequate for them, as PPI underwriting costs for their loan products were higher than for other PPI. This is because of the generally lower credit rating of borrowers in that sector and because of the higher cost of life cover for the typically long duration of that type of loan.

The comparative approach is too difficult and costly to implement

3.26 Many industry responses argued that we had greatly underestimated the administrative and technical difficulties and costs involved in firms delivering the comparative approach to relevant complainants.

3.27 Some such responses reflected a misunderstanding of our proposals. We were not requiring or anticipating that firms would set up a new insurance policy. Our proposal was that, where the consumer wished to retain cover, the existing policy would be maintained, with the consumer paying regular premiums (at the referent price) from then on (and with their loan repayments restructured to remove the cost of the single premium). This puts the consumer back in the position they would have been in if they had bought a regular premium policy rather than the single premium one they bought because of the firm's failings.

3.28 However, there were also criticisms from firms who had understood us correctly. Most lenders and some insurers argued that it was technically much harder than we had implied to maintain the policy and its cover but change its payment basis, and to change the level of the loan, while still maintaining the systems linkage between that policy and that loan, which is vital to the prompt and fair assessment of any claim made on the policy in due course.

3.29 They also argued that just because the policy was single premium did not mean that the insurer had necessarily been paid in full at the outset of the policy, and that the contractual agreements between the insurer and the lender/broker may mean that monies continue to be owed to the insurer through the life of the policy – the adjustment and reconciliation of which in the context of the comparative approach implies a further administrative complexity.

3.30 Firms that had only brokered the loan and the PPI argued further that adjusting the loan and/or means of payment for the policy was simply not in their power at all, and could only be done if the lender and/or insurer agreed to do it, and facilitated it technically. But they might not feel disposed to do this, if it was not their mis-sale liability and given they would incur technological and administrative costs in doing so. At best, such firms might facilitate the solution for some of their brokers (for example the larger ones) but would be unlikely to do so for smaller ones or those with whom they no longer had business links.

3.31 There were also concerns that the altered basis of the insurance cover's payment effectively makes it a new insurance sale, and so incurs fresh conduct of business obligations, giving rise to further administrative costs to the firms involved.

3.32 Some consumer responses expressed concern that the value to the consumer of choosing to maintain their existing cover (now on a regular premium basis at the referent price) depends on the quality of that cover – which may not be good, or at least may be less good than other PPI policies now on the market, or than other quite different protection products now available. So these responses felt that the invitation to relevant consumers to maintain cover on a regular premium basis should be accompanied by all the disclosures and advice considerations that would be expected of a new insurance sale.

3.33 Some industry responses queried whether rescheduling the loan (to the level it would be without any single premium) raises issues around compliance with, and contractual enforceability under the Consumer Credit Act.

Our response and revised proposed approach

Our general approach

We are not bound to follow in our Handbook or thematic work an approach to redress that necessarily reflects the approach a court might take, provided any alternative approach we follow is reasonable and we have good reasons for adopting it. From that perspective, we still believe that the comparative approach, viewed in the context of particular kinds of sales failing concerning single premium policies, meets these criteria in the redress it provides to relevant complainants and the opportunity it gives to maintain cover.

A firm that prefers, as a matter of principle or because it finds the implementation practicalities too onerous, to make payments equivalent to a full refund of premiums (on condition the consumer cancels the policy) even to upheld complainants who could otherwise appropriately be given comparative redress, may do so, provided it does so fairly and consistently. That is, we would regard it as unfair if the firm were to 'pick and choose' full return of premiums or the comparative approach on a complainant by complainant basis (for example because of the cost of the redress it entails in a particular case or because of the firm's perception, were it to maintain cover, of the underwriting risk for a particular complainant going forward). The revised proposed guidance reflects this.

We anticipate that smaller firms in particular, who may have relatively few single premium PPI complaints to resolve and may not wish to commit the time and resource to implement the comparative approach, may find this appealing.

We do not see the proposed referent price as an intervention in, or 'fix' of, the pricing of insurance cover. Rather, the referent price is a very specific tool concerning the calculation of fair redress, deployed in the context of our efforts to establish a fair approach that is workable for large complaint volumes. The referent price aims to balance the interests of complainant and firm where the former wishes to maintain existing cover on a new payment basis. It ensures a measure of consistency in firms' assessment of redress and offer of forward cover, and thereby also ensures a basic transparency that allows all complainants offered redress on this basis to understand how that redress has been calculated, and to have confidence in that assessment. This should help avoid unnecessary consumer queries to firms about the redress offered and unnecessary referrals to the FOS.

From this perspective, the referent price should certainly not be considered as in any way our view of a 'fair price' in this market, either in the past or future, since we are not seeking to regulate prices, and consider that prices are for competitive and properly functioning markets to set.

The level of the referent price

We have considered the various arguments the industry put forward concerning the level of the proposed referent price and conducted further analysis of its effect when used within the proposed comparative approach.

While we recognise that products do vary in quality, our view is that trying to reflect these variations would be inappropriate because:

- it would get us involved in firms' approach to pricing, which is not generally our role;
- from the perspective of our presumptions and redress, the cover the customer bought is less relevant than the cover they *could* have bought; and
- any variations in the price driven by quality of cover would lead to significant variations in redress offers and so make it difficult for customers to understand and asses the redress offers they get.

We have concluded that at £6 the proposed referent price:

- results, for some complaints about some products in certain circumstances (for example where the complaint was early in the life of the policy and the cancellation terms' refund is pro rata) in a higher cost to firms than a redresss payment equivalent to a return of the premium,[25] which was not our intention (and is something we want to mitigate); and/or
- is highly likely to disincentivise firms from applying the comparative approach at all, with the result that many people would lose cover they might wish to keep, and avoiding that consequence has been an important aspect of our proposals from the start.

25 This mainly stems from the fact that the comparative redress approach involves an off-setting relationship between the value of the policy's cancellation value and the future value of the regular premiums.

In light of these various considerations, we have raised the referent price in the revised proposed guidance to **£9 per £100** of benefit.

A menu of ways to implement fairly the comparative approach

We have also considered very carefully the detailed concerns raised by the industry about the practical implementation of the comparative approach. To address these, and in particular ensure the approach was feasible for all kinds of firms, we have widened our conception of how exactly it might be implemented to take in a 'menu' of four different approaches, each of which we consider remains fair to upheld complainants and comprehensible to them. In brief:

- All four approaches (A-D below) use the (new) referent price to calculate the redress owed, so a high degree of consistency remains;
- Three of the four options (A-C) use the (new) referent price to calculate what the consumer should now pay for the maintenance of cover; and
- Two of the four options (A and C) involve collecting regular premiums, but do it in different ways.

Approach A Set up a new payment arrangement for regular premiums

This is the approach which we previously consulted on and envisaged as the most straightforward, at least for consumers.

- The firm calculates a redress sum that reflects the difference between what the complainant has paid so far toward the single premium and (the lesser sum) they would have paid so far on a regular premium policy at the £9 referent price, and pays all of that sum to the complainant (plus interest).
- The firm makes an additional compensation payment into the loan to reduce its outstanding balance (and thus the consumer's future monthly repayments) to the (lower) level it would be at had no single premium ever been included within the loan.
- If the consumer wants to maintain cover, they now pay regular premiums at the referent price, with the firm setting up a new direct debit or other payment arrangement to collect these.
- If the consumer chooses to cancel the policy subsequently, no further refund is due (as they have already been adequately compensated for the cancellation value of the policy through the previous redress and additional compensation into their loan).

Approach B Withhold part of the redress to fund regular premiums

This was the variation we asked about in the previous consultation.

- The firms calculates (as in Approach A) a redress sum that reflects the difference between what the complainant has paid so far toward the single premium and (the lesser sum) they would have paid so far on a regular premium policy at the £9 referent price.

- If the consumer does not want cover maintained they are paid all of this sum.
- If they want to maintain cover, the firm only pays them some of that redress sum, keeping back from it, on the consumer's behalf, enough (discounted at a fair commercial rate) to pay for the future regular premiums at the referent price that will maintain the cover to the end of the policy term.
- The firm makes (as in Approach A) an additional compensation payment into the loan to reduce its outstanding balance (and thus the consumer's future monthly repayments) to the (lower) level it would be at had no single premium ever been included within the loan.[26]
- No regular payments are collected from the consumer.
- If the consumer cancels the policy in due course, they get back what remains of the sum originally retained by the firm.

Approach C Regular premiums collected through loan repayment

This is an approach proposed by some responses to the consultation, as it allows firms to implement the comparative redress approach without collecting regular premiums, although it does require the firm to restructure the loan.

- The firm calculates (as in Approach A) a redress sum that reflects the difference between what the complainant has paid so far toward the single premium and (the lesser sum) they would have paid so far on a regular premium policy at the £9 referent price, and pays all of that sum to the complainant (plus interest).
- The firm makes (as in Approach A) an additional compensation payment into the loan to reduce its outstanding balance (and thus the consumer's future monthly repayments) to the (lower) level it would be at had no single premium ever been included within the loan.
- Where the consumer wants to maintain cover, the firm adds to this revised outstanding loan balance an amount that drives a flat monthly repayment at the referent price to pay for the maintained cover.
- If the consumer cancels the policy subsequently, the firm makes an additional compensation payment into the loan so that future loan repayments no longer include any monthly payment for cover.

Approach D Non-referent price for maintaining cover

This is a new approach, designed with general insurance intermediaries who are not lenders and/or insurers in mind, which avoids the need for either loan restructuring or regular premium collection.

- As in Approach A, the firm calculates a redress sum that reflects the difference between what the complainant has paid so far toward the single premium, and

26 But in Approach B, if the redress sum would not suffice to cover the future regular premiums, the firm can pay down the loan to a lesser degree that covers the difference.

(the lesser sum) they would have paid so far on a regular premium policy at the £9 referent price, and pays all of that sum to the complainant (plus interest).

- Where the consumer wants to maintain cover, the firm first calculates (as in Approach A) what additional compensation payment it would need to pay into the loan to reduce its outstanding balance (and thus the consumer's future monthly repayments) to the (lower) level it would be at had no single premium ever been included within the loan.
- But then (unlike Approach A) the firm doesn't pay that additional sum into the loan: instead, the firm **subtracts** from that sum an amount equivalent to the current cancellation value of the policy, and then pays the remainder as cash to the consumer. The consumer can choose to use it to pay down their loan or not; (the firm should also offer, as part of this choice, to pay for any fees and charges that the consumer incurs in paying down the loan in this way).
- In effect, the amount equivalent to the cancellation value at the time, which is left in the loan (and thus in the consumer's future repayments), is deemed to pay for maintaining the cover.
- So, no premiums need be collected going forward.
- If the consumer cancels subsequently, they get back the (reduced) cancellation value that will be applicable as at the date they cancel.

Under this approach, the consumer does not pay the referent price for the maintained cover. The notional price for their maintained cover will depend on the precise approach to cancellation values set out in the PPI contract. Generally, for single premium PPI policies of the same price, the closer to pro rata the cancellation terms in the contract, the more the consumer is likely to pay for the maintained cover; while the less pro rata the terms, the less the consumer is likely to pay for maintained cover.

Using the menu of approaches

Approach A remains our preferred approach, as the simplest for consumer to understand concerning what they are paying for maintained cover. But Approach C is also relatively straightforward, and involves no hidden costs to the consumer. So we would strongly prefer that all firms who can, with reasonable effort, implement comparative redress in either of these ways, do so.

Approach D is our least preferred approach. Different firms have different cancellation terms, so there will be significant variations in the notional prices to consumers of their maintained cover, with some notional prices potentially being significantly higher than the £9 referent price used in the other approaches. Moreover, for technical reasons, it will often be hard for the firm to specify in advance to the consumer what the notional price will be.[27]

27 For example, the cancellation value typically reduces significantly at the product anniversary. So someone who cancels shortly after that will have experienced a higher notional price per month of cover than someone who cancelled just before. More generally, where the terms imply a reduction of cancellation value over time that is non-linear, the notional price for the maintained cover the consumer has enjoyed will depend on the shape of the curve and where he is on it (as determined by the date he cancels).

So we would generally expect Approach D to be used only by firms who are unable, with reasonable effort, to take any of the other approaches – a group we would expect to be mainly confined to general insurance intermediaries who are not lenders or insurers. We will expect any firm adopting this approach to make as clear as possible the notional price for the maintained cover, so that the consumer can weigh the alternative option of cancelling the cover, receiving the cancellation value as cash, and then potentially seeking different cover elsewhere.

Concerning Approach B, responses from consumer representatives raised several concerns, namely that:

- there is an opportunity cost to the consumer from the sum the firm retains;
- in not physically paying regular premiums, consumers will forget what they are paying and be insensitive to favourable price changes in the market;
- it could lead to barriers to switching, if the firm declines to return the rest of the retained sum on subsequent cancellation; and
- if the firm was to go into liquidation the consumer might not get back the retained sum.

Firms should spare the consumer such opportunity cost by retaining only a smaller sum calculated on a discounted basis, as we specify in our guidance.

Provided the notional price is explained to the consumer, we consider that it is reasonable to expect the consumer to remember, for the relatively short period of one to three years for which most relevant consumers will be maintaining their cover, how much they are paying for this cover and to compare this to ongoing trends in the market. But even if they don't remember or compare, this is unlikely to amount to a significant opportunity cost in the interim, given the referent price is already a reasonable and competitive one.

Concerning subsequent cancellation, we would of course expect the firm to act fairly and return the residual retained sum accurately and promptly.

Concerning the potential insolvency risk, and to safeguard the consumer's interests more generally, we would expect the retained sum to be treated as client money by the firm, with the attendant disciplines implied by that. This is likely to make Approach B impractical for firms who do not already have permission to hold client money.

Overall, we consider Approach B to be a reasonable one, less preferred than Approaches A and C, but preferable to Approach D for firms that can manage it.

Worked examples and supporting detail

In the proposed guidance we included several worked examples of redress. We have now developed further examples to illustrate the four approaches, and to illustrate some particular aspects which responses to the consultation asked for, including calculations of redress where:

- there is early cancellation of a single premium or it is refinanced;
- the PPI is on a credit card; and,
- a regular premium policy has been previously successfully claimed on by the consumer.

We now consider that the increased complexity and length of these examples would not sit appropriately in the Handbook text; so we have moved all examples into separate material, which is included at Appendix 2 of this Consultation Paper (and which will be made available on our website). The examples are in line with the revised proposed guidance and should be considered as supplementary supporting material. We invite comments on these examples (see questions below).

Communicating with consumers

Though we consider all four approaches to be fair and reasonable ones, we accept that they may appear technical to grasp, and so may accentuate the concerns expressed by some responses that consumers would struggle to understand the comparative approach or make an informed choice about it. However, the menu of approaches is for firms, not for consumers. We expect firms to choose one approach to implementing comparative redress and then adopt that approach consistently towards all relevant consumers (and not offer different approaches to any one consumer).

However, given those concerns about comprehension, and notwithstanding our view that none of the approaches incur fresh FSA insurance conduct of business obligations, we have added guidance to emphasise that a firm offering the comparative approach in one of these ways should:

- offer to provide details of the existing PPI policy;
- make the complainant aware of the changes to the cancellation arrangements if cover continues;
- explain how the future premiums will be paid for and collected and the cost of the future cover; and
- remind the consumer that if their circumstances have changed (for example their health or employment prospects) since the original sale, they may not be eligible for cover under any new policy they buy; and
- refer the complainant to www.moneymadeclear.fsa.gov.uk as a source of information about a range of alternative PPI products.

We will treat seriously any firms that we find sending offer letters that give unbalanced messages that seem to push the consumer towards cancellation rather than maintenance of cover or the other way around.

For their part, consumers who receive such invitation to continue cover will wish to consider, among other things, whether their own health or employment circumstances, for example, have altered since their policy began, such that they might struggle to get new cover, or at a comparable price, elsewhere.

Firms should also remember that, to the extent the original cover did not meet the consumer's demands and needs (for example because of ineligibility criteria or poorly-disclosed exclusions), the comparative redress would not generally be the fair and reasonable approach anyway, with return of full premiums being appropriate instead. Only in exceptional circumstances and **at the instigation of the consumer** would we anticipate that some consumers owed and offered the return of full premiums might indicate a preference for comparative redress because of their own anticipated difficulties in obtaining new cover elsewhere.

Consumer Credit Act implications

We agree that the approaches give rise to some implications for the existing credit agreement(s) under the Consumer Credit Act (CCA).

We contacted the Office of Fair Trading to understand the implications for firms in this area and reached the following conclusions.

Where the PPI is sold alongside a loan, there are in fact two credit agreements. One for the principal loan and a second to finance the optional PPI. The former is debtor-creditor (d-c) and the latter is debtor-creditor-supplier (d-c-s). This is irrespective of whether the creditor is also the supplier of PPI.

In CCA terms, where the PPI is sold alongside a loan, there are multiple agreements within section 18(1)(a) CCA. Each part – the principal credit agreement and the PPI credit agreement – would be treated as a separate agreement by virtue of section 18(2). They may be documented together, subject to the Consumer Credit (Agreements) Regulations 1983 (CCA Regulations). Regs 2(8) and 2(9) of the current CCA Regulations allow for a common heading and signature box and common statements of protection and remedies. Reg 2(7) requires an additional form of consent.

If PPI is found to have been mis-sold, the remedy is generally to return the parties to the position they would have been in had the PPI not been taken out. This should lead to the cancellation of the PPI credit agreement and refund of monies paid by the debtor. This is consistent with Article 15.1 of the new Consumer Credit Directive which states that 'where the consumer has exercised a right of withdrawal, based on Community law, concerning a contract for the supply of goods or services, he shall no longer be bound by a linked credit agreement'.

As the PPI credit agreement is separate (for CCA purposes) from the principal credit agreement, it should be possible to cancel the former without affecting the latter. Clearly though, if payments were made together as a single monthly instalment, the amount of the instalment will need to be adjusted (as our approaches indicate). This would not require a modification of the principal credit agreement. It would simply be a consequence of cancellation of the PPI credit.

Even if the principal credit and PPI credit were treated as one agreement for CCA purposes (which we do not believe would be the intended effect of section 18 CCA), it would be possible to modify the agreement to remove the PPI elements. This could be done via a modifying agreement for section 82(2) CCA purposes. The debtor would have to agree (but we generally see no reason why he would not). Alternatively, the creditor could simply refrain from collecting part of the payment and from enforcing the relevant aspects of the agreement. This could be done as a unilateral concession, although this would be less satisfactory from the debtor's point of view as it would not have the effect of amending the contract and in theory the creditor could withdraw the unilateral concession at any time. It is better (and clearer all round) to have a modifying agreement, signed by both parties, and binding on both of them. At the very least the concession should be documented in some durable way, such as a letter acknowledging it, given the potential for disputes.

Consequently, we do not see why our approaches discussed above should raise CCA enforceability issues.[28] However, a firm should take care in how it documents the arrangements and what information it gives to the consumer.

Q10 Do you agree with our proposal to increase the referent price from £6 to £9?

Q11 Do you agree with our four approaches to implementing the comparative approach to redress?

Q12 Do you agree with our proposed consumer communications concerning offers of comparative redress?

Q13 Do you agree with the redress calculation examples (see appendix 2)?

Other aspects of redress

3.34 Responses from consumer representatives argued variously that when upholding PPI complaints, firms should include additional redress to reflect:

a) any costs associated with repaying the loan early (for example overpayment charges);

b) any consequential losses the consumer suffered (for example where the PPI policy's mis-sale contributed significantly to financial difficulties the consumer experienced and to fines or extra payments they incurred as a result); and

c) any distress and inconvenience suffered by the consumer.

28 There is the possibility of action by individual consumers under the unfair relationships provisions in s140A CCA. This enables the court to make an order under s140B if it determines that the relationship between a creditor and debtor arising out of a credit agreement (or the agreement taken with any related agreement) is unfair to the debtor, because of (a) any of the terms of the agreement (or related agreement), (b) the way in which the creditor has exercised or enforced any of his rights under the agreement (or related agreement) or (c) any other thing done (or not done) by or on behalf of the creditor either before or after the making of the agreement (or related agreement). A related agreement can include an agreement for PPI, whether or not financed by credit. See for instance the county court judgment in MBNA Europe Bank Ltd v Thorius (21 September 2009).

Our response

We agree concerning a) and b) that such additional redress would be fair and appropriate in many circumstances, and so we have flagged this explicitly in the revised proposed guidance.

Concerning c) however, the general consideration of whether a firm needs to pay redress for distress or inconvenience to the complainant is one that the FOS has already helpfully discussed in its own technical notes, and we refer firms to these.[29]

3.35 Some responses from industry argued that, for the management of their own credit risk and the benefit of the borrower, firms should be able to deduct redress from the outstanding balance owed by the borrower on the credit product the PPI covers, or at least from any arrears in the scheduled repayment of that balance; not least because this is simpler, swifter and more beneficial for the consumer.

Our response

Where a customer has arrears, a firm's right to deduct redress from the arrears will depend on the contractual arrangements in place between firm and customer. We think it is generally reasonable for a firm to deduct redress from the arrears, provided it has the contractual right to do so. But the firm should consider whether the borrower's arrears were the result of financial difficulties materially caused or aggravated by the mis-sale of the policy (for example, if the customer was ineligible under the terms of the policy and therefore was unable to claim, or if the cost of the PPI made the loan repayments unaffordable). If so, the firm should redress such consequential losses appropriately.

Where the firm considers that it can lawfully and fairly deduct the sum of redress from arrears, it should explain in its redress offer letter to the complainant that this is what will happen in the event the redress offer is accepted by them.

We do not believe it is reasonable for firms to use such sums to reduce loan balances that are *not* in arrears, unless the consumer wishes this to happen and explicitly agrees to it.

3.36 Some responses challenged the appropriateness of our requiring a firm, as part of its redress, to now pay a claim that would not otherwise have been covered under the terms of the policy. Other responses from industry expressed concern at the practical difficulty involved, when the seller was not the insurer, in deciding and assessing claims whose previous rejection had been linked to deficiencies at point of sale.

Our response

We accept the industry argument that it may be disproportionate to require firms to pay a previously rejected claim solely because an exclusion or limitation later relied upon was not disclosed to the customer. So the revised proposed guidance now states that this redress should only be considered where the complainant may have reasonably expected that the claim would have been paid. A reasonable expectation

29 www.financial-ombudsman.org.uk/publications/technical_notes/distress-and-inconvenience.htm

could be created where, for example, a firm sold the customer the policy and failed to disclose an exclusion or limitation and it should have been clear to the firm that such an exclusion was relevant for that particular customer.

If a reasonable expectation was created, we do not consider it to be unduly difficult for the seller to obtain relevant information and views from the underwriter. In cases where third-party information is required (for example, how long the claimant's ill-health had continued), reasonable efforts should be made to obtain this. If difficulties remain, the firm may reasonably use some estimation and assumptions – we do not expect the selling firm to replicate the insurer's claims process.

In cases where the firm has reasonable grounds to believe that the claim is less than the full premiums, it may prefer to simply repay the full premiums, rather than incur the cost of investigating what the claim would have been.

Q14 Do you agree with our approach to the position where a customer was mis-sold the PPI and subsequently made a claim which was rejected?

Q15 Should the guidance also address the position of a customer who was mis-sold the PPI but did not subsequently claim because he knew the claim would be rejected (for example, because he subsequently reviewed the detailed policy documentation)? If so, how?

3.37 Some industry responses objected that the rate of 8% simple interest that the proposed guidance applies to redress payable by firms to complainants is too high and should be reduced, being more than an investor could have obtained. Some responses also referred to recommendations by the Law Commission in 2004 on pre-judgment interest in court cases, which included that the courts should normally award interest at 1% above Bank of England base rate.

Our response

We have not been persuaded that it is appropriate to use a rate less that 8%, nor do we agree that the interest rate that might have been earned through investment is the only relevant factor. The intention of the guidance is that a customer is put in the position that they would have been in if the sale had not been flawed. In attempting to achieve that, it is appropriate to consider not only what loss the customer may have suffered by not having invested his money or leaving it where it was, but also other effects of not having that money available to him. In the particular circumstances of PPI the customer is already one who is taking on a debt, and the interest rates payable on the amounts borrowed are likely to be considerably in excess of investment returns. It is likely in practice that the effect on the customer will be difficult to specify precisely. For that reason we are content that the rate of 8% should be applicable in general. We understand that this is the rate usually adopted by the FOS and we see no reason to depart from it.

Complaint handling provisions: guidance, rules or evidential provisions?

3.38 Some of the responses from consumer representatives queried whether our complaint handling proposals would change firms' behaviours, as they are presented as guidance rather than rules.

Our response

Our original proposal had been to deal with firms' shortcomings in handling PPI complaints by issuing guidance on the existing complaints resolution rule DISP 1.4.1R. We have published our approach to giving guidance and the status of guidance.[30] Guidance is not binding on those to whom our rules apply. Rather, such materials are intended to illustrate ways (but not the only ways) in which a person can comply with the relevant rules.

So, firms would not have to follow the proposed guidance, however, following the guidance is a way in which a firm can show it is meeting DISP 1.4.1R (i.e. fairly assessing a complaint) in relation to PPI complaints.

This does mean there is no certainty that firms will apply the proposed guidance, although our own expectation is that it will change the behaviours of firms (and that is the basis on which we have carried out our CBA). This is because firms would be expected to satisfy themselves that any alternative approach would meet DISP 1.4.1R, because we would challenge firms if we felt the outcomes for consumers were not fair.

Alternative courses of action would be to implement the key provisions as a combination of rules and guidance, or as a combination of rules, guidance and evidential provisions.

If the key provisions were instead formulated as rules this would have two consequences:

- if a firm does not comply with the rules then an actionable civil liability would arise on the part of any private person who suffers loss as a result; and
- a possible rule breach may lead us to investigate or take enforcement action against a firm (our approach to such matters is set out in the Enforcement Guide and in DEPP).

The relevant provisions could also be made as 'Evidential Provisions' (EP), a special type of rule that does not give rise to the consequences of usual rules described above. Instead, the EP has evidential value, so that where a firm has acted in accordance with it, this is evidence that it has complied with a specified substantive rule (in this case DISP 1.4.1R). Alternatively, or in addition, we may specify in the EP that if the firm has not acted in accordance with the EP, this would be evidence that it has not complied with the substantive rule.

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30 http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009/guidance.shtml

These alternative courses of action would have their advantages and disadvantages. Specifically:

- if the provisions are issued as guidance, then firms have greater clarity because the provisions are illustrative of one way a firm may comply with the rules. We will not take action against the firm for behaviour that we consider to be in line with FSA guidance (though rights conferred on third parties, such as a firm's customers, are nor affected, nor does it bind a court). This does give firms significant reason for following FSA guidance; though we will not have certainty that firms will follow it, and if they do not they must find another way of acting fairly and complying with DISP 1.4.1R);

- if the provisions are rules, this would have the consequences above in respect of contravention by a firm and would be more binding on the firm and give us more certainty they will be followed. On the other hand, it may be a disadvantage that rules would 'fix' a certain approach to PPI complaints handling (and redress) to the exclusion of others, when it is quite possible that there might be other ways of fairly dealing with the complaints;

- if the provisions are EPs then these lack the direct enforceability (by the FSA and private individuals) of normal rules, but would support evidentially the main complaint resolution rule in DISP 1.4.1R, which could be directly enforced against. If the EP so specifies, if a firm does not comply with the EPs then the onus is on the firm to show how they have nevertheless complied with the main rule. On the other hand EPs can have advantages for firms in that if the EP so specifies, compliance with the EPs offers a 'safe harbour' that a firm has complied with the main rule unless it can be shown otherwise.

In CP09/23 we drafted the proposed provisions as guidance, and we have retained that approach in the draft handbook text provided here.

However, we have considered, and wish to consult upon, an alternative approach whereby the provisions are a combination of guidance and EPs (with the substantive text drafted the same in either case and the EPs having evidential status both to evidence compliance and contravention). Specifically, this would involve:

- the provisions in 3.1 (Introduction), 3.2 (The assessment of a complaint), and 3.3 (The approach to considering evidence) as guidance. The reasons for this (for 3.2 and 3.3 particularly) include that we would not want to be too prescriptive in requiring firms to act in accordance with each of these provisions in all cases if the firm's assessment and consideration of a complaint is carried out fairly *overall*;

- the provisions in 3.4 (Root cause analysis) as EPs. Contravention of these provisions may be relied upon as tending to establish contravention of the root cause analysis rule set out in DISP 1.3.3R. The reason for this is that we would expect the onus to be on a firm to show how they have nevertheless complied with DISP 1.3.3R otherwise;

- most of the provisions in 3.5 (Re-assessing rejected claims) as EPs. Contravention of these provisions may be relied upon as tending to establish contravention of the complaint resolution rule DISP 1.4.1R.
- most of the provisions in 3.6 (Determining the effect of a breach or failing – including our 'presumptions') as EPs. Contravention of these provisions may be relied upon as tending to establish contravention of the complaint resolution rule DISP 1.4.1R. The reason for this is that we would expect the onus to be on a firm to show how they have nevertheless complied with DISP 1.4.1R otherwise. (The exception would be 3.6.3 which would be guidance for the same reasons as set out above for 3.3)
- most of the provisions in 3.7 (Approach to redress) as EPs. Contravention of these provisions may be relied upon as tending to establish contravention of the complaint resolution rule DISP 1.4.1R. The reason for this is that we would expect the onus to be on a firm to show how they have nevertheless complied with DISP 1.4.1R otherwise. (The exception would be 3.7.12 relating to the price of the alternative regular premium policy which would be guidance for the same reasons as set out above for 3.3 and because we are aware that this price may be too high if the firm sold some specific tailored PPI products); and
- most of the provisions in 3.8 (Other matters concerning redress) as EPs Contravention of these provisions may be relied upon as tending to establish contravention of the complaint resolution rule DISP 1.4.1R. The reason for this is that we would expect the onus to be on a firm to show how they have nevertheless complied with DISP 1.4.1R otherwise. (The exception would be 3.8.1 which would be guidance for the same reasons as set out above for 3.3 and because it is a statement of a 'permissive' element for firms, rather than requiring compliance by firms.)

The evidential status of these EPs would apply for sales of PPI on or after 14 January 2005. The standards before that date were not set by the FSA although we believe they had much in common with the later standards. Accordingly, we would propose that any EPs would remain as guidance for firms to have regard to in their handling of complaints about earlier sales.

We welcome views on this possible approach (see question 16 below).

We have also considered an approach whereby the provisions are mainly made as rules, but accompanied by guidance where appropriate. Essentially, this would involve changing all instances in the text where, as currently framed as guidance, a firm 'should' act in a particular way, to saying it 'must' do so. We are not in favour of this because while we want to direct firms' behaviour in a certain way, we do not consider that in all cases it would be appropriate to accompany this with the consequences of non-compliance described above (i.e. enforcement and actionability). We have considered in detail whether this might be dealt with by having the text as a combination of guidance, rules and EPs but we consider that if the provisions are not to be guidance, then EPs would be more appropriate than rules throughout (as in the alternative described above) because of the differences between the two kind of provisions and the policy aim to change firms' behaviour rather than create new causes of action, particularly where some firms might have good reasons for taking an alternative approach which is also fair to the customer.

We welcome views on this possible approach (see question 17 below).

Q16 Do you think that we should make the key provisions in the proposed Appendix 3 to DISP as guidance, or alternatively as (a) a combination of guidance and evidential provisions or (b) as a combination of guidance, rules and evidential provisions?

Q17 If preferring alternative (a) do you agree with the designation of EPs and guidance described above and, if not, which ones would you change? If preferring alternative (b) are there any provisions which currently say a firm "should" act in a particular way that you would not make as rules; what would they be instead, guidance or EPs?

4 Main revisions to our CBA of the draft Handbook text, and our assessment of other costs and benefits of our measures

4.1 In CP09/23, we provided a cost-benefit analysis (CBA) of our proposals which can be summarised as follows:

- a transfer from firms to consumers (over a period of around five years) estimated at between £58m and £80m a year, in the form of increased redress for increased numbers of upheld new complaints, resulting from our proposed complaint handling guidance;
- a one-off transfer, resulting from our proposed rejected complaint review rule, estimated at £57m-£115m from firms to consumers, in the form of redress for upheld reassessed complaints; plus one-off associated administrative costs to firms estimated at £37m;
- for both our forward-looking guidance and the proposed re-review of previously rejected complaints, we noted that the proposals were prompted by considerations of equity (i.e., justice and fairness), as any redress paid represented a fairness-driven transfer from mis-selling firms to mis-sold customers.

4.2 Responses from consumers did not raise significant concerns over the assumptions made in our CBA.

4.3 However, industry responses made a number of criticisms of our analysis, suggesting that we had significantly underestimated the cost to industry of our proposals. Some respondents also questioned the benefits which we suggested our proposals would bring.

4.4 Insofar as those criticisms concerned the proposed rejected complaints re-opening rule, we will not discuss them further here, given we are not consulting on that proposed rule at this time. We will deal with them in due course when we decide how to proceed with that proposal (see Chapter 2).

4.5 As regards our proposed guidance on the handling of future complaints, this chapter outlines the main criticisms made of our previous CBA, and highlights the main changes we have made to the revised CBA of our proposed Handbook guidance (provided at Annex 2). These changes follow further analysis by us, including analysis of additional data we sourced from firms following the responses to CP09/23. Based on these changes, our estimate of the incremental redress costs which firms will incur has increased from around £58m-£80m per year to c.£117m-£203m per year (for five years). Taking into account estimated administrative costs (including set-up costs), we expect our guidance to result in total costs to firms from future complaints of **c.£0.7bn-£1.2bn** over this five-year period.

4.6 Several industry responses criticised the fact that our CBA did not estimate the wider costs to industry which may arise as a result of our package of measures. Specifically, responses commented that we had not assessed the costs which may arise if firms, having regard to our publication of common failings at point of sale and their existing root cause analysis obligations, identify that non-complainants may have suffered detriment because of sales shortcomings, decide to conduct reviews of historical sales to non-complainants and, if appropriate, pay redress. We have now provided an estimate of such costs at Annex 3, a summary of which is presented in this chapter. Depending on firms' conclusions regarding their past practices, and hence the extent of any historical sales review, we estimate that total cost to firms may be in the range of **c.£1bn -£3bn**. We also note that this cost to firms is mostly a beneficial transfer to past consumers mis-sold PPI products.

4.7 We note that cost estimates set out in Annex 2 and Annex 3 are not additive: cases that have been properly dealt with through the complaint handling route will not feature in any reviewof sales to non-complainants; similarly, consumers who have been redressed appropriately through the review are much less likely to complain.

The impact of our proposed Handbook guidance on firms' handling of new PPI complaints

Benefits

4.8 A number of challenges were raised in relation to our assessment of the benefits of our proposals, as discussed in CP09/23. These included:

a In the view of some industry respondents, the redress paid is based on a retrospective application of sales standards, hence this is not a fair transfer at all.

b While redress paid to and retained by consumers represents a benefit to them, the commission paid to claims management companies (CMCs) on redress paid to consumers does not.

c Customers whose policies are still in force and who are encouraged to complain as a result of our proposed guidance risk losing valuable insurance cover in a period of economic uncertainty.

Our response

We have discussed the question of retrospectivity in Chapter 2. For the reasons outlined in that chapter, we are satisfied that this guidance is not a retrospective application of sales standards, and so we continue to believe that redress paid to customers is a fairness-driven transfer for previously mis-sold policies.

Compensation received by consumers who complain about past PPI sales through claims management companies will be reduced by the commission charged by the CMCs. However, the decision to use a CMC or not is a choice consumers make, presumably based on what action they consider to be in their best interests.[31] In addition, our proposals aim to ensure that firms' complaint handling processes are clear and transparent for consumers; this may reduce future demand for the services of CMCs, thus ensuring that a greater proportion of future redress paid is retained by consumers.

Where complaints about past PPI sales are upheld, we only expect this to result in cancellation of the policy where the customer would not have bought the policy but for the failings on the part of the firm. In many such cases, the policy was not of benefit to the customer, and so the cancellation of the policy does not result in detriment. The option for firms to use the comparative redress approach aims to ensure that complainants can continue cover where this is appropriate for their circumstances.

Given these factors, any potential detriment that may result from some customers cancelling policies which could otherwise offer genuine protection is limited, and is clearly outweighed by the benefit of paying redress to those customers whose policies have been mis-sold (and for whom cancellation would not be detrimental).

4.9 We remain of the view that the main direct benefit of our proposed guidance is that complainants who would not receive fair redress without its introduction are more likely to do so once our guidance has been implemented. Our guidance may also lead to improved consumer confidence in the fairness of firms' complaints handling processes more generally.

Q18 Do you agree that our proposed complaint handling guidance will bring the benefits described in this CP (including in the cost-benefit analysis at Annex 2)?

Estimation of redress costs

4.10 Several responses commented on the assumptions used in our cost estimates in CP09/23. The following paragraphs summarise the main criticisms made of these assumptions, and how we have reflected these comments in the revised CBA.

4.11 *Our estimate of the average redress cost paid by firms at present (i.e. before considering the impact of our proposals) is too low.*
(In CP09/23, we assumed average redress of £570 and £160 per case for single and regular premium products respectively. As discussed further at Annex 2, our estimate of the average redress currently paid by firms forms part of the baseline estimate of redress costs, i.e. the estimate of future redress costs without our guidance, which is used as the basis for estimating the incremental redress costs which may arise as a result of our proposed guidance.)

31 e.g., weighing the different possibilities of success of their complaints and/or the trade-off between the time and effort involved in making and following a complaint unaided and the fees charged by CMCs.

Our response

Based on our analysis of further data obtained from firms, we have revised our estimate for current average redress upwards, to around £2,000 and £735 per case for single and regular premium products respectively. (This is a weighted average across the range of PPI products.)

4.12 *The average redress which we assumed would be paid by firms under our guidance is too low.*
(In CP09/23, we estimated this at £1,700 per case for single premium products, and £160 per case for regular premium products.)

Our response

For regular premium products, we have revised our assumptions for estimated future redress; we have increased our estimate from £160 per case to approximately £990 per case, which is to be compared with the revised baseline figure of £735 per case for regular premium products. This estimate is based on FSA analysis of historical sales data, from which we have modelled the average redress which we expect firms would pay were they to redress upheld complaints in line with our guidance.

For single premium products, our estimates have increased from £1,700 per case (as consulted on in CP09/23) to an average of approximately £1,925 per case (weighted across products). This represents a slight decrease relative to the current estimated average level of redress (£2,000 per case), which reflects the interaction between two expected changes: improvements in firms' complaints handling practices, leading to more consumers receiving fair (i.e. higher) redress, and the introduction of the comparative approach to redress, which may reduce the redress payable for around 50% of single premium complaints.

4.13 *The uphold rate assumptions for future complaints are too low. The uphold rate on FOS PPI adjudications in the last financial year was 89%; by adopting our proposed approach, which is aligned with the FOS's, firm uphold rates are likely to be at least this high in the future.*
(We modelled uphold rates of 55% and 70% in CP09/23.)

Our response

We accept that the 55% scenario included in CP09/23 may be unlikely to arise in practice for the market as a whole.

However, we do not believe that current FOS uphold rates are necessarily a direct benchmark for future firm uphold rates. This is because the cases on which the FOS adjudicates are not necessarily a representative sample of complaints received by firms, and if firms investigate cases appropriately and engage properly in the complaint handling process, it is possible that their future uphold rates may be lower than the current FOS uphold rates.

Consequently, for the revised CBA in this Consultation Paper, we model a revised low-impact scenario, where our guidance leads to an uphold rate of 75% for single premium products and 70% for regular premium products, and a revised high-impact scenario, where we model uphold rates of 90% for single premium products and 85% for regular premium products. (For further discussion, see paragraph 14 of Annex 2.)

4.14 *The number of complaints that will be made in the future has been underestimated.* (We assumed that, going forward, complaints would remain at around 2008 levels, i.e. approximately 158,000 complaints per year. This estimate assumed that the implementation of our guidance would not have any impact on the number of complaints received.)

Our response

Having assessed more recent data on trends in PPI complaint volumes, we have increased our expectation of future complaint volumes. In our baseline scenario, (i.e. before taking into account any impact of our proposed guidance), we assume that firms would receive around 450,000 complaints in the next 12 months[32] after our proposed implementation date even without the proposed guidance.

We noted in CP09/23 that our proposals may lead to some additional increase in complaint volumes, although we did not estimate this increase in our original CBA. In the revised CBA accompanying this Consultation Paper, we assume that, after implementing our guidance, firms will receive approximately 500,000 complaints in the 12 months following implementation of our guidance.

We also assume that our guidance will lead to a small uplift in complaints volumes over a period of around five years. After this, we expect that complaint volumes will return to the levels which they would have been at without our guidance (which may be lower than current levels).

4.15 *The cost estimates in the CBA of CP09/23 are insufficiently granular and are not reflective of all products (e.g. secured loan PPI).*

Our response

The cost estimates in the revised CBA are based on a product-level assessment, supported in part by additional data received from firms after the consultation period. We provide a breakdown of estimated redress costs by product for our Handbook guidance at Table 4 of Annex 2.

Where we have assessed the possible prudential risks to specific sectors which may result from firms reviewing sales to non-complainants, these assessments are based on product-level redress cost estimates, combined with estimates of the potential share of redress for the sectors we have assessed. Hence, we are confident that this revised CBA gives appropriate consideration to the potential prudential impact of our proposals on relevant sectors of the PPI market.

4.16 As discussed in Chapter 3, in response to consultation responses, we have increased the referent price from £6 to £9 per £100 of benefit. This has been reflected in the

32 For the purposes of our cost estimations, we assume that firms implement our guidance from 1 July 2010.

revised CBA at Annex 2. This has the effect of reducing the redress paid by firms under the comparative approach.

4.17 Some responses from industry felt that our CBA over-estimated the proportion of upheld complaints that would fall into the comparative redress approach, because CMCs would strive to ensure that complainants received full redress instead so as to increase their commission, e.g. by referring cases to the FOS.

Our response

As we note in our responses to industry comments in Chapter 3, firms are not obliged to automatically assume that a policy has been mis-sold, solely because an allegation is made by a consumer (or their representative). Instead, firms should assess complaints fairly and in good faith, to identify whether any failings occurred at point of sale, and from this what redress might be appropriate, if any. We remain confident that where firms assess complaints appropriately, the scope for customers or CMCs to game firms' complaint handling process is minimal.

We are also satisfied that our guidance is consistent with the FOS's approach to cases and the standards which firms should apply in assessing complaints. Consequently, where firms correctly offer redress in line with our guidance, it is unlikely that it would be necessary for FOS to award further redress – provided the firm has assessed the complaint fairly and there are no other reasons to make an award. As a result, CMC activity is unlikely to significantly skew the proportion of cases offered full redress.

4.18 Having reflected the changes above in our CBA, we estimate that the additional redress costs to firms from upheld complaints will be in the range of c.£220m-£330m a year (for five years), including redress costs arising from complaints received during this period which relate to future sales.

4.19 However, this range does not take into account the reduction in costs to firms which is likely to arise from fewer cases being referred to the FOS – if firm uphold rates increase in line with our scenarios, this would lead to lower FOS case fees and a reduction in FOS-stipulated redress. We estimate that, under our low-impact scenario, firms would see a reduction of c.£103m a year in FOS costs, and under our high-impact scenario, this reduction would be c.£127m a year (for five years).

4.20 Taking into account this reduction in FOS costs, our estimate of the additional redress costs resulting from our final guidance is now in the range of **c.£117m-£203m** a year, compared to the c.£58m-80m a year estimated in CP09/23. We expect these costs to fall most heavily on unsecured personal loan and credit card PPI, as these have historically had the highest volumes of complaints.

4.21 As mentioned above, we estimate that the incremental impact of our guidance will continue for five years. (However, as explained in paragraph 4.7, we note that there is a broadly inverse and thus offsetting relationship between the complaint handling and root cause analysis costs: any particular post-January 2005 sale is likely to be in one pool or the other, so if significant numbers of firms conduct reviews of sales to non-complainants, the volume of future complaints may decline more rapidly than we expect.) Assuming that the impact of our guidance does continue over five years, the estimated **total additional redress costs** arising from our proposals will be **c.£583m-£1bn**.

> Q19 Do you agree that our underlying assumptions about redress costs for PPI complaints are appropriate? Do you agree with our resultant estimates of these redress costs? What additional data can you provide to support any further refinements to these assumptions and/or estimates?

Estimation of administrative costs

4.22 Some responses from industry felt that the CBA in CP09/23 did not adequately reflect the significant implementation costs to industry that arose from the proposals. To address this concern, we include a more refined assessment of the likely implementation costs associated with our proposals at Annex 2; a summary of this assessment is provided at paragraphs 4.24 and 4.25 below.

4.23 We expect firms to incur one-off set-up costs, in preparing to handle complaints in line with our guidance, and additional ongoing costs (above those which firms incur at present) where firms spend more time investigating and assessing complaints. The main types of incremental costs which we expect firms to incur are outlined below, with headline estimates for each cost type; additional detail on the cost assumptions behind these figures is provided at Annex 2.

One-off costs

4.24 We expect firms to incur initial set-up costs from defining new processes, changes to IT systems and staff recruitment and training.

a **Process definition and training development and IT costs: c.£36m**
Each firm will have to review its complaint handling processes against our guidance; based on this, firms may incur costs arising from activities such as developing revised procedures, developing training programmes, and conducting initial quality assurance or testing to ensure that the new processes are properly embedded. Firms may incur IT costs in implementing any changes that may be required. This may include the development or adaptation of document handling software, customer complaints databases and redress calculation software. Where new systems are developed or existing systems altered, firms may also incur costs in integrating these into other systems (such as accounting and customer relationship management systems).

b **Staff recruitment and training delivery costs: c.£4.6m**
As firms implement our guidance, they will incur costs in retraining existing staff to handle complaints in line with our guidance (including procedures for assessment of complaints 'in the round', and for calculating redress for upheld complaints). Since we expect firms to spend longer assessing each PPI complaint, we expect that

firms are likely to need to recruit additional complaints handlers; firms will incur costs in recruiting extra staff, and in providing initial training to them.

Ongoing costs

4.25 Ongoing costs primarily arise from staff costs. We assume that the incremental cost of systems maintenance will be small, and that maintenance of any new/revised systems can be performed with existing resources, hence we do not include additional costs for systems maintenance in our cost estimates. The expected costs arising from this can be summarised as follows:

a **Additional staff costs – distributors: c.£18m p.a.**
Since we expect firms to take on additional staff in order to handle complaints in line with our guidance, firms will incur ongoing staff costs. These will include salary costs (and other benefits), additional overheads and additional management/monitoring costs.

b **Additional recruitment and training costs: c.£1m p.a.**
Where firms take on additional staff to handle PPI complaints in line with our guidance, the additional recruitment and training costs linked to staff turnover may be ascribed to the impact of our proposed guidance. Assuming an annual staff turnover rate of approximately 25%, this adds a further c.£1m in recruitment and training costs.

c **Additional staff cost – insurers and lenders: c.£6m p.a.**
In addition to the costs incurred by distributors, as outlined above, other firms in the sales chain (i.e. lenders and insurers) may also incur additional costs as a result of our proposals. These costs are likely to be incurred in responding to increased volumes of queries and requests from brokers and non-bancassurance lenders, regarding for example claims or restructuring of loans. Insurers and lenders may have to hire additional staff to deal with these queries.

4.26 Based on this analysis, we expect firms to incur c.£41m in one-off set-up costs, and additional costs of c.£25m a year to deal with complaints in accordance with the proposals outlined in this Consultation Paper. Assuming that the incremental impact of our proposed guidance for firms lasts for five years, this would lead to **total administrative costs over this time period of c.£166m**.

Q20 Do you agree that our underlying assumptions about administrative costs for PPI complaint handling are appropriate? Do you agree with our resultant estimates of these administrative costs? What additional data can you provide to support any further refinements to these assumptions and/or estimates?

Summary of costs arising from our complaints handling guidance

4.27 Based on the redress cost estimates at paragraph 4.21, and the estimates for administrative costs above, the estimated **total overall cost** to firms resulting from our proposed Handbook guidance would be around **£0.7bn-£1.2bn, over five years**.

4.28 We highlight that the increase in expected costs to firms (relative to the level estimated in CP09/23) has not altered or undermined our view that the redress sum paid to consumers is a fairness-driven transfer for policies that have been mis-sold. Firms may try to recover from current and future consumers at least some of the additional redress and administrative costs which we expect our guidance to entail, through higher pricing and/or reduced service. However, to discontinue our proposed guidance, and thus to maintain the status quo, would not be acceptable for the reasons we discuss in Chapter 2. Additionally, the extent to which firms can pass on costs may be limited by competition (especially as not all firms will bear the same levels of additional costs). Consequently, our view remains that the guidance we propose is the most appropriate and proportionate response to our concerns about firms' current PPI complaint handling practices.

Wider impact of our proposals

4.29 As noted above, some industry respondents criticised the fact that we had not included an assessment of the costs which may arise from firms conducting reviews of sales to non-complainants, where firms identify recurrent or systemic problems from root cause analysis of PPI complaints such that non-complainants may have suffered detriment. In the interests of transparency and of responding to industry concerns, we have now set out our estimate of the wider impact of our package of measures on industry, and why we consider that our proposals are a proportionate approach to addressing the problem we have identified.

Estimation of redress costs arising from firms conducting reviews of sales to non-complainants

4.30 The scope of any review which firms may conduct, and therefore the potential redress cost, is limited by two main factors:

a The FSA was only given statutory responsibility for regulating intermediaries GI selling activity from 14 January 2005. Therefore in respect of those firms' carrying on of that activity, principle 6 only applies from that date forward. Consequently, we do not expect any material review of PPI sales made before this date to occur.[33]

b Given our lesser concerns about selling practices for regular premium first-charge mortgage PPI (see Chapter 2), we do not expect many firms to conclude

33 We would have jurisdiction to include sales made direct to consumers by general insurers before this date. However, to ensure consistency of treatment for firms and a consistent outcome for consumers, we would not expect general insurers to review sales made before 2005, especially since these represent only a small proportion of historical sales. Nevertheless, should individual general insurers wish to take action regarding pre-2005 sales to provide fair treatment to their customers, they would be free to do so.

that it would be appropriate to conduct reviews of sales of this product. Therefore, we have not included any redress costs for sales of this product in our estimates.

4.31 If all sales made since 2005 (excluding those for regular premium first-charge mortgage PPI) were assumed to be mis-sales causing consumer detriment, and redress was paid on all sales in line with our guidance, we estimate that the redress cost might be around £15.6bn. However, this is not a plausible scenario. To arrive at a more plausible figure, we have also taken into account a number of additional factors:

a We would expect any review of sales to non-complainants to be undertaken on a response-led basis, where firms would write to potentially affected customers, and assess the individual cases of those customers who respond providing the necessary information. Based on previous PPI sales reviews, we expect average response rates of c.20%, with response rates varying for products according to the average level of redress; this reduces the potential redress cost to around £4.0bn;

b Customers who respond to these mailings will typically be those who consider that there may have been a sales failing which has caused them detriment. Consequently, we expect the uphold rate on such responses to be in a similar range to the estimated uphold rate for PPI complaints. We assume that the highest of our uphold rate scenarios used in relation to the impact of our proposed guidance applies to reviews of sales to non-complainants – i.e. of the cases where customers respond to a firms contact letter, that 90% of single premium cases, and 85% of regular premium cases, are mis-sales causing detriment, and are redressed. This implies redress of around £3.5bn, if *all* firms contact all customers who have bought PPI policies since 2005.

4.32 Lastly, the extent of any historical sales reviews will depend upon what individual firms themselves find and conclude about their potential sales failings. We do not expect that all firms will identify significant shortcomings in their selling practices, and many firms that do identify such shortcomings may identify them only in respect, for example, of *certain* of their sales channels or *certain* periods of selling. Taking this into account, if between 25% and 75% of firms' sales are covered by a customer contact exercise, this would lead to an overall redress cost of approximately £880m-£2.6bn.

4.33 To this, we add an estimated £8m-£26m of costs relating to respondents whose cases are reviewed but rejected, and who then refer their cases to the FOS. (This estimate includes both FOS case fees and FOS-stipulated redress, where complaints are upheld by the FOS in favour of the complainant.)

4.34 Hence, assuming that between 25% and 75% of customers who have bought policies since 2005 are contacted by firms, we expect the cost to firms (before considering administrative costs) to be around **£0.9bn-£2.7bn.**

Estimation of administrative costs arising from firms conducting reviews of sales to non-complainants

4.35 Administrative costs to firms in conducting historical sales reviews arise primarily from: defining the process for the review and compiling an initial dataset of customers to be contacted; contacting customers; and assessing subsequent responses.[34] (We assume that the costs involved in calculating and processing redress payments are minimal once systems are set up to enable this.) Assuming that firms contact between 25% and 75% of customers who have bought policies since 2005, we estimate administrative costs from these reviews as follows:

4.36 **Process definition and data sourcing**
Firms conducting reviews of historical sales will need to define processes for conducting these reviews. Firms may also incur significant IT costs in identifying those customers who they may need to contact, based on the failings identified with their historical sales practices. These are estimated at c.£30m-£57m.

4.37 **Customer contact exercise**
Where firms decide to conduct customer contact exercises, we expect that they will incur costs relating to the initial mailing and answering any subsequent queries, as follows:

a Contacting customers, via the mailing of a cover letter and questionnaire. This involves the cost of a bulk mailing (including the costs of a mail merge, stationery, printing, sorting and delivery). Costs are estimated at c.£3.8m-£11.3m (i.e. approximately £1 per customer mailed).

b Setting up an inbound call centre for queries from customers on, for example, the letter, their position regarding it, and any effect it may have on their relationship with the lender. This may carry additional costs for recruitment and training of call centre staff, salary costs, and relevant overheads and management costs. We estimate the total costs for responding to customer queries at c.£3.5m-£10.5m.

4.38 **Assessment of responses**
Firms conducting customer contact exercises will then assess responses received from customers in line with our proposed guidance. In doing so, we estimate that firms in total may incur staff costs in the range of approximately £70m-£210m (depending on the number of customers contacted), including recruitment and training costs for case handlers, relevant salary costs and overheads, and also the costs to non-distributors in the sales chain dealing with enquiries and information requirements. In addition, firms may also incur c.£9m-£26m of other costs in assessing complaints, notably from correspondence and telephone calls with the complainant. For firms who are still handling PPI complaints and who will implement our complaint handling guidance, we assume that other systems costs which firms may have incurred are already covered in our cost estimates for complaints handling, hence we do not duplicate them here for other firms, we assume potential IT costs of £13m-£40m.

34 Further details on the basis for our cost estimates are provided in annex 3.

4.39 Based on the above cost estimates, if firms contact between 25% and 75% of customers, we estimate total administrative costs relating to these sales reviews to be in the range of c.£116m-£315m.

Improvements to firms' conduct of sales

4.40 Improvements to firms' conduct of sales may reduce firms' future revenues relative to what they would have earned had they not corrected these failures. This resulting reduction in revenue would be partly offset by the reduced costs of having fewer complaints. Consumers would also benefit from fewer mis-sales. In Annex 3, we estimate a yearly net revenue loss to firms of about £50m from correcting sales failings identified through root cause analysis. Corresponding to this is a yearly benefit to consumers of about £65m, arising from consumers being sold more appropriate products.

Summary of costs arising from our wider package of measures

4.41 Based on the cost estimates for reviews of historical sales to non-complainants at paragraphs 4.34 and 4.39, and our assumptions for the impact of our wider package of measures on conduct of sales discussed above, the estimated **total additional cost** to firms resulting from our wider package of measures would be around **£1bn-£3bn**.

Prudential impact of potential reviews of sales to non-complainants

4.42 We have assessed the potential prudential risk of our guidance on three sectors in particular, for which prudential risks were raised in the responses to CP09/23: building societies, general insurance brokers, and specialist secured lenders. A summary of the position of these sectors is outlined below; further detail is provided at Annex 3.

4.43 For **building societies**, we do not publish details of our assessment here for confidentiality reasons (given the small number of societies potentially affected). However, we have assessed the impact of our proposals on this sector and are satisfied that the potential impact does not undermine the proportionality of our proposals.

4.44 We estimate that **general insurance (GI) brokers** may be liable for up to around £430m of total redress and administrative costs (including both costs of any historical sales reviews and cost of handling future complaints). This implies that around a maximum of 15% of general insurance intermediaries may require extra capital to meet ongoing requirements. We do not expect this to give rise to significant prudential issues for larger firms. We estimate that up to around 100 smaller GI brokers may be affected. These firms are likely to account for up to around £10m of the total redress and administrative costss payable. If one or more networks of appointed representatives were to be unable to meet its capital requirements, greater amounts of redress would be vulnerable, upto a maximum of around £40m should some of the affected firms be unable to raise the additional capital required, and should firms close as as result, it is possible that this may have some impact on the level of competition in the market, although this may be geographically localised. However, the number of GI brokers who fail is likely to be only a small percentage of the total, and consumers have a range of other options for accessing the financial services products offered by these brokers. It may also be possible for other incumbent brokers to expand their businesses and for new brokers to enter the market. However, there are a number of potential competition responses that firms could make, and the the conditions for competition in the relevant markets may change materially when the Competition Commission's package of remedies is implemented. It is not yet clear whether the package will include a 'point of sale prohibition'. It is therefore not possible to accurately predict the outcome of our propoals on competition.

4.45 **Specialist secured lenders** may face total costs of around £120m as a result of our guidance. Many specialist secured lenders active in the market since 2005 are currently closed to new business. Should specialist secured lenders incur the costs outlined, this will add further pressure to their financial position. However, the fact that many firms previously active in this market are currently closed to new business indicates that the impact of any failures of firms on consumers' access to credit, or on competition in the market, is likely to be limited. Consequently, we do not believe that the risk of failure in this section of the market undermines the proportionality of our proposals.

Impact of our proposals on the FSCS

4.46 We estimate that up to c.£160m[35] of the costs described above might pass through to the FSCS and then on to firms through the levy. These costs would fall initially within the 'General Insurance - Intermediation' sub-class and it is unlikely that firms outside this pool would need to contribute towards any redress costs. We do not expect that the potential cost to levy firms would trigger any additional prudential issues.

Benefits

4.47 Should firms reach the view that, in order to meet their obligations under DISP and Principle 6 (treating customers fairly), they need to take action that involves paying redress to non-complainants, the direct result of this would be a fairness-driven transfer to mis-sold consumers.

4.48 Where, through root cause analysis, firms identify matters which bring into question the quality of their sales, we would expect firms to make changes that will address the issues identified. This should reduce the potential gain to firms, and the potential detriment to consumers, from future mis-selling, reflecting improved sales standards for PPI. These wider effects may bring a number of benefits in future, by helping to ensure that customers buy products which meet their needs, and by improving confidence in the retail financial services markets.

4.49 Where firms incur significant costs from conducting reviews of sales to non-complainants, they may attempt to pass on some of these costs to consumers (or other customers of firms) through higher pricing and/or lower product quality; given that many firms have stopped selling PPI products, any cost pass-through

35 Consisting of upto £40m of the potential costs for GI brokers and up to £120m of the potential cost for specialist secured lenders (though we highlight that especially in the case of specialist secured lenders whom we dont regulate a lack of available data has meant that we've adopted a very conservative estimate of the impact on this sector).

may affect other products besides PPI. This is a risk inherent in any regulatory action which imposes costs on firms, especially where the financial impact may be significant for firms. However, the pass-through of costs to consumers may also be limited by competition. Costs of review and redress are unlikely to be uniform across the PPI market because these will depend on what firms conclude about their own past pracices. Importantly, the extent to which higher firm costs are passed through to consumers will depend on how firms compete with each other in each relevant market. If competition is sufficiently effective then less-affected firms may keep PPI prices, and other possibly affected product prices, from increasing. Where customers also have the option to purchase PPI from standalone providers, rather than from providers of loan products, this external competition may also keep prices down (and prevent consumers from being 'priced out of the market'). However, this effect may be small if the market is dominated by sales from providers of loan products, and standalone sellers merely reference PPI prices set by providers of loan products. The ability of some firms to leverage off other products they sell (e.g. offering PPI to consumers when purchasing a mortgage product) may also reduce the competitive impact standalone sellers have on prices. Given the complexity of the competitive landscape for PPI products, and in particular the uncertainty around by the Competition Commission's package of remedies, and the markets' response to the remedies, the impact of higher firm costs on prices may best be considered to be ambiguous (see competition impacts section, Annex 2).

4.50 It is possible that some firms will be unable to bear the costs associated with past mis-selling revealed through root cause analysis (as discussed at paragraphs 4.42–4.45 above) for building societies, general insurance brokers and secured lenders. We conclude from this that, while it is likely that some small- and medium-sized firms may close as a result of our guidance, we do not expect this to have a material impact on consumer access to the market, or on competition.

4.51 Based on the above, we believe that there would be significant benefits for customers associated with firms' undertaking root cause analysis and, where systematic failings are identified, acting on their own initiative, including by paying redress to customers who have been mis-sold.

Q21 Do you agree with our assessment of the wider impact of our package of measures on industry?

5 Next steps

Consultation Period

5.1 In CP09/23, we set a consultation period of one month (closing 30 October 2009), citing our concerns about the mounting number of PPI complaints and the need to limit consumer detriment, and noting that we had undertaken extensive pre-consultation.

5.2 A number of industry responses criticised this decision, arguing that it gave insufficient time to assess and respond to the wide range of issues, including some technical ones, which CP09/23 raised or implied.

5.3 Some firms' responses objected that they had not been involved in our pre-consultation, that this meant they were especially disadvantaged by the one month consultation period, and that their non-involvement meant we could not have properly considered a wide range of potential options before taking forward some in CP09/23.

Our response

Clearly, it is not feasible to invite every firm to pre-consultation discussions. We note that the list of attendees at most of these pre-consultation discussions reflected the composition of the industry-led group (referred to in Chapter 2), to which industry itself had nominated and invited the attendees it considered appropriate to the discussions. But in any case, we are content that our pre-consultation appropriately involved stakeholders who were able to speak for all main types of firms relevant to the PPI issue (in addition to consumer stakeholders). We considered, in discussion with these stakeholders, a wide range of options and potential approaches. We do not consider that the proposals we put forward in CP09/23 were undermined by the absence of any particular firm from our pre-consultation discussions.

We subsequently stated (on 20 November 2009) that we would continue to accept responses until the end of 2009. Some new or supplementary responses were received in that time, which we duly assessed.

The revised proposals put forward in this CP, notably the proposed wider menu of approaches to the practical delivery of comparative redress, clearly reflect our careful consideration of the concerns many firms expressed about the particular challenges presented by our original proposals to the particular business models and contractual arrangements of their type of firm.

Given the original consultation lasted in practice for two months or more, the number and detail of responses we received during it and then assessed, and our continuing concerns about the need to limit consumer detriment, we consider that a further consultation period of six weeks (to 22 April 2010) is sufficient time for stakeholders to identify and raise any new points about the package of measures described in this CP.

Implementation of the complain handling guidance

5.4 In CP09/23, we said that if we proceeded to finalise the proposed guidance, we would look to bring it into force immediately. We asked:

> Q7: Do you agree that the immediate implementation of our proposals would be reasonable?

5.5 Most industry responses criticised such immediate implementation as impractical and undeliverable. They argued it would take several months to train their complaint handlers to handle PPI complaints in line with the proposed guidance, and to establish wider procedures for investigating PPI complaints and for obtaining and assessing evidence and records about them in line with the proposed guidance. They further argued that it would take several more months to gear up operationally to provide redress in line with the proposed guidance, and in particular the comparative approach.

5.6 Consumer representatives' views in contrast endorsed the need for rapid implementation to ensure that complainants started getting fairer and more consistent outcomes as soon as possible.

Our response

We have considered these responses carefully. We do not consider that our proposed guidance concerning the assessment of complaints, and how to fairly determine the way the complainant would have acted if a failing by the firm had not occurred, contains anything that (from the perspective of DISP's existing requirements) could be reasonably seen as so novel that it would really need several months to train complaint handlers on or gear up for procedurally. Therefore, we consider that only a short period for implementation of these parts of the guidance is warranted.

Concerning the implementation of the approaches to redress, we consider that the approach our guidance sets out concerning the full return of premiums should have substantial continuity with the approach many firms have been taking (at least in respect of the redress awards made against them by the FOS), and so should not be that novel either. We accept, however, that a likely implication of our guidance (and cost-benefit assumptions) is that most firms will probably now be taking this approach to redress in respect of many more complaints than before, such that some enlargement and/or formalisation of their existing redress procedures may well be required.

Concerning the comparative redress approach, we accept that, notwithstanding our introduction of a menu of alternatives to ensure the approach is feasible for all types of firms, implementing any of those approaches will still present genuine practical challenges to firms which they will take time to overcome.

So, we propose that, if we proceed with our proposals and make the guidance, we will allow firms to implement it in a staggered manner, such that:

- by one month after the guidance is made, firms should take it as illustrating how DISP 1.4.1R may be complied with in respect of assessing complaints and the evidence about them, and where appropriate determining the way the complainant would have acted if a breach or failing by the firm had not occurred (see parts 3.1G to 3.6G of the draft Handbook text); and
- by three months after the guidance is made, firms should take it as illustrating how DISP 1.4.1R may be complied with in respect of assessing redress to relevant conplainants (see parts 3.7G to 3.8G of the draft Handbook text).

In the interim periods, firms remain under their existing obligations in DISP to assess complaints fairly and consistently, including what redress and/or remedial action it may be appropriate to pay or take concerning an upheld complaint (see DISP 1.4.1R (2)(c)).

Firms will of course be free to adopt the approaches to redress in the guidance that we set out *sooner* but we will consider it unfair if they do so in a way that is not accurate or not consistent across their relevant books of PPI business (see 3.7.7G in the draft Handbook text).

Q22 Do you agree that this proposed (staggered) implementation period for the complaint handling guidance is reasonable and practicable?

The FOS PPI complaint questionnaire

5.7 In CP09/23, we noted that the FOS was minded to design such a questionnaire and to generally require a copy to be completed before a referral of a PPI complaint to it.

5.8 A number of consumer representative responses, and some firm responses, commented warmly on the idea of the questionnaire, welcoming it as being likely to assist both complainants and firms in achieving swifter and fairer outcomes.

5.9 Some industry responses, however, criticised the unavailability, at the time of consultation, of the mooted questionnaire, arguing that sight of it was vital to assessing the practical impact of our proposed guidance on assessing PPI complaints and the evidence about them.

Our response

The questionnaire was an initiative of the FOS, and not of the FSA, and so was not part of our consultation. We do not consider that its unavailability at the time of our original consultation in any way prevented stakeholders from making a full and informed assessment of our proposed guidance. But in any case, we are now consulting further for six weeks on our revised proposed guidance, and the FOS questionnaire is now in near final draft (the FOS having received important input from both industry and consumer stakeholders).

We remain of the view that the questionnaire would potentially help ensure that both firms and consumers (and their representatives) do the necessary leg work in setting out and looking into the details of the case, thus helping to avoid generic complaints and generic rejections respectively. To that extent it may also help firms and consumers with some of the aspects we have discussed in this CP (such as the fair assessment of oral and documentary evidence, and of a complainant's circumstances – see Chapter 3).

FSA messaging to consumers

5.10 Some responses to our consultation suggested that it would be helpful to all concerned if complainants were helped to understand that they too need to play their part in the PPI complaint handling process and that improved co-operation on their part might help them to get speedier and better handling from firms.

5.11 Also, and as noted in Chapter 3, some responses from consumer representatives welcomed our proposed guidance on redress, but were concerned that offers made under the comparative approach in particular might be hard for consumers to understand and assess (including whether they should maintain their existing cover). Such responses thus suggested that the FSA might be able to assist in facilitating consumer awareness and knowledge of such redress and choices.

Our response

We will consider whether, and how, we might distribute messaging to PPI consumers about their role in the complaint handling process and about the potential redress that can ensue and its implications. We could do this, for example, through our website and consumer publications, and through working with consumer bodies and representatives (such as claims management companies) and their publications and events.

Future Monitoring

5.12 Going forward, we will retain our focus on ensuring good outcomes for consumers by undertaking a risk-based approach to monitoring firms' behaviours.

5.13 A main part of our focus will be monitoring firms' PPI complaint handling practices, to assure ourselves that complaints are being fairly assessed and, where appropriate, fairly redressed.[36]

5.14 Given our proposed guidance applies to complaints concerning sales of all types of PPI, firms in all sectors can expect to be involved in our monitoring. But we do intend to pay particular attention to complaints about single premium PPI policies

36 Concerning monitoring of firms' actions towards non-complainants, see paras 2.19.

on unsecured personal loans, as this is the sector where we have previously seen significant sales failings and potential consumer detriment, and it is to (some of) these complaints that our regular premium presumption and comparative redress approach can potentially apply. We will also attend closely to the handling of complaints about single premium PPI policies on secured personal loans, where the comparative redress approach may also feature.

5.15 We receive monthly reports concerning PPI sales and complaints from the largest PPI intermediaries and underwriters, who together cover most of the PPI market. We intend to revise these data reporting requirements to be more granular concerning complaints decisions and redress and of more use in supporting our monitoring of these firms' PPI complaint handling.

5.16 We do not intend to extend such bespoke reporting to PPI firms more generally. We will continue to utilise standard six monthly general complaints data (which firms submit as part of their integrated regulatory reporting to the FSA), and leverage off supervisory relationships, so as to be able to pick out in a risk based way those firms whose PPI complaint handling we should then assess in more depth.

5.17 However, we may approach any firm in either reporting set for more qualitative information about their handling of PPI complaints, including (but not limited to):

- a sample of the firm's PPI complaint files;
- details of the governance structures, internal procedures and guidance, and quality assurance, in place for PPI complaints handling;
- papers and minutes from senior management meetings discussing PPI complaints;
- management information supplied to senior management on PPI complaint handling operations and quality (for example concerning the firm's PPI complaint volumes, its decisions thereon and redress thereof, its experience at FOS and lessons learned therefrom);
- any checklists or questionnaires used when handling PPI complaints and/or determining the level of redress offered and paid; and
- details on processes in place for undertaking root cause analysis on PPI complaint handling, on any recent trend analysis and root cause analysis work done on PPI complaints, and any changes or improvements made to PPI sales policies, procedures and processes that were undertaken as a result.

5.18 Where we find that firms cannot demonstrate that they are delivering fair outcomes to PPI complainants through the implementation of our guidance (or an equally fair alternative), such firms can expect tough action from us.

Market failure analysis of relevant aspects of the PPI market

1. The PPI market suffered from a collection of information asymmetries at the point of sale. This included but was not limited to:

   - consumers being sold PPI as part of a bundle with the loan product;
   - consumers not realising that the PPI policy was optional;
   - consumers not realising how much it cost;
   - consumers not realising the extent of the cover or any exclusions; and
   - consumers not realising the extent of any premium refund for single premium products in the case of early cancellation of policy.

   These all contributed to mis-selling and to firms not addressing consumers' subsequent complaints properly.

2. In order to mitigate this market failure, we issued conduct of business rules, guidance and high-level principles covering both the sales standards and complaint-handling standards that firms are expected to adhere to. However, as some of these problems (e.g. details of cover or exclusions, or any premium refund for single premium products in the case of early cancellation of policy) can be dormant and only become apparent later on (when consumers want to make a claim or repay the loan earlier) firms and/or their sales staff, motivated by the short-term financial rewards, still have incentives and opportunities to mis-sell PPI and to reject complaints that may be valid.

3. Indeed, our data indicates that PPI complaints have risen rapidly in recent years (e.g. the number of PPI complaints to FOS has risen from 2,000 in 2006/07 to 31,000 in 2008/09) and since 2007 firms have upheld nearly half (46%) of PPI complaints they received. Of the PPI complaints rejected by firms, around 30% were referred to the FOS. A large majority of these referred cases – as high as 89% for the year to 31 March 2009 – were upheld in favour of consumers. However, as only 30% of rejected PPI complaints go to the FOS, firms still have an incentive to reject some valid complaints. In addition, data that we received from firms after the CP09/23 consultation period indicate that, while the average redress offered on complaints in cases upheld by firms has shown an upward trend since 2005, it still remains lower

than the average redress later stipulated by the FOS on cases referred to it. This indicates that firms may not be providing fair redress on upheld complaints.

Cost-benefit analysis of complaint-handling guidance

Benefits

1. Our proposed complaint handling guidance in this Consultation Paper would lead to greater redress to policyholders. This is prompted mainly by considerations of equity (i.e. justice and fairness) and addresses the consequence of the market failure outlined in Annex 1. To the extent that our complaint-handling guidance reduces firms' potential gains from mis-selling, the proposed guidance would also mitigate the problems associated with the information asymmetry by making mis-selling less profitable and therefore potentially reducing the occurrence of mis-selling in future.

2. Consumers who have been mis-sold, and who would not otherwise receive fair redress (or in many cases, any redress), will be the main beneficiaries of our guidance. The anticipated increase in firms' uphold rates also means that some consumers will benefit from receiving redress (where this is appropriate) more rapidly, as more complainants will receive redress without the need to refer their complaints to the FOS. Consumers will also benefit from time saved complaining. One benefit of reduced mis-selling is the saving in administrative costs associated with any potential redress required as a result of mis-selling. In addition, improved outcomes in PPI complaint handling may have knock-on effects by improving consumer confidence in the fairness of firms' complaint handling processes more generally.

Costs

3. In estimating the compliance costs to firms of our complaint-handling proposals we have divided costs into the following categories: redress costs, costs to firms from FOS adjudications (including both FOS case fees and FOS-stipulated redress costs) and administrative costs. We do not expect any material increase in the fees payable to the FSA by firms to result from our proposals.

4. These costs will be borne initially by the firms. However, some of these costs are likely to be passed through to consumers – both PPI consumers and consumers of other financial products. The extent to which firms are able to pass costs through to consumers will be determined by the state of competition in the markets for these,and possibly other products. We provide a discussion on the possible outcomes given different assumptions on competition at the end of this Annex. We expect

the amount of PPI sold to decrease. However, since we cannot predict the extent of competition in the market following implementation of our proposals and in particular the package of measures proposed by the Competition Commission, the effect on price is uncertain.

5. To understand the incremental redress costs for firms that may arise from our guidance, we construct a broad range of potential costs based on a set of assumptions. Future trends in redress costs are necessarily uncertain, and are influenced by a number of factors independent of our proposals. Given this, we begin by estimating the potential additional costs that firms may incur over the 12 months following the implementation of our proposals,[1] and then discuss the expected trends in complaints beyond this time horizon.

6. The costs incurred are estimated relative to a baseline which assumes that firms continue to handle future complaints in the same way as they do at present. In practice, if we do not proceed with our proposed guidance, it is likely that we would continue to take alternative measures, such as enforcement action against individual firms, where appropriate; some of these measures may result in costs to firms. However, since it is difficult to predict in advance exactly what action we might take in individual cases and the cost implications for firms of these alternative measures, and the extent to which they may reduce as a result of our guidance, we have not quantified their impact on the baseline. Consequently, the baseline estimate of the total costs to firms without our guidance may be an underestimate, and our estimates of the incremental cost impact to firms from our guidance may be an over-estimate.

Redress cost: baseline

7. **Volume:** In 2008, firms received approximately 126,000 sales-related PPI complaints. In 2009, we estimate that firms received around 260,000 sales-related PPI complaints.[2] We expect complaint volumes to continue to increase in the short term, driven primarily by the ongoing media focus on PPI, advertisements and other activities from CMCs, and word-of-mouth effects (as customers may be more likely to complain if they know someone who has had a successful complaint). It is difficult to predict how significant, or how sustained, an increase in PPI complaint volumes may be; we assume that even without our guidance, complaint volumes will continue to increase significantly, in line with the trend observed, at least for the next 12 months. Therefore, in our baseline we assume that firms would receive around 450,000 sales-related PPI complaints (split between single premium and regular premium based on the proportions evidenced in historical data)[3] over the next 12 months.

8. **Average redress:** In the baseline, we have used the average redress paid by firms in 2009. We have not assumed a continuation of the upward trend in the amount of

1 In the calculations that follow, we assume an implementation date of 1 July 2010 for our guidance on assessing complaints. Our estimate of redress costs in the 12-month period from July 2010 does not take into account the fact that some firms will not be able to implement the comparative approach to redress immediately. In reality, this means that firms may initially pay full redress on some complaints which they will later be able to deal with under the comparative approach. However, since we use the cost estimates over the 12 months from July 2010 to project the medium-term cost of our proposals, we ignore the effect of this delay for the purposes of our modelling, as we expect its impact on our overall costs estimates to be limited.

2 Source: Firms' data returns to the FSA.

3 Source: Firms' data returns to the FSA.

redress, as the extent of any future increase is unpredictable. This means that our estimate of the incremental redress cost resulting from our guidance may be an over-estimate (if the baseline average redress becomes higher than that in 2009).

9. **Uphold rate:** In the baseline, we have assumed that, over the 12 months from the implementation date of guidance, firms' uphold rates would remain at current levels. We estimate that firms currently uphold approximately 56% of single premium complaints, and approximately 33% of regular premium complaints, based on data submitted by firms.[4]

10. **FOS adjudications:** Currently, about 30% of rejected complaints are referred to the FOS, and the FOS upholds 89% of PPI complaints in favour of complainants. In the baseline, we assume that the referral rate and the FOS uphold rate would continue. We estimate the average redress as the average that firms would pay under the full redress approach (as the FOS currently uses the comparative approach to redress in only a limited number of cases). This gives overall average redress of c.£1,760 per case (c.£2,650 per case for single premium policies and c.£970 per case for regular premium policies). The FOS case fee is £500 per case.

11. Table 1 summarises the baseline redress costs firms would have paid for the next 12 months without the proposed guidance.

Table 1: Estimation of redress costs in the 12 months following implementation of our guidance: *baseline*

	Single Premium (SP)	**Regular Premium (RP)**	**SP and RP (summed or averaged as appropriate)**
Firm redress: baseline			
Number of PPI complaints to firms p.a (a)	c.261,000	c.189,000	c.450,000[5]
Average firm redress per upheld complaint(b)	c.£2,000	c.£735	c.£1,625[6]
% of complaints upheld by firms (c)	c.56%	c.33%	c.46%[7]
Estimated firm redress total (d=a*b*c): baseline	**c.£294m**	**c.£45m**	**c.£340m**
FOS: baseline			
Number of PPI complaints referred to FOS (30% of firm rejected complaints)	c.34,000	c.38,000	c.72,000
Average redress per upheld complaint	£2,650	£970	£1,760
% of complaints upheld by FOS	89%	89%	89%
FOS redress total	**c.£80m**	**c.£33m**	**c.£113m**
FOS case fees (@ £500 per referred case)	c.£17m	c.£19m	c.£36m
Estimated FOS total: baseline	**c.£98m**	**c.£52m**	**c.£150m**
Estimated redress total: baseline	**c.£391m**	**c.£97m**	**c.£489m**

4 The uphold rate for all single premium products is largely driven by the uphold rate for single premium unsecured personal loan PPI (59%). Results of our thematic reviews and enforcement cases show that this has been the market segment with the greatest risk of consumer detriment; consequently, it is unsurprising that complaints on this product have a higher uphold rate than complaints on other PPI products. We estimate the total uphold rate based on firms' monthly returns to the FSA for the period 2007-2009.

5 Split of single versus regular premium complaints based on historical data for 2009 (source: firms' report to the FSA).

6 Firms' data submission to the FSA (November 2009). We have used the average redress paid by firms in 2009 as our baseline.

7 Firms' monthly returns to the FSA, based on data for the period 2007-2009.

Estimated redress costs after the guidance: low-impact and high-impact scenarios

12. Volume: Although our guidance does not directly aim to increase the number of complaints made to firms, the increase in uphold rates and the increase in average redress for regular premium policies, in conjunction with any broader publicity which our proposed guidance may generate, could lead to some increase in complaint volumes. However:

    a. we expect any increase in the number of complaints from the increase in firms' uphold rate to be limited. Any increase in complaints will come primarily from customers who are currently either unaware of the possibility of referring rejected complaints to the FOS or who are otherwise discouraged from complaining. However, we expect the complaints from this group to be limited, given that the current high level of complaints and FOS uphold rates on PPI have already been widely publicised (not least through CMCs and consumer activist forums), and we have already seen a significant increase in number of complaints to firms and to the FOS in recent years;

    b. similarly, we do not expect any increase in average redress for regular premium policies to lead to a significant increase in the number of customers making complaints.

    The ongoing media focus on PPI and the activities of CMCs have already contributed to the significant increase in the number of complaints to firms and to the FOS in recent years,[8] and we do not expect that additional media coverage as a result of our consultation would have a substantial impact. For a comparison we analysed complaints around the time of the bank charges publicity. While increased media coverage did significantly increase complaints about bank current account charges in 2006, complaints on PPI products have already increased to levels similar to that of the peak in bank charge complaints. [9] For this reason, we do not expect further large increases in complaint volumes.

    In paragraph 14 below we define, two scenarios: low- and high-impact. Based on the above mentioned factors, we assume that in both of these scenarios, our guidance will lead to a 10% increase in complaint volumes over the 12 months following implementation of our guidance, from a baseline of c.450,000 to c.500,000.[10]

13. Average redress: In both our low- and high-impact scenarios, we expect firms who are currently not offering fair redress (i.e. paying less redress than the customer is entitled to) to improve their practices.

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8 We also note that any increase in complaint volumes driven by CMCs as a direct result of our proposals is likely to be limited, as many such companies already target customers by claiming high success rates in obtaining redress on PPI sales (currently through referring cases to the FOS where these are rejected by firms). Consequently, the fact that more complaints may now be settled through firms without being referred to the FOS does not add significantly to the strength of CMCs' marketing messages (though they may emphasise the fact that some complainants may be receiving redress more quickly).

9 The numbers of complaints on current accounts referred to the FOS were 3,500, 8,000 and 39,000 respectively for years ending March 2006, March 2007 and March 2008. In comparison, the numbers of PPI complaints referred to FOS were 2,000, 11,000 and 31,000 respectively for years ending March 2007, March 2008 and March 2009. See http://www.financial-ombudsman.org.uk/publications/ar09/about.html#4

10 It should be noted that, if significant numbers of firms conduct reviews of sales to non-complainants, and dependent on the extent of any such reviews, the number of BAU complaints received (on post-2005 sales) and the resulting redress costs may be correspondingly lower than the figures noted below.

a. For regular premium products, we estimate that fair redress will lead to an increase in the average redress offered of about 35%;

b. For single premium policies, we estimate that in 50% of cases, firms will pay the "full redress" amount; in these cases our guidance on fair redress will lead to an increase of redress offered of about 25% (compared with our baseline). In the other 50% of cases, it might be appropriate for firms to use the proposed "comparative redress" approach, which is expected to lead to a reduction in redress offered of about 30% (again compared with the baseline). The combined effect of this for single premium policies is that the average redress on single premium policies will be marginally lower than the average specified in our baseline.

14. Uphold rate: In estimating the cost impact of our guidance, we construct two scenarios as follows:

a. a low-impact scenario where our guidance leads to a 75% uphold rate for single premium products and a 70% uphold rate for regular premium products other than first-charge mortgages; and

b. a high-impact scenario that assumes a 90% uphold rate for single premium products and an 85% uphold rate for regular premium products other than first-charge mortgages.

For both scenarios, regular premium first-charge mortgage PPI is considered separately because we assume that the uphold rate will show a more limited increase relative to current levels, given there are fewer concerns about sales standards and complaint handling standards for this product. The current uphold rate for PPI complaints relating to first-charge mortgage is around 40%. We assume in both the low and high-impact scenarios that this will increase to 50%.

15. FOS adjudications: we expect that our proposed guidance will lead to a significant reduction in the amount to be paid by firms in FOS-stipulated redress and FOS case fees. Specifically, we assume that in both scenarios, after the guidance:

a. 30% of rejected complaints will be referred to the FOS, (as per our baseline scenario);[11] [12]

b. for those complaints referred to FOS 40% will be upheld (instead of the baseline figure of 89%) – when firms are assessing and redressing complaints in line with our guidance, the uphold rate on cases referred to FOS is likely to fall in line with that for other insurance products (the average FOS uphold rate for which is currently between 30% and 50%); and

c. where the FOS does uphold referred complaints in favour of the consumer, the comparative redress approach (which the FOS will implement alongside firms)

11 This figure may be lower, if firms clearly explain to customers the reasons for rejecting a complaint, such that few customers decide to refer their case to the FOS. However, it is not clear that this decrease would arise in practice. Hence for the current calculation we conservatively assume that the proportion of rejected complaints referred to the FOS remains at its current level.

12 We note that the FOS currently estimates that it will receive 46,000 PPI complaints in the financial year 2010/2011 (source: FOS Corporate plan and 2010/2011 budget (p.12) – see www.financial-ombudsman.org.uk/publications/pb10/cpb-10-11.pdf). This would be in line with our low-impact scenario (which leads to the higher-end estimate of the number of rejected complaints, and thus the expected number of cases referred to the FOS), with a smaller number of additional referrals from non-sales-related complaints.

would lead to a reduction in redress costs (compared with the baseline) on some complaints about single-premium policies and we anticipate that this will reduce the overall average redress (across single and regular premium products) from currently c.£1,760 to c.£1,450 per case upheld.

16. Table 2 summarises the estimated redress costs firms would payfor the next 12 months in the low-impact scenario, and Table 3 summaries the estimated redress costs firms would have pay for the next 12 months in the high-impact scenario.

Table 2: Estimation of redress costs in the 12 months following implementation of our guidance: *low-impact scenario*

	Single Premium (SP)	Regular Premium (RP)	SP and RP (summed or averaged as appropriate)
Firm redress: low-impact scenario			
Number of PPI complaints to firms p.a (a)	290,000	210,000	500,000
Average firm redress per upheld complaint(b)	1,930	£990	£1,560
% of complaints upheld by firms (c)	75%	67%	72%
Estimated firm redress total (d=a*b*c): low-impact	**c.£420m**	**c.£140m**	**c.£559m**[13]
FOS: low-impact scenario			
Number of PPI complaints referred to FOS (30% of firm rejected complaints)	21,800	20,800	42,500
Average redress per upheld complaint	£1,930	£1,020	£1,480
% of complaints upheld by FOS	40%	40%	40%
FOS redress total	c.£17m	c.£8m	c.£25m
FOS case fees (@ £500 per referred case)	c.£11m	c.£10m	c.£21m
Estimated FOS total: low-impact	**c.£28m**	**c.£19m**	**c.£46m**
Estimated redress total: low-impact	**c.£447m**	**c.£159m**	**c.£606m**
Estimated incremental redress: low-impact vs. baseline	**c.£55m**	**c.£61m**	**c.£117m**

13 Totals may not sum due to rounding.

Table 3: Estimation of redress costs in the 12 months following implementation of our guidance: *high-impact scenario*

	Single Premium (SP)	Regular Premium (RP)	SP and RP (summed or averaged as appropriate)
Firm redress: high-impact scenario			
Number of PPI complaints to firms p.a (a)	290,000	210,000	500,000
Average firm redress per upheld complaint(b)	£1,930	£990	£1,560
% of complaints upheld by firms (c)	90%	80%	86%
Estimated firm redress total (d=a*b*c): high-impact	**c.£504m**	**c.£166m**	**c.£670m**[13]
FOS: high-impact scenario			
Number of PPI complaints referred to FOS (30% of firm rejected complaints)	8,700	12,700	21,400
Average redress per upheld complaint	£1,930	£1,050	£1,400
% of complaints upheld by FOS	40%	40%	40%
FOS redress total	c.£6m	c.£5m	c.£12m
FOS case fees (@ £500 per referred case)	c.£4m	c.£6m	c.£11m
Estimated FOS total: high-impact	**c.£11m**	**c.£12m**	**c.£23m**
Estimated redress total: high-impact	**c.£515m**	**c.£177m**	**c.£692m**
Estimated incremental redress: high-impact vs. baseline	**c.£123m**	**c.£80m**	**c.£203m**

17. Based on the ranges above, we estimate that firms would incur additional redress costs of c.£117m-£203m in the 12 months following implementation of our proposed guidance.

18. Table 4 provides an approximate breakdown of these cost estimates by product, for the same time period. We note that the impact of incremental redress falls primarily on providers of single premium unsecured loan PPI and credit card PPI, as these products have historically had the highest share of the PPI market and the highest complaint volumes. We also expect a significant increase in the level of redress to be paid on single premium second-charge mortgage PPI – this reflects the fact that the average uphold rate on this product is currently only 15%.

Table 4: Estimation of breakdown of incremental redress costs by product

	Single Premium (SP)	Regular Premium (RP)	Total
Low-impact scenario			
Personal loans	£35m	£10m	**£45m**
Mortgage(first charge)[14]	-	£7m	**£7m**
Credit cards	-	£33m	**£33m**
Mortgage(second charge)	£19m	£9m	**£28m**
Motor finance[15]	£1m	-	**£1m**
Other[16]	-	£2m	**£2m**
Estimates Total	**c.£55m**	**c.£61m**	**c.£117m**
High-impact scenario			

	Single Premium (SP)	Regular Premium (RP)	Total
Personal loans	£94m	£16m	**£110m**
Mortgage(first charge)	-	£7m	**£7m**
Credit cards	-	£43m	**£43m**
Mortgage(second charge)	£27m	£11m	**£38m**
Motor finance	£2m	-	**£2m**
Other	**-**	**£2m**	**£2m**
Estimated Total	**c.£123m**	**c.£80m**	**c.£203m**

Estimated administrative costs

19. We have estimated the additional administrative costs that firms will incur in handling complaints in line with our proposed guidance. Our estimates are based on data from past enforcement cases related to complaint handling;[17] discussions with specialist consultancies with experience of PPI complaint handling projects; and information received from individual financial institutions, including comments raised by firms on expected administrative costs in responses to CP09/23. We also model separately the expected costs for small, medium and large firms, since the complaint handling processes used by firms, and consequently the costs incurred in making changes to existing processes, are likely to vary based on the size of the firm.

20. We expect that firms will incur initial set-up costs in preparing to handle complaints in line with our proposed guidance; firms will also incur additional ongoing costs from investigating complaints more fully than many do at present. These costs depend (among other factors) on the additional number of Full Time Equivalent staff (FTEs) required to handle complaints as a result of our guidance. We first estimate this number of additional FTEs, and then proceed to estimate the initial set-up costs and ongoing costs to industry arising as a result of our guidance.

Estimated number of additional FTE required to handle complaints in line with our guidance

21. We estimate that firms currently spend an average of 1.7 hours per PPI complaint.[18] Once firms implement our guidance, we estimate that it will, on average, take them approximately 3.5 hours to properly evaluate each non-credit card PPI complaint – additional time will be needed to gather relevant information and to thoroughly assess the complaint. For credit card PPI complaints, we assume a

14 While some single premium PPI has been sold on first-charge mortgages, indicative information (based on firms' data submission to the FSA in November 2009) suggests that the proportion is very low relative to regular premium MPPI (of the order of 1%-3% of total GWP). For the purposes of our cost estimations, we have assumed this to be zero. However, firms who have sold single premium MPPI should not take this to indicate that the guidance does not apply to complaints about such sales.

15 Motor finance sales are assumed to be exclusively single premium.

16 This includes PPI sold on overdrafts and retail shopping products/store cards. We have assumed that all sales falling into this category are made on a regular premium basis.

17 Including data from our actions relating to endowment mortgages, which involved modelling firms' complaint handling processes.

18 This includes: entering details of the complaint on relevant systems; collating relevant evidence and documentation; communication with the customer and with other staff members; analysis of the basis for the complaint; calculation of redress for upheld complaints (including for rejected complaints which are later upheld in favour of the customer by the FOS). This also includes the time taken for quality assurance and monitoring of complaints.

lower average time of 2.5 hrs per complaint. This reflects our understanding that a greater proportion of credit card PPI sales are non-advised compared with other PPI products, and as such the structure of PPI sales is simpler and complaints can be assessed more quickly. As credit card PPI complaints are estimated to make up around 25% of future complaints, this leads to an estimated average time per complaint of 3.25 hours, across all PPI products.

22. We have assumed that the percentage of complaints received by small, medium and large firms reflects their share of sales. On this basis, large firms represent around 80% of complaints received, and medium and small firms around 10% each.[19] Based on these assumptions, we estimate the total number of additional FTEs required in Table 5 below:

Table 5: Total number of additional FTEs required

	Large firms	Medium firms	Small firms	Total
Baseline				
Number of complaints received	360,000	45,000	45,000	**c.450,000**
Time taken per case	1.7 hrs	1.7 hrs	1.7 hrs	**c.1.7 hrs**
Number of FTEs required	350	44	44	**c.438**
Post-implementation				
Number of complaints received	400,000	50,000	50,000	**c.500,000**
Time taken	3.25 hrs	3.25 hrs	3.25 hrs	**c.3.25hrs**
Number of FTEs required	743	93	93	**c.929**
Number of additional FTEs required	393	49	49	**c.491**

23. In addition to the time taken by the distributor in assessing complaints, other firms in the sales chain (such as insurers, or lenders where the product was sold via a broker) may also be required to spend additional time dealing with aspects of a complaint. This might include, for example, answering questions relating to claims, such as when lenders whose products have been sold via brokers may need to also arrange for loans to be restructured where a complaint is received by the broker which requires this action. We assume that for vertically-integrated firms, the time required for information gathering/sharing within a group is included in our timing estimates outlined in the above estimate. For complaints to non-vertically integrated firms (which include around 40% of complaints to large firms, and all complaints to small and medium firms), we estimate that other firms in the sales chain may spend, on average, an additional one hour on each complaint received by the distributor, above the time which they would have spent in dealing with complaints without our guidance. This would lead to an additional labour requirement equal to approximately 153 FTEs[20] for non-distributors.

19 Large firms' refers to the top 13 distributors of PPI (by gross written premium) in 2007, based on Mintel data. 'Medium firms' are other FSA relationship-managed firms, of which we estimate that around 40 may still be handling PPI complaints and so may incur the costs outlined in this section. 'Small firms' are the remaining, non-relationship-managed firms; we estimate that there are around 350 such firms which may still be handling PPI complaints.

20 (400K*42%+50K+50K)*1hr/(7hrs per day*250 days)= 153 FTE

24. So in total, we estimate that the industry will need additional labour requirement equal to approximately 644 FTEs to handle complaints in line with our guidance.

Initial set-up costs

25. **Complaint handling process and IT –** based on discussions with the industry, we estimate that for firms to revise their complaint-handling processes in line with our guidance, they may incur:

- costs from activities such as process mapping, gap analysis, and training design;
- IT set-up costs from integrating these new processes into customer relationship management software, finance and accountancy software; and
- costs from any PPI complaint specific IT requirements (new form letters, redress calculators, etc).

We estimate that these changes would cost the largest firms approximately £1.5m each, including the cost of external consulting support where required. Medium-sized firms would incur costs of c.£300,000 each. Small firms would incur cost of c. £7,000 each.[21] Therefore we estimate that the total one-off cost for revising the complaint handling process (including IT) for all firms will be around £36m.[22]

26. **Staff recruitment and training costs –** we assume that each employee would be hired via an employment agency charging 18%[23] of base salary. The base salary is assumed to be around £25,000 a year. In addition, we estimated the cost of staff training at approximately £1,000 per head for existing staff, and £2,000 per head for new joiners. Therefore, we estimate that the total one-off cost for staff recruitment and training will be c.£4.6m.[24]

27. Based on the assumptions above, we estimate that the total one-off administrative cost to firms will be approximately £41m.

Ongoing costs

28. The major on-going costs to firms that we expect to arise from our proposed guidance are staff employment costs and, where there is staff attrition within the additional employees recruited as a result of our guidance, the on-going cost of training and recruiting new staff to replace them.

29. We estimates that distributors, based on employing around 491 additional FTEs, will have an incremental ongoing employment cost of c.£18m.[25] Other firms in the sales chain, based on hiring and recruiting approximately 153 extra staff, will have an estimated additional cost of around £6m. In addition, the recruitment and

21 Small firms were each estimated at handling around 75 complaints per year, so their IT infrastructure costs should be negligible.

22 13*£1.5m+40*£350K+350*£7K= £36m

23 This is a standard high street recruiter rate.

24 644*£25K*18%+(644*£2K+438*1K)= £4.6m

25 The base salary is assumed to be of £25,000 (and a 50% will be factored in to cover additional employment costs such as accommodation, equipment and taxation). 491*£25K*(1+50%)=£18m.

training costs associated with staff attrition – assuming 25% attrition per annum – are estimated to be approximately £1m.[26]

30. We therefore estimate that the total ongoing administrative costs will be approximately £25m for the 12 months following implementation of our guidance.

Estimated total costs for the 12 months following implementation of our guidance

31. Under our low-impact scenario, we estimate incremental redress costs over the 12 months after implementation of our guidance of around £117m for the entire population of firms affected, after taking into account the expected reduction in the costs incurred by firms as a result of FOS adjudications. Under our high-impact scenario, we estimate this figure to be around £203m. In addition, over the 12 months following the implementation of our guidance, we expect that firms will incur c.£25m in ongoing costs for the first 12 months.[27] So, we estimate that the total increase in BAU costs to firms will be in the range of c.£142m-£228m, for the 12 months following implementation of our guidance. We use this range as the basis for estimating the cost impact of our guidance over the medium term, which we discuss in the next section.

32. In addition to these additional BAU costs, we also expect firms to incur c.£41m of one-off set-up costs, which will not carry forward into future years.

33. We realise that the above cost estimates are more than double the range that we consulted on in CP09/23. However, it is important to remember that the incremental redress cost that our guidance may impose on firms is a transfer to consumers, compensating them for mis-sold policies. Therefore, to the extent that our previous CBA underestimated this cost of our proposals to firms, the size of the transfer to consumers was also underestimated. The administrative costs to firms in implementing our proposals are a dead weight cost, but, these are small in relation to redress costs.

Estimated cost impact of our guidance beyond the 12-month horizon

34. We would not expect the incremental impact of our proposed guidance to continue indefinitely. This section outlines our expectations for future volumes of complaints, redress costs and administrative costs.

35. We expect a number of factors to influence the baseline trend in complaint volumes, i.e. the complaint volumes that we would expect firms to receive before taking into account the impact of our proposed guidance. It is likely that, even without our guidance, the trend in rising complaint volumes would continue in the short term, driven by publicity and word-of-mouth effects. However, in the medium term this is likely to be counterbalanced by other factors such as:

    a. given the number of firms that have exited the PPI market over the last five years, and the possibility of the Competition Commission (CC) prohibition on

26 (491+153)*25%*(£2000+18%*£25,000)= £1m
27 We assume the administrative costs to firms to be independent of the uphold rate scenario.

the sale of single premium PPI policies coming into force at some future point, we expect future sales of PPI to remain lower than before. As a result, the overall level of complaints received by firms is likely to decrease.

b. other work (e.g. communication of recent enforcement actions) is also likely to limit the number of future complaints which firms will receive.

36. We do not expect the increase of our guidance on the number of complaints received to continue indefinitely. The publicity directly generated through publishing our proposals will only continue for a short time, and even taking into account any indirect publicity (e.g. word-of-mouth effects), it is likely that any increase in complaint volumes which may arise as a result of our guidance will decrease over time. Moreover, since we assume that our proposed guidance will lead to only a small percentage increase in complaint volumes, a decrease in the number of complaints in our baseline scenario (driven by the factors outlined above) also implies a decrease, in absolute terms, in the number of additional complaints received as a result of our guidance.

37. Regarding the increase in average redress that we expect to result from our guidance, we note that in recent years, some firms have already increased the average redress paid on upheld complaints. There is also some indication that firm uphold rates are increasing, though the trend is less clear. It is possible that in time, even without our intervention, other firms might have increased their uphold rates and the redress offered, potentially to the levels our proposed guidance stipulates. Were this to be the case, this would limit the time period over which our proposed guidance leads to an incremental redress cost to firms, above that which firms would have paid without our guidance.[28]

38. We also note that, if the volume of complaints does decrease in the medium term based on the trends discussed above, this will also lead to a decrease in the associated administrative costs incurred in handling these complaints, and hence the additional administrative costs incurred as a result of our guidance. Also, if firms were to improve their complaint handling standards in future even without our guidance (in line with the increase in uphold rates and average redress discussed above), this would again limit the time period over which our proposed guidance would lead to additional administrative costs to firms. So, as for redress costs, we do not expect the impact of our guidance on firms' administrative costs to continue indefinitely.

39. Given the inherent uncertainty around these factors, it is difficult to predict over what time period the incremental impact of our guidance will continue. As a broad estimate, we assume that the incremental redress and administrative costs that we predict firms will incur over the next 12 months will continue for five years, and then revert broadly to the level which they would have reached without our intervention[29] (which, depending on the trends in complaints volumes noted above, may well be lower than current levels). Therefore, we estimate that the total

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28 However, this does not diminish the rationale for issuing the current proposed guidance, since it is not certain that firms will in fact further increase the redress or uphold complaints in this way. Even if firms were to increase the levels of redress paid in future to the levels which our proposed guidance stipulates, customers making complaints before that time would be less likely to receive fair redress without our proposed guidance.

29 Should significant numbers of firms conduct reviews of historical sales, as discussed at Annex 2, the marginal impact of our guidance on future complaints may decrease more quickly, as consumers who may complain in the future would already have had their sales reviewed and be unlikely to complain again.

additional redress cost resulting from our guidance is approximately £583 million – £1.0 billion,[30] over five years, and the total administrative cost incurred over this period (including one-off set-up costs) is c.£166m.[31] This results in an estimated total incremental cost of our guidance of c.£0.7 billion – £1.2 billion, over five years.

40. The costs associated with complaints handling that are estimated in this Annex are linked to the costs recorded in Annex 3 because it is possible that the higher standards which our guidance will require will contribute to the wider costs of the package of measures recorded in Annex 3 by increasing the average level of redress. It would be arbitrary to separate this cost from the total cost recorded in Annex 3, which includes it.

Competition impacts

41. We note at paragraph 4 that some of the costs incurred by firms as a result of our proposals will partly or wholly be passed onto consumers rather than recovered through lower wages, efficiency gains and lower dividends to shareholders. The extent of cost pass-through to consumers will depend on the price and quantity outcomes in the PPI market or markets that result from the proposals. This in turn depends on the nature of competition in relation to PPI. We have not carried out a full analysis of this as economic forecasts may require considerable investment and still give very uncertain results, and in the case of PPI mis-selling the fundamental rationale for intervention – that consumers who have been mis-sold deserve redress – is very strong regardless. Moreover, there is highly material uncertainty at present, due to the package of remedies proposed by the Competition Commission, which may or may not ultimately include a point of sale prohibition. Thus, while we expect our initiative to result in higher product quality for consumers as a result of improved matching of specific products to individual consumers in the sales process (see Annex 3), any possible impacts on product quantity and variety and on the efficiency of competition are unclear. In the interests of transparency, however, we set out in brief the main issues about cost pass-through.

42. Figure 1 presents a stylised description of the range of price outcomes that could occur from the policy proposals. The supply and demand curves in the charts are standard outcomes from economic analysis of competition. In theory, a firm with some ability to influence prices will sell a quantity of goods or services where marginal cost and marginal revenue are equal. Prices are then determined by demand faced by the firm for the amount of goods and services offered.

43. Where mis-selling may occur due to information differences between consumers and firms, as in the market for PPI, consumer demand may become relatively insensitive to price. That is, consumers may purchase goods with only limited reference to price. This is represented by the curves labelled 'average revenue (initial) = demand (faced by the firm)'. Initially, we assume that firms are willing to supply products according to the curves labelled 'marginal cost = supply (initial)'.

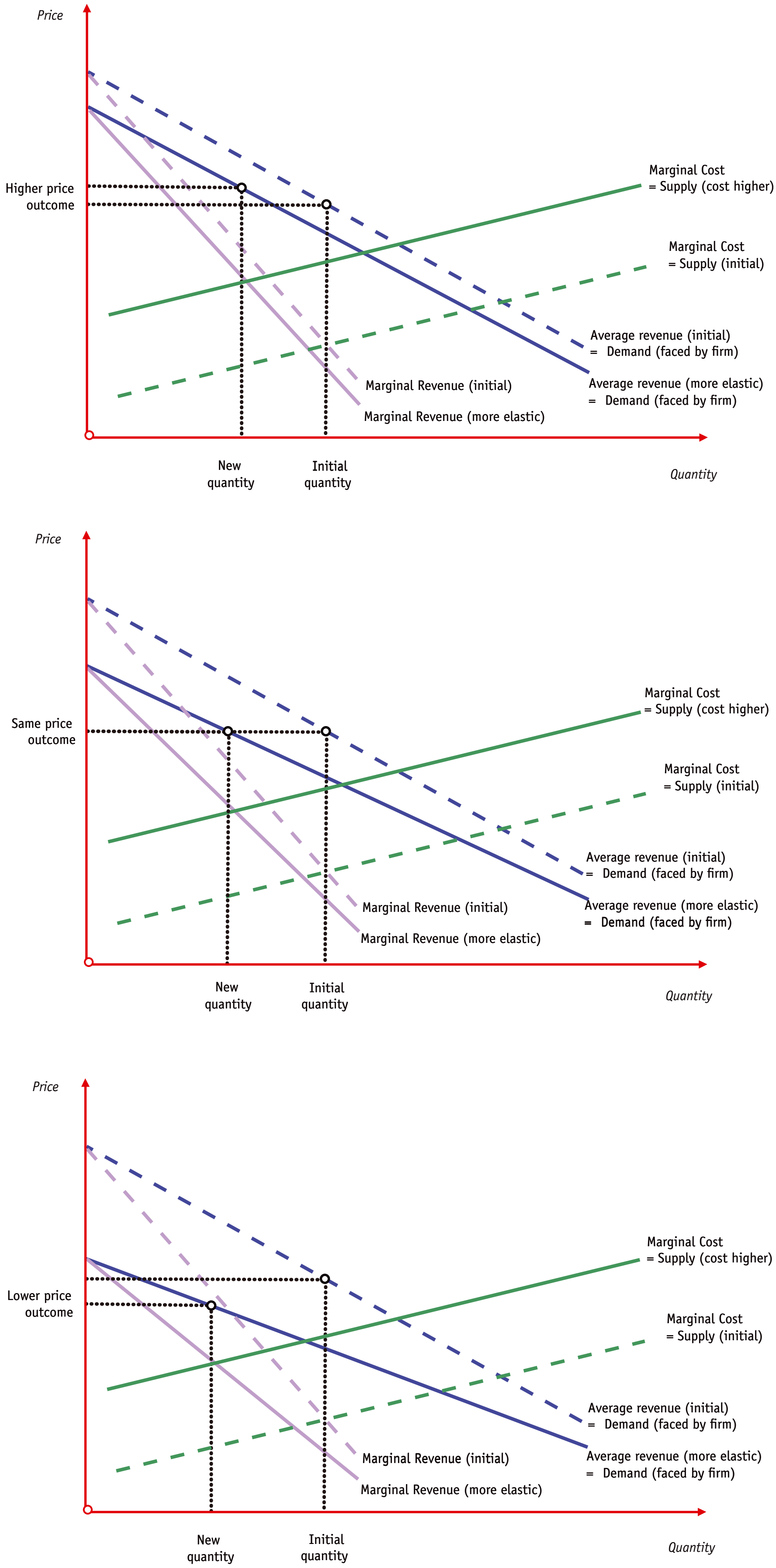
30 This figure is based on simple multiplication (i.e. [£117m-£203m per year] * 5 years, without applying any discount factor.

31 £25m*5+£41m= £166m.

44. Reducing mis-selling is expected to make consumers more sensitive to price movements, such that the demand curve faced by the firm is less steep, represented by the curves labelled 'Average revenue (more elastic demand)'. In addition, we expect that firms will face higher costs of supplying this product which will make firms supply less products for a given price, represented by the curves labelled 'marginal cost = supply (cost higher)'.

45. In this stylised example, the quantity of goods sold by firms will always be reduced, in line with the policy aim of reducing the mis-selling of products in the market. However, the eventual impact on price is ambiguous. The change in price depends on the relative size of the shifts in the supply, demand and marginal revenue curves. If the shift in the consumers' demand curve is accompanied by a shift in marginal revenue as shown in the middle chart of Figure 1, then the new price will be identical to the old price. However, different competitive conditions in markets could see firms reduce the supply of products such that prices rise above their previous level (see first chart). Where firms are less able to set prices, i.e. demand faced by the firm is even more elastic, then prices could fall (see third chart). The outcome depends on the initial state of competition in the market, on how much competition is impacted and how much costs of supplying increase. Since in the case of our proposals we cannot know with any degree of certainty the extent of competition in the market following the proposed change in policy, the impact on price and consequently future consumer surplus remains ambiguous.

Figure 1: Possible price impacts of PPI policy



Other costs and benefits of our measures

1. As noted in Chapter 1, many industry responses criticised the appropriateness of our comments concerning the potential redress by firms of non-complainants, especially given that our Cost Benefit Analysis (CBA) had not touched on or quantified the costs implied by this. Some industry responses estimated these costs to be very large, with potentially significant prudential implications – two respondents provided us with estimates, both of which assumed that a significant proportion of all PPI sales ever made would lead to complaints which would be upheld and redressed. We do not view these estimates as realistic, for the reasons set out later in this Annex.

2. We are of the view that, as the requirement to conduct root-cause analysis is an existing one, this was not a new 'proposal' that needed its own CBA in CP09/23. However, in the interest of transparency and of responding to industry concerns, we set out here the costs and benefits of actions which firms may take arising from root-cause analysis of complaints, particularly reviews of historical sales to non-complainants and changes to sales practices. We have also evaluated the possible prudential impact that may result if firms pay the level of redress estimated, and this evaluation includes an assessment of the impact that this redress might have on the FSCS and its funding firms.

3. We also remain of the view that the standards expected of PPI sales (as set out in the open letter) restate existing requirements (as explained in Chapter 2). Information on the costs (and benefits) of our existing requirements can be found in previous Consultation Papers regarding the FSA Principles for Businesses,[1] the FSA's role as the supervisor of insurance selling and implementation of the Insurance Mediation Directive,[2] and amendments to the Insurance: Conduct of Business sourcebook.[3] To the extent that any of the expected standards were not covered by the CBA in these

1 CP13, The FSA Principles for Businesses, September 1998
2 CP187, Insurance selling and administration & other miscellaneous amendments, June 2003
3 CP07/11, Insurance selling and administration: Proposed amendments to the Insurance: Conduct of Business sourcebook, June 2007.

publications, we judge that these issues are minor and give rise to costs of no more than minimal significance.[4]

4. We note that the future complaint redress costs estimated (as set out in Annex 2) and the estimate in this annex of the wider costs that firms may incur are not additive: cases that have been properly dealt with through the complaint-handling route will not be included in a review of sales to non-complainants. Similarly, consumers who have been redressed appropriately through the review of sales to non-complainants are unlikely to complain about the same sale at a later date.[5] Consequently, the total cost to the industry of our package of measures will be less than the sum of the costs estimated in Annex 2 and Annex 3.

5. Firms may reach the view that, in order to meet their obligations under DISP[6] and Principle 6 (treating customers fairly), they need to take action that involves reviewing past sales to non-complainants. Any such root-cause analysis may entail costs to firms to the extent that they identify sales which did not meet the appropriate sales standards and that they decide should be corrected . In addition, addressing the root causes of the issues is likely to reduce firms' future revenue from inappropriate sales.[7]

6. We estimate below the potential costs – firms' redress costs, costs to firms from FOS adjudications, administrative costs, and the costs of correcting root causes of complaints – that firms could incur through any reviews of sales to non-complainants. We note that the redress costs are a transfer to consumers who were mis-sold products from the firms involved, at least initially. However, in most states of competition, firms will eventually pass on some costs (redress and administrative costs) to present and future consumers of both PPI and, potentially, other financial products. Please refer to Annex 2 for an analysis of the possible competition impacts of our package of measures.

7. Should firms reach the view that, in order to meet their obligations under DISP and Principle 6 (treating customers fairly), they need to take action that involves reviewing historical sales and paying redress to non-complainants, the consumers who have been mis-sold, and who would not otherwise receive redress, will be the main beneficiaries of the review.

8. To the extent that this review and redress makes mis-selling less profitable, it should reduce the incentives to mis-sell and lead to an improvement in sales standards. There are benefits associated with improved sales standards and any reduction in the occurrence of mis-selling. These include, but are not limited, to the saving in administrative costs associated with any potential redress. In addition, this could

4 To the extent that firms are already complying with the standards they will of course incur no additional costs in this respect. Specifically, we noted in CP07/11 that firms' compliance costs would vary with how far they already meet our standards; where firms delay compliance they will incur these costs later rather than earlier. We also noted in CP07/11 that the compliance costs may have been under-estimated and invited comments, comments which we then reflected in PS07/24. So we do not intend to reopen now the cost of complying with our rules and principles from 2005 or with the further changes required in 2008 with the introduction of ICOBS.

5 Or if they do complain they are less likely to be due redress.

6 DISP1.3.3(3)R requires a firm to take reasonable steps to ensure that in handling complaints it identifies and remedies any recurring or systemic problems.

7 Although of course that revenue would under our complaints guidance be due to be paid back to complainants in a lot of cases, if/when they complain.

improve consumer confidence, which might lead to greater participation in the financial services market.

Firms' redress costs

9. The scope of any historical sales review that firms may conduct, and therefore the potential redress cost, is limited by two main factors:

   a. The FSA was only given statutory responsibility for regulating intermediaries' general insurance selling activity from 14 January 2005 (N3). Therefore, in respect of firms' carrying on that activity, Principle 6 (treating customers fairly) only applies from that date forward. Consequently, we do not expect any material review of PPI sales made before N3[8] to occur.

   b. As we have fewer concerns about selling practices for regular premium first-charge mortgage PPI (see Chapter 2), we do not expect many firms to consider it necessary to conduct reviews of sales of this product. Therefore, while firms that do identify issues with their sales process should take appropriate action in line with their obligations under DISP, we have not included any redress costs for these sales in our estimates.

10. We estimate the total gross written premiums (GWP) for PPI policies sold since 2005[9] to be approximately £17bn and the total number of policies sold since 2005 to be approximately 16.1m. If all of these were deemed mis-sales causing consumer detriment, and redress was paid on all sales in line with our guidance, we estimate that the redress cost would be around £15.6bn.[10] However, we note that this is not a plausible scenario and, in practice, the redress costs which firms actually incur are likely to be significantly lower than this. To arrive at a more plausible figure, we have also taken into account a number of additional factors as set out below.

Consumer response rates

11. We anticipate that any review of sales to non-complainants would be undertaken on a response-led basis, where firms would write to potentially affected customers and then assess the individual cases of customers who respond providing the required information. This approach is reasonable as it is rarely possible to identify whether detriment was caused to specific customers without input from them and consequently it is unlikely to be possible for firms to assess in isolation whether or not the consumer would have bought the policy but for failings on the part of the firm. For example, it may be difficult for a firm to assess whether detriment was caused by a failure to adequately identify a customer's existing insurance cover in an

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8 We would have jurisdiction to include sales made direct to consumers by general insurers before this date. However, before that date in applying the Principles in relation to general insurance business the FSA committed to proceeding in a prudential context only. In addition, direct sales by general insurers represent only a small proportion of historical sales. Accordingly, we do not expect any material reviews of sales by general insurers made before 2005 to occur. However, should individual general insurers wish to take action regarding pre-2005 sales to provide fair treatment to their customers, they would be free to do so.

9 Regular premium first charge mortgage PPI is excluded from this figure and from subsequent figures in this calculation.

10 This figure is calculated by adding to the GWP figure the historical interest accruing on single premium policies and the 8% simple interest which would be payable on any redress paid; we also subtract claims paid, to the extent that these can be offset against redress payable, and policies which have led to complaints. We also take into account the impact of the comparative redress approach for 50% of single premium policies sold.

advised sale, without clarifying with the customer what cover they had at the time and thus whether the policy was suitable in this respect, if this information was not gathered at the time of the sale.

12. We have estimated response rates for each product category based on our experience of customer contact exercises for relevant products. We have also reflected the expected impact on response rates of the average redress payable, as we have some information that suggests that response rates may correlate with the average redress customers might expect to receive.

- Previous experience of customer contact exercises for unsecured loan PPI suggests that, if firms were to conduct such exercises for their past sales, a response rate of around 30% would be expected. We also apply this response rate to motor finance PPI, as the average redress for motor finance is most similar to that of unsecured loan PPI.
- For second-charge mortgage PPI, a higher response rate may be expected given the larger average redress, and the fact that customers in this product category are typically less financially secure than customers for other PPI products. So, for this product category we assume a 45% response rate.
- Previous contact exercises for credit card PPI (which, conversely, often attracts relatively small amounts of redress) have led to significantly lower response rates, so for this product we assume a response rate of 10%. Given that average redress is lowest in our 'Other' product category, which includes PPI on store loans and overdrafts, we also assume a 10% response rate for this category, which may be an overestimate. Applying these response rates reduces the potential redress cost estimate to around £4.0bn, on approximately three million policies.

Uphold rates

13. We assume that, where firms conduct reviews of sales to non-complainants, the initial customer-contact letters sent would set out the key elements of their policy and enable the customer to review their position in light of that information. Since customers who respond to these mailings will typically be those who consider that there may have been a sales failing that caused them detriment, we expect the uphold rate on such responses to be in a similar range to the uphold rate on forward-looking complaints i.e. 70–90%. Since we expect that firms will probably decide to focus any customer-contact exercise on specific areas of their portfolio where there is the greatest risk of detriment (e.g. sales in a particular time period or through a particular channel), we assume that the uphold rate from such reviews is likely to be at the high end of this range. Therefore, we assume an uphold rate of 90% for all single premium products and 85% for all regular premium products, in line with the high-impact scenario we model in Annex 2. These uphold rates would lead to an estimated maximum potential redress cost of c.£3.5bn, on approximately 2.6 million policies. However see below for a more realistic estimate based on the number of customers likely to be covered by customer-contact exercises.

Scope of firm customer contact exercises

14. This c.£3.5bn redress figure is dependent on all firms in the market deciding to contact all their PPI customers over the relevant time period. In practice, the extent of any review will depend on what firms themselves find and conclude about their potential sales failings. It may well be that not all firms will identify recurrent or systemic problems in their selling practices, and that firms that do so will identify them only in respect of, for example, certain of their sales channels or certain periods of selling.

15. Consequently, as a broad range, firms may decide that between 25% and 75% of historical sales to non-complainants are to be included in a customer-contact exercise. Should this be the case, this would mean that the number of consumers redressed may be in the range of c.655,000 to 2.0m, with estimated overall potential redress costs within the range of c. £880m to c.£2.6bn.

Cost to firms from FOS adjudications arising from past sales reviews

16. In addition to the redress costs calculated above, firms may incur additional costs in relation to consumers who respond to a firm's request for information, subsequently have their case investigated and rejected, and decide to refer the matter to the FOS.

17. Indicative FOS information suggests that the volume of cases which they receive from historical past business reviews is typically low, although it is difficult to estimate precise figures. For those firms who conduct reviews of past sales, assuming that they handle responses properly in line with our guidance, we expect that the number of rejected cases referred to the FOS will also be low. Since respondents have not complained pro-actively, but instead have responded to a mailing by the firm, this suggests that the percentage of rejected cases referred to the FOS from such reviews may be lower than the past percentage of rejected BAU PPI complaints that are referred.

18. If 10% of rejected respondents refer their cases to the FOS, and if 40% of these cases referred are upheld, this would mean approximately 9,000–26,000 additional cases would be referred, with FOS case fees of around £4m–£13m and potential additional redress costs also in the range of c.£4m–£13m.

19. Taking into account the additional costs to firms from respondents who refer their rejected cases to the FOS, our estimate of the potential cost to firms from reviews of sales to non-complainants increases to around £890m–£2.7bn. An extimated break-down of costs across different product categories is shown in Table 1 (assuming 25% of non-complainants contacted) and Table 2 (assuming 75% of non-complainants contacted).

Table 1: Estimation[11] of potential approximate redress costs by product for review of sales to non complainants: 25% of non-complainants contacted

Product	Average redress per SP case	SP redress costs (firms + FOS)	Average redress per RP case	RP redress costs (firms + FOS)	Total
Personal loans	£1,570	£640m	£875	£38m	**£678m**
Mortgages(first-charge)	-	-		-	**-**
Credit cards		-	£615	£77m	**£77m**
Mortgages(second-charge)	£5,165	£87m	£1,595	£17m	**£104m**
Motor finance	£865	£13m		-	**£13m**
Other[12]	-	-	£430	£19m	**£19m**
Total		**£740m**		**£151m**	**£891m**

Table 2: Estimation of approximate redress costs by product for review of sales to non complainants: 75% of non-complainants contacted

Product	Average redress per SP case	SP redress costs (firms + FOS)	Average redress per RP case	RP redress costs (firms + FOS)	Total
Personal loans	£1,570	£1,921m	£875	£113m	**£2,034m**
Mortgages (first-charge)	-	-		-	**-**
Credit cards		-	£615	£231m	**£231m**
Mortgages(second-charge)	£5,165	£260m	£1,595	£51m	**£311m**
Motor finance	£865	£38m		-	**£38m**
Other	-	-	£430	£57m	**£57m**
Total		**£2,219m**		**£452m**	**£2,671m**

20. We note that the estimated average redress costs per case we use in our calculations are less than those used for future complaints at Annex 2. This is explained by the fact that any review of sales to non-complainants would only include sales made since 2005, whereas firms currently receive significant numbers of complaints relating to pre-2005 sales. Older sales will typically receive higher redress, as the number of monthly payments made for regular premium policies is likely to be greater, and the additional 8% simple interest payable on redress applies over a longer period. Also, older single premium cases will typicallly receive higher redress because they usually would have accrued more interest.

Administrative costs

21. We envisage that firms will additionally incur operational costs arising from any mass customer-contact exercise. We derived the cost estimates for future complaints discussed at Annex 2 from data from previous exercises and discussions with firms and with outsourcing experts with relevant experience. We have also taken into account the comments made by firms on expected administrative costs in response to CP09/23.

11 We assumed: firms' uphold rate is 85% for regular premium policies and 90% for single premium policies; FOS referral rate is 10%; FOS uphold rate is 40%.

12 This includes PPI sold on overdrafts and retail shopping products.

22. We assumed that as a result of firms' work to comply with our guidance, all IT costs related to the complaint-handling process have already been incurred (and are already reflected in Annex 2).

23. In line with our redress cost estimates above, we estimate administrative costs assuming that between 25% and 75% of non-complainants who have bought policies since 2005 are contacted; that is, between approximately 3.8 million (rounded up from 3.75 in footnote 15) and 11.3 million customers. Our estimates of administrative costs also reflect the response rate assumptions discussed above.

24. We modelled the cost of an initial database scan, and a detailed customer and product identification exercise. For large and medium sized firms (90% of distribution) conducting the initial scan, we estimated a cost of approximately £1 per customer scanned, and £2 for small firms (10% of distribution). In total, we estimated that approximately 15 million customers[13] (all PPI sales since 2005) would be assessed for an initial mailing. We envisaged the initial scan as identifying the name and address list for the bulk mailing. This leads to an estimated industry wide cost of around £16.5m.[14]

25. We assume bulk mailing costs of £1 per customer, which include stationery, sorting and delivery. We did not consider copywriting to be a significant cost, and the costs of compiling any mailing lists are included in our cost estimates for the database scan. This leads to an estimated bulk mailing cost of c.£3.8m–£11.3m, corresponding to 25% and 75% contact rates respectively.

26. Once the mailing goes out, we assume that 50% of the customers who were sent an initial contact letter make some preliminary inquiry to their firm. To estimate the cost to firms of employing staff to handle these enquiries, we assume that firms would outsource their call centre requirement, and would pay a cost equivalent to £13,000 per year, per member of staff, plus a 50% increase to reflect other employment costs (such as employment benefits, employer's National Insurance contributions and the cost of office space and providing IT infrastructure). We assume that on average, staff would handle a fresh call every 10 minutes during their seven-hour day. Based on these assumptions, we estimate that the number of call centre staff required ranges between 179[15] and 536 full-time equivalent staff (FTE), with an associated cost of between approximately £3.5millon[16] and £10.5 million.

27. Thereafter, we expect some percentage of mailed customers (see the discussion on customer response rates at paragraphs 11 and 12) to formally respond to the letter, triggering a complaint. We have made the same assumptions as in Annex 2 for the staff costs incurred in handling these complaints (£25,000 base salary, with a 50% increase to reflect other employment costs). We have also assumed recruitment costs for each new staff member recruited of 18% of annual base salary. However, we assume that attrition costs are negligible, as we assume that reviews of sales to non-complainants are a one-off exercise of relatively limited duration of around one year,

13 This represents all PPI sales since 2005, excluding sales which have led to a complaint, policies which were cancelled within the cooling-off period, or policies on which a claim was settled which is sufficiently substantial that no further redress would be paid.

14 15m*(£1*90%+£2*10%)=£16.5m

15 3.75m*50%*10/(250*7*60)=179FTE.

16 179*£13000*(1+50%)=£3.5m

and so costs relating to staff turnover during the period of the review are unlikely to be material. Assuming that between c.742,000 and c.2,230,000 customers respond to the mailing (corresponding to 25% and 75% contact rates, respectively), the number of staff approximately required ranges from c.1,600[17] to c.4,800 FTEs. Based on these assumptions, we estimate that the total staff-related cost will be around £70m[18]–£210m.

28. In addition, the relevant IT costs are estimated to be approximately £4 per customer for large firms, £5 per customer for medium sized firms, and up to £140 per customer for small firms (these estimates represent either the implementation of necessary systems or the cost of employees sifting through paper records and in the case of small firms reflect the inevitable limits to economics of scale and scope). Taking this into account we estimate IT costs in the range of around £13m–£40m.

29. Finally, we modelled the costs to firms of communicating with customers by telephone and mail . This was based on an estimated cost of £12 per customer, including 40 minutes of phone calls at 10p per minute, and three letters to the customer (two progress reports, and a final letter). This leads to an estimated additional cost of around £9m[19]–£27m.

30. Table 3 summarises the estimated administrative costs from reviews of sales to non-complainants.

Table 3: Summary of estimated administrative costs from reviews of sales to non-complainants

	25% Contact Rate	75% Contact Rate
Initial database scan	c.£16.5m	c.£16.5m
Bulk mailing to potentially affected customers	c.£3.8m	c.£11.3m
Preliminary inquiries from customers contacted	c.£3.5m	c.£10.5m
Staff costs associated with reviewing responses	c.£70m	c.£210m
Relevant IT costs associated with redressing	c.£13.2m	c.£40m
Cost of contact with respondents (by letter/phone)	c.£9m	c.£27m
Estimated total	**c.£116m**	**c.£315m**

31. The total estimated administrative costs of around £116m-£315m represent about 12% of the potential redress costs.

32. We also reiterate that (as set out at paragraph 4), were a firm to conduct a review of past sales as a result of conducting root-cause analysis of their PPI complaints, the volume of future PPI complaints that it will receive is likely to decrease, as those who have had their complaint reviewed via a customer-contact exercise are unlikely to complain again about the same sale. This may translate into a reduction in the ongoing administrative costs for handling future complaints outlined at Annex 2.

17 742,000/500,000*(929+153) =1,606FTE

18 Employment cost: 1,606*£25K*(1+50%)= £60m, the recruitment and the training cost: 1,606*£25K*18%+1,606*£2,000= £10m

19 £12*742,000=£9m

33. Therefore, we estimate the total cost to firms associated with conducting a review of past sales, and compensating non-complainants if appropriate, to be approximately £1bn–£3bn.

Other costs from addressing root causes

34. As mentioned in paragraph 5, addressing the root causes of complaints may reduce firms' future revenues in the longer term, through fewer future inappropriate sales, relative to what they would have earned had they not corrected these failures. This resulting reduction in revenue would be partly offset by the reduced costs of having fewer future complaints, redress payments and a reduction in associated FOS costs. Consumers would also benefit from fewer inappropriate sales in future.

35. To provide an estimate of the net cost to firms we assume that, if root causes were not addressed, annual complaints in the long run would settle to around 5% of annual sales levels, where sales remain at 2009 levels. The 2009 sales volume has been chosen to take into account the drops in sales volume that have occurred over the past five years; the five percent is an estimate for the historical ratio of total PPI complaints to total PPI sales. We also take into account that firms have recently discontinued sales of single premium PPI on loans in our calculations. Since these sales accounted for almost all single premium product sales, we assume that future PPI sales are in regular premium products.

36. Given this and other assumptions made,[20] we estimate a yearly net revenue loss to firms from decreased future sales of about £50 million from addressing root causes. Corresponding to this is an estimated yearly benefit to consumers of about £60 million,[21] arising from consumers being sold more appropriate products. The excess of estimated consumer benefits over firm costs shows explicitly an increase in market efficiency. This arises from the anticipated reduction of complaint levels where firms improve sales practices by addressing root causes.

Prudential impact of potential reviews of sales to non-complainants

37. As noted in Chapter 4, we have evaluated the risk of our proposals on three sectors in particular, for which prudential concerns were raised in the responses to CP09/23 by building societies, general insurance brokers, and secured lenders. To evaluate the impact of complaint handling guidance and root-cause analysis, we have conducted our analysis on the basis that firms decide to contact 75% of non-complainants in these sectors, i.e. the high end of the range which we consider to be plausible. However, as noted above, the number of customers contacted may be significantly lower.

38. The figures discussed below also take into account the costs estimates to these sectors from our guidance on handling BAU complaints (i.e. their share of the

20 Specifically we assume that in the long run only some proportion of mis-sold products lead to complaints; the cost to consumers of being mis-sold a product equals the time-discounted average redress given by FOS for a regular premium; time taken for firms to process complaints is in line with Annex 2; addressing root causes reduces mis-sales by 75%; and uphold rates and administration fees are in line with the average of the low and hight impact scenarios set out in Annex 2.

21 This figure does not take into account the gain to consumers from having to spend less time and effort complaining. Including this would increase this estimated benefits figure.

costs estimated at Annex 2), and the expected administrative costs relating to both business as usual (BAU) complaints and any reviews of sales to non-complainants.

39. When taking into account the cost estimate for future complaints (i.e. the share of the costs in Annex 2 which may fall on each sector), we have assumed that there is no overlap with the sales reviewed in any customer contact exercise. In reality, firms who conduct a customer contact exercise and pay appropriate redress are likely to see a significant reduction in complaints thereafter, (compared to the number which they would have received had they not conducted the customer contact exercise), as customers who might have complained in the future will already have had the opportunity to have their case reviewed.

40. In evaluating the prudential impact of our proposals, we have also assumed that firms would start any review of sales to non-complainants as soon as they identify any recurring or systemic sales failings which might require this. We reiterate that firms have an existing obligation to take reasonable steps to ensure that, in handling complaints, they identify and remedy any recurring or systemic problems (through analysis of the root causes of complaints). Consequently, our starting position is that firms should commence any reviews of past sales as soon as is feasible, should such problems be identified. However, where firms believe that immediate implementation of such a review would have a disproportionately negative impact on their liquidity position, we will discuss with them, on a bilateral basis, the most appropriate timing for these reviews.[22]

Impact on building societies

41. We have conducted an assessment of building societies in our analysis. These institutions do not necessarily seek to maximise profits, and instead seek to return profits to members through lower pricing. These firms may therefore hold less excess capital than other types of institution, and this may limit their ability to fund any review and/or redress that they consider appropriate based on any root cause analysis undertaken.

42. We have fewer concerns about selling practices for regular premium first-charge mortgage PPI, so we do not expect many firms to consider it necessary to conduct reviews of sales of this product. This significantly reduces any prudential risk to this sector, as, in particular, smaller building societies typically sell a restricted range of loan products, often only mortgage products.

43. A very small number of building societies also offer other forms of lending and associated PPI products, typically the larger societies. Given that very few firms fall into this category, it would not be appropriate to comment in detail on estimates of the expected redress cost for this sector, or on any prudential risks that may arise from this. However, we have analysed the possible prudential impact on these firms and are satisfied that it does not undermine the proportionality of our proposals.

22 However, under IFRS and UK-GAAP firms would be required to account for provisions on the expected cost of past sales reviews (including expected redress and administration costs) from the point at which (a) a present obligation arising from a past event exists; (b) payment of the obligation is more likely than not; and (c) the amount can be estimated reliably.

Impact on general insurance brokers[23]

44. We include an assessment of the impact of our guidance on brokers as they are typically smaller firms. So, there may be a higher risk of significant prudential implications if firms in this sector decide it is appropriate to conduct a wide-ranging redress program following any root cause analysis undertaken.

45. We estimate that up to around 20% of PPI is sold via brokers, depending on the product. We estimate that, taking into account both the impact of our complaints handling guidance and the potential cost of any reviews of sales to non-complainants, these brokers may be liable for up to around £430m of total redress costs.[24] This compares to annual revenues from FSA-regulated activities by firms who report that they sell PPI and those whose primary regulated activity is general insurance intermediation of around £3bn in the most recent financial year, although, as noted in Chapter 4, the impacts of our proposals may be greater for certain type of general insurance broker. The same group of firms had total revenues (arising from regulated and unregulated activities) of around £30bn over the same period. This is because, for most of these firms, general insurance intermediation is not their core business (for example, motor vehicle and other retailers).

46. Based on our analysis, we believe that the vast majority of these types of firms will not require additional capital in order to absorb the possible cost of our proposals. Our analysis suggests that a maximum of 15% of firms who sell PPI and whose primary FSA-regulated activity is GI intermediation might require access to additional capital as a result of our guidance, under the conservative assumption that 75% of all relevant PPI consumers in this sector are contacted.

47. We believe the largest 100 affected firms, who account for around 85% of the general insurance revenue in this group, and might account for a similar share of the redress, will be best placed to fund the additional capital requirements, especially as these firms are more diversified, and their core business is not general insurance intermediation. However, some of the smaller, directly authorised firms will not be as well-placed to fund the additional capital. Of the smaller, directly authorised firms (accounting for around 15% of general insurance revenue in this group) we estimate that up to around 100 may be unable to meet ongoing capital requirements unless they receive additional capital. These firms are likely to account for up to around £10m of the redress payable.

48. Although we believe that larger networks are reasonably well positioned to pay redress, there is a risk that if one or more networks of appointed representatives is unable to meet its capital requirements greater amounts of redress may need to be paid by the FSCS. This could be up to about £30m, making a maximum for general insurance brokers of around £40m.

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23 We have estimated redress costs on the basis that firms will not review sales of regular premium first-charge mortgage PPI. Consequently, we have excluded home finance brokers from our analysis and from the figures discussed in this section.

24 This breaks down as c.£310m of redress and administrative costs relating to any historical sales reviews, and c.£120m of costs relating to future BAU complaints.

Impact on secured lenders

49. Finally, we have also estimated the impact of our proposals on secured lenders. The prudential risk in this sector is mainly driven by the fact that response rates to contact letters may be higher for secured loan PPI than for other products, given that the average redress will be larger than for other PPI products, and considering the relative financial vulnerability of the customer demographic to whom the product is typically sold.

50. Provision of second charge mortgages is not an FSA-regulated activity; consequently, the data available to us are more limited for this product. We estimate that since 2005, specialist secured lenders have had a market share of approximately 20-25% of gross advances in the second charge market. Assuming that these firms have a similar share of GWP on second-charge mortgage PPI, and of overall redress and administration costs, we estimate a potential cost for the sector of around £120m.[25]

51. Second charge mortgages sold by brokers are generally aimed at consumers in financial difficulties who are often unable to access further credit from their lenders because of their poor payment history. The availability of second charge mortgages has fallen as a result of lack of funding, but demand has also fallen (the reduction in house prices over the last two years has reduced the equity that homeowners have in their properties and so reduced demand for second charge mortgages).

52. Many secured lenders active in the market since 2005 are not currently accepting new business, reflecting difficult trading conditions; HM Treasury's recent consultation on mortgage regulation notes that specialist lenders "have virtually stopped lending".[26] To the extent that they have to conduct a review and pay out redress, this will add further pressure on secured lenders at a difficult time.

Firms failure: exit costs and impact on FSCS and (other) levy firms

53. For brokers and secured lenders, if significant numbers of firms were to review sales to non-complainants, our analysis suggests that some firms may fail and their share of total redress may require FSCS support in order to be delivered.

54. When firms fail, there will be associated exit costs. Our work on the Retail Distribution Review (RDR) suggests an average cost of exit of approximately £26,000 per firm. Assuming that firms selling PPI that are most likely to fail as a result of our proposals are from the population of small general insurance mediation firms and are similar to those firms affected by the RDR proposals,[27] we estimate the potential costs of exit of approximately 100 impacted brokers to be around £3m. It is difficult to estimate the number of specialist secured lenders who may fail as a result of our prosposals but, given the small number of such lenders who have been active in the market since 2005, we do not expect the total cost of market exits to exceed £5m.

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25 This breaks down as c.£90m of redress and administrative costs relating to any historical sales reviews, and c.£30m of costs relating to future BAU complaints.

26 HM Treasury, *Mortgage regulation: A consultation (December 2009)*, p.8. Available online at: www.hm-treasury.gov.uk/d/consult_mortgage_regulation.pdf

27 E.g., small brokers, or small advisory firms

55. We estimate that compensation due from brokers who might become insolvent could be in the region of £40m and that compensation due from secured lenders who might become insolvent could be in the region of £120m. In principle, these amounts could be passed through to the FSCS and fall on its levy-paying firms. In practice, this is likely to overestimate the true figure.

56. Under FSCS rules, this cost would fall initially within the general insurance – intermediation sub-class. The annual cap for levies for this sub-class is £195m; since any draws on the FSCS might be spread over a number of years, it is unlikely that firms outside of this pool would be required to contribute towards any redress costs, assuming that there are not significant numbers of firm defaults for other reasons in this sub-class and over the same time period. Levies by the FSCS to cover redress, minus any recoveries, would fall most heavily on the larger firms in the sub-class, including the major retail groups and other firms that earn significant revenues from non-regulated activities. Consequently, we do not expect that the cost of the levy to firms would trigger any further prudential issues.

Compatibility statement

1. This annex sets out our assessment of the compatibility of our proposals with our general duties under section 2 of the Financial Services and Markets Act 2000 (FSMA) and with our regulatory objectives set out in sections 3 to 6 of FSMA.

2. A compatibility statement is only strictly required where the FSA is consulting on rules. However since in, this Consultation Paper, we are consulting on whether some of our proposals should be made as rules, we have included one.

3. CP09/23 included a compatibility statement, and in the course of consulting we received a number of objections to the content of it. These related to a variety of issues, including the sales failings identified in our Open Letter, the appropriateness and effect of our evidential standards, comparative redress and referent price, and the overall appropriateness of our proposed solution to the issue of PPI mis-selling (guidance and rule making, rather than taking enforcement action or conducting a market-wide past business review). Since we have noted, and responded to, these concerns elsewhere in this Consultation Paper, we do not propose to reiterate those matters here, so what follows is simply our new statement in relation to our revised proposals.

Compatibility with the statutory objectives:

Market confidence

4. Our proposed guidance, and the wider implications of it, may help to sustain and increase consumer confidence in the market for retail products, by ensuring confidence in improved sales standards going forward, and increasing consumers' confidence that, should they need to complain, their complaint will receive fair and balanced consideration, and consistent and fair levels of redress where appropriate.

Promoting public awareness

5. Our proposals are not specifically aimed at this objective. However, as noted in our CBA, press coverage of our actions may increase public awareness of the redress mechanisms available and the standards which consumers can expect of firms.

The protection of consumers

6. The proposals in this CP will play an important role in assisting the FSA to achieve the appropriate level of consumer protection through setting out a fair and consistent approach for assessing PPI complaints and, where appropriate, redressing complainants. The FSA considers that compliance with the guidance by firms should also reduce the number of consumers having their complaint unfairly rejected, receiving inadequate redress, or from having to refer their case to the FOS.

The reduction of financial crime

7. Our proposals are not aimed at this objective, nor directly relevant to it. The FSA does not consider that our proposals will have any impact on this objective.

Compatibility with the principles of good regulation

8. Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. In discharging its general functions the Authority must have regard to the specific matters set out below.

Efficient and economic use of resources;

9. We do not consider that the proposals will significantly impact on our resource requirements. Compliance with them will be monitored in the course of our existing supervision and enforcement roles and will be integrated in the resources we commit to those areas. Further, we consider that the issue of guidance should enable the FSA to use these resources in an efficient and economic way, since it will enable us to gauge more quickly and effectively whether firms are applying fair and appropriate standards in relation to complaints.

Management responsibility;

10. Our guidance is designed to ensure maximum clarity for those tasked with achieving, maintaining and overseeing the appropriate handling of complaints in their firms.

The principle that a burden or restriction should be proportionate to the benefits;

11. As detailed in our CBA, most of the estimated cost to firms arises from a transfer to consumers who have been mis-sold PPI. Thus, this cost is proportionate to the benefit consumers receive in having their past detriment redressed. As for the associated administrative costs to firms, these are a deferred cost that would have been incurred earlier, had firms acted to provide redress more appropriately. Additional benefits arise from consumers receiving the appropriate level of redress without having to resort to the FOS.

The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;

12. We do not expect the proposals to have a material effect on this principle of good regulation.

The need to minimise the adverse effects on competition and the desirability of facilitating competition between those we regulate;

13. Our proposals apply to all firms selling PPI products, although the extent to which they will be affected by our guidance is likely to vary. Though somewhat uncertain, we identify in Annexes 1 and 2 some potential effects on competition. We expect a reduced volume of PPI sales, and acknowledge that some secured lenders and second charge mortgage brokers may become insolvent. However, the reduction in volume includes reduced mis-selling levels, itself a competitive distortion which our guidance seeks to address.

The desirability of facilitating innovation in connection with regulated activities;

14. Whilst not directed at this principle, broader opportunities for changes in the design, marketing and sale of payment protection insurance, or equivalent successor products, may arise. From a marketing point of view there will be a desire to dissociate future creditor insurance products from the PPI brand. Were the Competition Commission to instate their point of sale prohibition, there would be pressure to change the form of the creditor insurance, either to a credit contract term (non-insurance) product, or to a short term income protection insurance policy sold independently of the credit event, and branded as lifestyle protection. We do not consider either of these effects as arising solely from our guidance.

Acting in a way that we consider most appropriate for the purpose of meeting our statutory objectives

15. We consider that issuing market-wide guidance is the best way of resolving a market-wide problem. We have considered other options (such as targeted enforcement action, or a Dear CEO letter, as discussed in Chapter 2) but we consider that the proposals set out in this Consultation Paper are the most appropriate for furthering our objectives of protecting consumer and increasing market confidence. The CBA in Chapter 4 sets out an estimation of the costs and an analysis of the benefits of our proposals. Although it results in a cost to firms, by proposing market-wide guidance, aimed at ensuring consistency and fairness across all firms handling PPI complaints, we consider that we meet these objectives more effectively than through the other options available to us.

List of questions consulted on

Q1 Do you consider that, taken as a whole, our package of measures – the proposed complaint handling guidance as revised and supporting materials (chapter 3 and appendix 1 and 2), and our statements on root cause analysis and non-complainants (in this CP and CP09/23), in light of our open letter and its recast list of common PPI sales failings (appendix 3), and our estimates of the costs and wider financial impact on industry (chapter 4 and annexes 2 and 3) – is a justified, appropriate and proportionate response to a genuine problem of PPI sales and complaint handling (this chapter), whose costs are matched or exceeded by its benefits?

Q2 Do you agree that the open letter and its appendix, in the version attached (appendix 3), lists common PPI sales failings under the relevant FSA Principles and rules since 14 January 2005?

Q3 Do you agree that the general principles of fair conduct when selling PPI before 14 January 2005 have much in common with our standards after this date?

Q4 Do you agree that our statements about our expectations concerning firms' treatment of their PPI non-complainants are appropriate in the context of Principle 6 and DISP 1.3.5G? Do you think there are particular circumstances concerning PPI which mean it would be unreasonable for us to expect firms to act towards PPI non-complainants in the way we have set out in our statements?

Q5 Do you consider that it would be helpful for our statements about our expectations concerning firms' treatment of their PPI non-complainants to be added to our proposed Handbook guidance concerning PPI complaints?

Q6 Do you agree with our revised proposed guidance on the approach to considering evidence?

Q7 Do you agree with our revised proposed guidance in respect of re-financed loans?

Q8 Do you agree with the revised proposed guidance on determining the effect of a breach or failing? Do you agree that it is appropriate to have both presumptions or should either of them not be included?

Q9 Do you agree with the list of significant flaws that lead the firm to presume that the customer would not have bought the PPI? Do you think that any of these should be removed or amended and/or lead to a different presumption, or that the presumption should apply for all sales flaws identified in the open letter?

Q10 Do you agree with our proposal to increase the referent price from £6 to £9?

Q11 Do you agree with our four approaches to implementing the comparative approach to redress?

Q12 Do you agree with our proposed consumer communications concerning offers of comparative redress?

Q13 Do you agree with the redress calculation examples (see appendix 2)?

Q14 Do you agree with our approach to the position where a customer was mis-sold the PPI and subsequently made a claim which was rejected?

Q15 Should the guidance also address the position of a customer who was mis-sold the PPI but did not subsequently claim because he knew the claim would be rejected (for example, because he subsequently reviewed the detailed policy documentation)? If so, how?

Q16 Do you think that we should make the key provisions in the proposed Appendix 3 to DISP as guidance, or alternatively as (a) a combination of guidance and evidential provisions or (b) as a combination of guidance, rules and evidential provisions?

Q17 If preferring alternative (a) do you agree with the designation of EPs and guidance described above and, if not, which ones would you change? If preferring alternative (b) are there any provisions which currently say a firm “should” act in a particular way that you would not make as rules; what would they be instead, guidance or EPs?

Q18 Do you agree that our proposed complaint handling guidance will bring the benefits described in this CP (including in the cost-benefit analysis at Annex 2)?

Q19 Do you agree that our underlying assumptions about redress costs for PPI complaints are appropriate? Do you agree with our resultant estimates of these redress costs? What additional data can you provide to support any further refinements to these assumptions and/or estimates?

Q20 Do you agree that our underlying assumptions about administrative costs for PPI complaint handling are appropriate? Do you agree with our resultant estimates of these administrative costs? What additional data can you provide to support any further refinements to these assumptions and/or estimates?

Q21 Do you agree with our assessment of the wider impact of our package of measures on industry?

Q22 Do you agree that this proposed (staggered) implementation period for the complaint handling guidance is reasonable and practicable?

List of non-confidential respondents to CP09/23

Adam Samuel

Adur and Worthing Citizens Advice Bureau

Anthony Pepper

Association of British Insurers

Association of Finance Brokers

Association of Mortgage Intermediaries

Bristol Debt Advice Centre

Building Societies Association

Citizens Advice Bureau

CPH Financial Advisory Services

David Stanton

Express Gifts Ltd

The Funding Corporation Ltd

Financial Services Consumer Panel

Genworth Financial

Give Me My Money Ltd

Home Retail Group Insurance Services

Leeds Building Society

Legal and General Assurance Society Ltd

Lloyd's of London

Mortgage Force Ltd

National Australia Group (Europe) Ltd

OTTO UK Home Shopping Group

Paymentshield Ltd

PFSL

RD Consultancy

Renaissance Easy Claim

Royal and Sun Alliance Insurance plc

St James's Place

Santander Cards UK Ltd

Yorkshire Building Society

Revised draft Handbook text

DISPUTE RESOLUTION: COMPLAINTS (PAYMENT PROTECTION INSURANCE) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

B. (1) Part 1 of the Annex to this instrument comes into force on 1 July 2010.
(2) The remainder of this instrument comes into force on 1 September 2010.

Amendments to the Handbook

C. The Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with the Annex to this instrument.

Citation

D. This instrument may be cited as the Dispute Resolution: Complaints (Payment Protection Insurance) Instrument 2010.

By order of the Board

[2010]

Annex

Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

In this Annex, underlining indicates new text, unless otherwise stated.

Part 1: Comes into force on 1 July 2010

Introduction

…

Appendix 3: FSA's guidance on handling payment protection insurance complaints

This appendix contains the *FSA's guidance* to *firms* on handling *complaints* relating to the sale of *payment protection contracts*.

…

1.4 Complaints resolution rules

…

1.4.6 G *DISP* App 3 contains *guidance* to *respondents* on the approach to assessing *complaints* relating to the sale of *payment protection contracts* and to determining appropriate redress where a *complaint* is upheld.

Insert the following new Appendix after DISP Appendix 2 (which is currently deleted). The text is not underlined.

Appendix 3 Handling Payment Protection Insurance complaints

3.1 Introduction

3.1.1 G (1) This appendix sets out how *firms* should handle *complaints* relating to the sale of a *payment protection contract* which express dissatisfaction about the sale, or matters related to the sale, including the rejection of claims on the grounds of ineligibility or exclusion (but not matters unrelated to the sale, such as delays in claims handling).

(2) It relates to the sale of any *payment protection contract* whether it was: on an advised or non-advised basis; conducted through any sales channel; in connection with any type of loan or credit product, or none; and for a regular premium or single premium payment. It applies whether the *policy* is currently in force, was cancelled during the *policy* term or ran full term.

3.1.2 G The aspects of *complaint* handling dealt with in this appendix are how the *firm* should:

(1) assess a *complaint* in order to establish whether the *firm's* conduct of the sale failed to comply with the *rules*, or was otherwise in breach of the duty of care or any other requirement of the general law (taking into account relevant materials published by the *FSA*, other relevant regulators, the *Financial Ombudsman Service* and *former schemes*). In this appendix this is referred to as a "breach or failing" by the *firm*;

(2) determine the way the complainant would have acted if a breach or failing by the *firm* had not occurred; and

(3) determine the appropriate redress to offer to a complainant.

3.1.3 G Where the *firm* determines that there was a breach or failing, the *firm s*hould consider whether the complainant would have bought the *payment protection contract* in the absence of that breach or failing. This appendix establishes presumptions for the *firm* to apply about how the complainant would have acted if there had instead been no breach or failing by the *firm*. The presumptions are:

(1) for some breaches or failings (see *DISP* App 3.6.2G), the *firm* should presume that the complainant would not have bought the *payment protection contract* he bought; and

(2) for certain of those breaches or failings (see *DISP* App 3.7.6G), where the complainant bought a single premium *payment protection contract*, the *firm* may presume that the complainant would have bought a regular premium *payment protection contract* instead of the payment protection contract he bought.

3.1.4 G There may also be instances where a *firm* concludes after investigation that, notwithstanding breaches or failings by the *firm*, the complainant would nevertheless still have proceeded to buy the *payment protection contract* he bought.

3.1.5 G In this appendix, the term "historic interest" means the interest the complainant paid to the *firm* because a single premium *payment protection contract* was added to the loan or credit product.

3.1.6 G In this appendix, the term "simple interest" means a non-compound rate of 8% per annum.

3.2 The assessment of a complaint

3.2.1 G The *firm* should consider, in the light of all the information provided by the complainant and otherwise already held by or available to the *firm*, whether there was a breach or failing by the *firm*.

3.2.2 G The *firm* should seek to establish the true substance of the *complaint*, rather than taking a narrow interpretation of the issues raised, and should not focus solely on the specific expression of the *complaint*. This is likely to require an approach to *complaint* handling that seeks to clarify the nature of the *complaint*.

3.2.3 G A *firm* may need to contact a complainant directly to understand fully the issues raised, even where the *firm r*eceived the *complaint* from a third party acting on the complainant's behalf. The *firm* should not use this contact to delay the assessment of the *complaint*.

3.2.4 G Where a *complaint* raises (expressly or otherwise) issues that may relate to the original sale or a subsequently rejected claim then, irrespective of the main focus of the *complaint*, the *firm* should pro-actively consider whether the issues relate to both the sale and the claim, and assess the *complaint* and determine redress accordingly (see *DISP* App 3.5).

3.2.5 G If, during the assessment of the *complaint*, the *firm* uncovers evidence of a breach or failing not raised in the *complaint*, the *firm* should consider those other aspects as if they were part of the *complaint*.

3.2.6 G The *firm* should take into account any information it already holds about the sale and consider other issues that may be relevant to the sale identified by the *firm* through other means, for example, the root cause analysis described in *DISP* App 3.4.

3.3 The approach to considering evidence

3.3.1 G Where a *complaint* is made, the *firm* should assess the *complaint* fairly, giving appropriate weight and balanced consideration to all available evidence, including what the complainant says and other information about the sale that the *firm* identifies. The *firm* is not expected automatically to assume that there has been a breach or failing.

3.3.2 G The *firm* should not rely solely on the detail within the wording of a *policy's* terms and conditions to reject what a complainant recalls was said during the sale.

3.3.3 G The *firm* should recognise that oral evidence may be sufficient evidence and not dismiss evidence from the complainant solely because it is not supported by documentary proof. The *firm* should take account of a complainant's limited ability fully to articulate his *complaint* or to explain his actions or decisions made at the time of the sale.

3.3.4 G Where the complainant's account of events conflicts with the *firm's* own records or leaves doubt, the *firm* should assess the reliability of the complainant's account fairly and in good faith. The *firm* should make all reasonable efforts (including by contact with the complainant where necessary) to clarify ambiguous issues or conflicts of evidence before making any finding against the complainant.

3.3.5 G The *firm* should not reject a complainant's account of events solely on the basis that the complainant signed documentation relevant to the purchase of the *policy*.

3.3.6 G The *firm* should not reject a *complaint* because the complainant failed to exercise the right to cancel the *policy*.

3.3.7 G The *firm* should not consider that a successful claim by the complainant is, in itself, sufficient evidence that the complainant had a need for the *policy* or had understood its terms or would have bought it regardless of any breach or failing by the *firm.*

3.3.8 G The *firm* should not draw a negative inference from a complainant not having kept documentation relating to the purchase of the *policy* for any particular period of time.

3.3.9 G In determining a particular *complaint*, the *firm* should (unless there are reasons not to because of the quality and plausibility of the respective evidence) give more weight to any specific evidence of what happened during the sale (including any relevant documentation and oral testimony) than to general evidence of selling practices at the time (such as training, instructions or sales scripts or relevant audit or compliance reports on those practices).

3.3.10 G The *firm* should not assume that because it was not authorised to give advice (or because it intended to sell without making a recommendation) it did not in fact give advice in a particular sale. The *firm* should consider the available evidence and assess whether or not it gave advice or made a recommendation (explicitly or implicitly) to the complainant.

3.3.11 G The *firm* should consider in all situations whether it communicated information to the complainant in a way that was fair, clear and not misleading and with due regard to the complainant's information needs.

3.3.12 G In considering the information communicated to the complainant and the complainant's information needs, the evidence to which a *firm* should have regard includes:

(1) the complainant's individual circumstances at the time of the sale (for example, the *firm* should take into account any evidence of limited financial capability or understanding on the part of the complainant);

(2) the complainant's objectives and intentions at the time of the sale;

(3) whether, from a reasonable *customer's* perspective, the documentation provided to the complainant was sufficiently clear, concise and presented fairly (for example, was the documentation in plain and intelligible language?);

(4) in a sale that was primarily conducted orally, whether sufficient information was communicated during the sale discussion for the customer to make an informed decision (for example, did the *firm* give an oral explanation of the main characteristics of the *policy* or specifically draw the complainant's attention to that information on a computer screen or in a document and give the complainant time to read and consider it?);

(5) any evidence about the tone and pace of oral communication (for example, was documentation read out too quickly for the complainant to

have understood it?); and

(6) any extra explanation or information given by the *firm* in response to questions raised (or information disclosed) by the complainant.

3.3.13 G The *firm* should not reject a *complaint* solely because the complainant had held a *payment protection contract* previously.

3.3.14 G The *firm* should consider all of its sales of *payment protection contracts* to the complainant in respect of re-financed loans that were rolled up into the loan covered by the *payment protection contract* that is the subject of the *complaint*. The *firm* should consider the cumulative financial impact on the complainant of any previous breaches or failings in those sales.

3.4 Root cause analysis

3.4.1 G *DISP* 1.3.3R requires the *firm* to put in place appropriate management controls and take reasonable steps to ensure that in handling *complaints* it identifies and remedies any recurring or systemic problems. If a *firm* receives *complaints* about its sales of *payment protection contracts* it should analyse the root causes of those *complaints* including, but not limited to, the consideration of:

(1) the concerns raised by complainants (both at the time of the sale and subsequently);

(2) the reasons for both rejected claims and *complaints*;

(3) the *firm's* stated sales practice(s) at the relevant time(s);

(4) evidence available to the *firm* about the actual sales practice(s) at the relevant time(s) (this might include recollections of staff and complainants, compliance records, and other material produced at the time about specific transactions, for example call recordings and incentives given to *advisers*);

(5) relevant regulatory findings; and

(6) relevant decisions by the *Financial Ombudsman Service*.

3.4.2 G Where consideration of the root causes of *complaints* suggests recurring or systemic problems in the *firm's* sales practices, the *firm* should, in assessing an individual *complaint*, consider whether the problems were likely to have contributed to a breach or failing in the individual case, even if those problems were not referred to specifically by the complainant.

3.5 Re-assessing rejected claims

3.5.1 G For the purposes of this appendix, a "claim" is a claim by a complainant seeking to rely upon the *policy* under the *payment protection contract* that is the subject of the *complaint*.

3.5.2 G Where a *complaint* is about the sale of a *policy*, the *firm* should, as part of its investigation of the *complaint*, determine whether any claim on that *policy* was rejected, and if so, whether the complainant may have reasonably expected that the claim would have been paid.

3.5.3 G For example, the complainant may have reasonably expected that the claim would have been paid where the *firm* failed to disclose appropriately an exclusion or limitation later relied on by the insurer to reject the claim and it should have been clear to the *firm* that that exclusion or limitation was relevant to the complainant.

3.5.4 G Where the *firm* concludes that the complainant may have reasonably expected that the claim would have been paid then, if the value of the claim exceeds the amount of the redress otherwise payable to the complainant for a breach or failing identified in accordance with the guidance in this appendix, the *firm* should pay to the complainant only the value of the claim (and simple interest on it as appropriate).

3.6 Determining the effect of a breach or failing

3.6.1 G Where the *firm* determines that there was a breach or failing, the *firm* should consider whether the complainant would have bought the *payment protection contract* in the absence of that breach or failing.

3.6.2 G In the absence of evidence to the contrary, the *firm* should presume that the complainant would not have bought the *payment protection contract* he bought if the sale was substantially flawed, for example where the *firm*:

(1) pressured the complainant into purchasing the *payment protection contract*; or

(2) did not disclose to the complainant, in good time before the sale was concluded, and in a way that was fair, clear and not misleading, that the *policy* was optional; or

(3) made the sale without the complainant's explicit agreement to purchase the *policy*; or

(4) did not disclose to the complainant, in good time before the sale was concluded, and in a way that was fair, clear and not misleading, the significant exclusions and limitations, i.e. those that would tend to affect the decisions of *customers* generally to buy the *policy*; or

(5) did not, for an advised sale (including where the *firm g*ave advice in a non-advised sales process) take reasonable care to ensure that the *policy* was suitable for the complainant's demands and needs taking into account all relevant factors, including level of cover, cost, and relevant exclusions, excesses, limitations and conditions; or

(6) did not take reasonable steps to ensure the complainant only bought a *policy* for which he was eligible to claim benefits; or

(7) found, while arranging the policy, that parts of the cover did not apply but did not disclose this to the *customer*, in good time before the sale was concluded, and in a way that was fair, clear and not misleading; or

(8) did not disclose to the complainant, in good time before the sale was concluded, and in a way that was fair, clear and not misleading, the total (not just monthly) cost of the *policy* separately from any other prices (or the basis for calculating it so that the complainant could verify it); or

(9) recommended a single premium *payment protection contract* without taking reasonable steps, where the *policy* did not have a pro-rata refund, to establish whether there was a prospect that the complainant would repay or refinance the loan before the end of the term; or

(10) provided misleading or inaccurate information about the *policy* to the complainant; or

(11) sold the complainant a *policy* where the total cost of the *policy* (including any interest paid on the premium) would exceed the benefits payable under the *policy* (other than benefits payable under life cover); or

(12) in a sale of a single premium *payment protection contract*, failed to disclose to the complainant, in good time before the sale was concluded, and in a way that was fair, clear and not misleading:

(a) that the premium would be added to the amount provided under the credit agreement, that interest would be payable on the premium and the amount of that interest; or

(b) (if applicable) that the term of the cover was shorter than the term of the credit agreement and the consequences of that mismatch; or

(c) that the complainant would not receive a pro-rata refund if the complainant were to repay or refinance the loan or otherwise cancel the single premium *policy* after the cooling-off period.

3.6.3 G Relevant evidence might include the complainant’s demands, needs and intentions at the time of the sale and any other relevant evidence, including any testimony by the complainant about his reasons at the time of the sale for purchasing the *payment protection contract.*

Part 2: Comes into force on 1 September 2010

Insert the following at the end of DISP Appendix 2. The text is not underlined.

3.7 Approach to redress

General approach to redress: all contract types

3.7.1 G Where the *firm* concludes that the complainant would still have bought the *payment protection contract* he bought, no redress will be due to the complainant, subject to *DISP* App 3.5.

3.7.2 G Where the *firm* concludes that the complainant would not have bought the *payment protection contract* he bought, and the *firm* is not using the alternative approach to redress (set out in *DISP* App 3.7.6G), the *firm* should put the complainant in the position he would have been if he had not bought any *payment protection contract*.

3.7.3 G In all cases the *firm* should pay to the complainant a sum equal to the total amount paid by the complainant in respect of the *payment protection contract* including historic interest where relevant (plus simple interest on that amount). If the complainant has received any rebate, for example if the customer cancelled a single premium *payment protection contract* before it ran full term and received a refund, the *firm* may deduct the value of this rebate from the amount otherwise payable to the complainant.

3.7.4 G Additionally, where a single premium was added to a loan:

(1) for live *policies*, subject to *DISP* App 3.7.5G, where there remains an outstanding loan balance, the *firm s*hould, where possible, arrange for the loan to be restructured (without charge to the complainant but using any applicable cancellation value) with the effect of:

(a) removing amounts relating to the *payment protection contract* (including any interest and charges); and

(b) ensuring the number and amounts of any future repayments (including any interest and charges) are the same as would have applied if the complainant had taken the loan without the *payment protection contract*; or

(2) alternatively, for live *policies* where the *firm* is not able to arrange for the loan to be restructured (e.g. because the loan is provided by a separate *firm*) it should pay the complainant an amount equal to the difference between the actual loan balance and what the loan balance would have been if the *payment protection contract* (including any interest and charges) had not been added, deducting the current cancellation value. The *firm* should offer to pay any charges incurred if the complainant uses this amount to reduce his loan balance; and

(3) for cancelled policies, the *firm s*hould pay the complainant the difference between the actual loan balance at the point of cancellation and what the loan balance would have been if no premium had been added (plus simple interest) minus any applicable cancellation value.

3.7.5 G Where the *firm* has previously paid a claim on the *policy*, it may deduct this from redress paid in accordance with *DISP* App 3.7.3G. If the claim is higher than the amount to be paid under *DISP* App 3.7.3G then the *firm* may also deduct the excess from the amount to be paid under *DISP* App 3.7.4G.

Alternative approach to redress: single premium policies

3.7.6 G Where the only breach or failing was within *DISP* App 3.6.2G(9) and/or *DISP* App 3.6.2G(12), and in the absence of evidence to the contrary, the *firm* may presume that instead of buying the single premium *payment protection contract* he bought, the complainant would have bought a regular premium *payment protection contract*.

3.7.7 G If a *firm* chooses to make this presumption, then it should do so fairly and for all relevant complainants in a relevant insurance book. It should not, for example, only use the approach for those complainants it views as being a lower underwriting risk or those complainants who have cancelled their *policies*.

3.7.8 G Where the *firm* presumes that the complainant would have purchased a regular premium *payment protection contract*, the *firm* should offer redress that puts the complainant in the position he would have been if he had bought an alternative regular premium *payment protection contract*.

3.7.9 G The *firm s*hould pay to the complainant a sum equal to the amount in *DISP* App 3.7.3G less the amount the complainant would have paid for the alternative regular premium *payment protection contract*.

3.7.10 G The *firm* should consider whether it is appropriate to deduct the value of any paid claims from the redress.

3.7.11 G Additionally, where a single premium was added to a loan, *DISP* App 3.7.4G applies except that in respect of *DISP* 3.7.4(1)G the cancellation value should only be used if the complainant expressly wishes to cancel the *policy*.

3.7.12 G The *firm* should, for the purposes of redressing the complaint, use the value of £9 per £100 of benefits payable as the monthly price of the alternative regular premium *payment protection contract*. For example, if the monthly repayment amount in relation to the loan only is to be £200, the price of the alternative regular premium *payment protection contract* will be £18.

3.7.13 G Where the *firm* presumes that the complainant would have purchased a regular premium *payment protection contract* and if the complainant expressly wishes it, the existing cover should continue until the end of the existing *policy* term. The complainant should pay the price of the alternative regular premium *payment protection contract* (at *DISP* App 3.7.12G) and should be able to cancel at any time. This pricing does not apply where *DISP* App 3.7.4G(2) applies.

3.7.14 G So that the complainant can make the decision on the continuation of cover from an informed position, the *firm* should:

(1) offer to provide details of the existing *payment protection contract*;

(2) remind the complainant that if his circumstances (for example his health or employment prospects) have changed since the original sale, he may not be eligible for cover under any new *policy* he buys;

(3) make the complainant aware of the changes to the cancellation arrangements if cover continues;

(4) explain how the future premium will be collected and the cost of the future cover; and

(5) refer the complainant to www.moneymadeclear.fsa.gov.uk as a source of information about a range of alternative *payment protection contracts*.

3.8 Other matters concerning redress

3.8.1 G Where the complainant's loan or credit card is in arrears the *firm* may, if it has the contractual right to do so, make a payment to reduce the associated loan or credit card balance, if the complainant accepts the *firm*'s offer of redress. The *firm* should act fairly and reasonably in deciding whether to make such a payment.

3.8.2 G In assessing redress, the *firm* should consider whether there are any other further losses that flow from its breach or failing, for example, where the *payment protection contract's* cost or rejected claims contributed to affordability issues for the associated loan or credit which led to arrears charges, default interest, penal interest rates or other penalties levied by the lender.

3.8.3 G Where, for single premium *policies*, there were previous breaches or failings (see *DISP* App 3.3.14G) the redress to the complainant should address the cumulative financial impact.

3.8.4 G The *firm* should make any offer of redress to the complainant in a fair and balanced way. In particular, the *firm* should explain clearly to the complainant the basis for the redress offered including how any compensation is calculated and, where relevant, the rescheduling of the loan, and the consequences of accepting the offer of redress.

Draft material, including examples, supporting the revised draft Handbook text

Appendix 2 – Providing PPI redress

Introduction

1. This Appendix is provided to supplement the text in Chapter 3 of the Policy Statement. It should also be considered alongside DISP App 3.7 and DISP App 3.8 in the Handbook text.

Examples of calculating PPI redress

Examples	
Table of examples of typical redress calculations	
Example 1	The complainant would not have purchased any PPI policy. The loan and the PPI policy are live.
Example 2	The complainant would not have purchased any PPI policy. The loan and the PPI policy ran the full term.
Example 3	The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan and PPI policy are live, and the complainant has not previously claimed.
Example 4	A claim was rejected, where the complainant may have reasonably expected that the claim would have been paid. The loan and the PPI policy ran the full term.
Example 5	The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan and the PPI policy are live, and the complainant has previously successfully claimed on the single premium PPI policy.
Example 6	The complainant would not have purchased a PPI policy at the outset. The credit card and the PPI policy are live.
Example 7	The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan was redeemed and the PPI policy was cancelled 12 months ago, having run for three years at the point of cancellation.
Example 8	The complainant would have purchased an alternative regular premium PPI policy at the outset. The firm finds it mis-sold a previous single premium PPI policy to the complainant that was subsequently cancelled to consolidate or refinance the connected loan.

Example 1 The complainant would not have purchased any PPI policy. The loan and the PPI policy are live.

As described in DISP App 3.7.3G, the firm should pay the complainant a sum equal to the total amount the complainant paid for the PPI including historic interest where relevant (plus simple interest on that amount).

In this example, this is the sum of the complainant's previous PPI policy payments made via the loan repayments. The simple interest is calculated on each monthly PPI policy payment, from the time each payment was made to the time the compensation is paid.

<u>Loan and policy details:</u>	
Monthly loan payment	£200
Monthly amount of PPI policy payments (including interest)	£50
Term of policy (in months)	60
Number of monthly PPI policy payments to date	20

<u>Compensation calculation:</u>

Compensation for total PPI policy payments (£50 x 20 months) £1,000

8% p.a. simple interest on each PPI policy payment since the month it was made, calculated as follows:

- Interest on first payment made = £50 x 8% x 20/12
  (8% p.a. simple interest on £50 payment over 20 months) plus
- Interest on second payment made = £50 x 8% x 19/12 (etc)
- Total interest = £50 x 8% x (20 + 19 + … + 2 + 1)/12

Total interest £70

Total compensation **<u>£1,070</u>**

As described in DISP App 3.7.4G, the firm should, where possible, arrange for the loan to be restructured. For this example, in addition to the above compensation to be paid to the complainant, the loan balance must be adjusted as if the PPI policy never existed and the future loan repayments would be £200 for the remainder of the term of the loan.

Example 2 The complainant would not have purchased any PPI policy. The loan and the PPI policy ran the full term.

As described in DISP App 3.7.3G, the firm should pay the complainant a sum equal to the total amount the complainant paid for the PPI including historic interest where relevant (plus simple interest on this amount).

In this example, this is the sum of the complainant's previous PPI policy payments made via the loan repayments. The simple interest is calculated on each monthly PPI policy payment, from the time each payment was made to the time the compensation is paid.

<u>Loan and policy details:</u>

Monthly amount of PPI policy payments (including interest)	£50
Term of policy (in months)	60
Period to date (in months)	72

<u>Compensation calculation:</u>

Compensation for total PPI policy payments (£50 x 60 months) £3,000

8% p.a. simple interest on each payment, calculated as:

- Interest on first payment made = £50 x 8% x 72/12
  (8% p.a. simple interest on £50 payment over 72 months (time since payment was made)) plus
- Interest on second payment made = £50 x 8% x 71/12 (etc)
- Total interest = £50 x 8% x (72 + 71 + … + 14 + 13)/12
  (Final payment on the loan was made 13 months ago)

Total interest £850

Total compensation **<u>£3,850</u>**

It is not necessary for the firm to arrange for the loan to be restructured in this example, as the loan ran for the full term.

Example 3 The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan and the PPI policy are live, and the complainant has not previously claimed.

As described in DISP App 3.7.3G and DISP App 3.7.9G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI including historic interest where relevant (plus simple interest on that amount), less the amount the complainant would have paid for the alternative regular premium PPI policy.

In this example, this is the sum of the complainant's PPI policy payments made via the loan repayments less the price of the alternative regular premium PPI policy. The simple interest is calculated on the difference between actual PPI policy price and the alternative policy price for each payment, from the time each actual PPI payment was made to the time the compensation is paid.

Loan and policy details:	
Monthly loan payment	£200
Price of monthly PPI policy payments (including interest)	£50
Term of policy (in months)	60
Monthly PPI policy payments to date	20

Difference between the price of the actual PPI policy purchased and the price of the alternative policy:	
Price per £100 of alternative regular premium PPI policy	£9
Resulting monthly alternative regular premium PPI policy price for current loan (based on £200 monthly loan repayments)	£18
Monthly difference between actual (£50) and alternative (£18) monthly payments	£32

<u>Compensation calculation:</u>	
Compensation for the total difference in PPI policy payments (£32 difference x 20 months)	£640
8% p.a. simple interest on difference between actual and alternative price for each payment, calculated as: • Interest on first month's payment = £32 x 8% x 20/12 (8% p.a. simple interest on £32 payment over 20 months) plus • Interest on second month's payment = £32 x 8% x 19/12 (etc) • Total interest = £32 x 8% x (20 + 19 + … + 2 + 1)/12	
Total interest	£45
Total compensation	**<u>£685</u>**

As described in DISP App 3.7.4 G, the firm should, where possible, arrange for the loan to be restructured. For this example, in addition to the above compensation to be paid to the complainant, the loan balance must be adjusted as if the PPI policy never existed and the future loan repayments would be £200 for the remainder of the term of the loan.

The customer should be given the option of maintaining regular premium PPI cover for the remaining term of the loan at the alternative cost of £18 (based on the reference price of £9 per £100 of cover, applied to the monthly loan repayments of £200).

Example 4 A claim was rejected, where the complainant may have reasonably expected that the claim would have been paid. The loan and the PPI policy ran the full term

As described in DISP App 3.5.4G, redress to the complainant should be the greater of:

(1) A sum equal to the amount payable to the complainant in accordance with DISP App 3.7.3G, i.e. the total amount paid by the complainant for the PPI policy including historic interest where relevant (plus simple interest on that amount); or

(2) The value of the claim, plus simple interest from the date each payment on the claim would have been made to the date the compensation is paid.

Loan and policy details:	
Monthly loan payment	£200
Price of monthly PPI policy payments (including interest)	£50
Term of policy (in months)	60
Period to date (in months)	72

1. Calculation of the compensation otherwise payable in accordance with *DISP* App 3.7.3G (all payments made with 8% p.a. simple interest):	
Total PPI policy payments (£50 x 60 months)	£3,000
8% p.a. simple interest on each payment since the month it was made (calculation as per Example 2)	£850
Total compensation representing PPI policy payments with interest	**£3,850**

Claim details:	
Time since the first payment that would have been covered by the claim (in months)	30
Monthly amount of claim	£250

2. <u>Calculation of the value of the claim (plus 8% p.a. simple interest):</u>

Scenario 1: Duration of the claim is 6 months	
Unemployment/Accident/Sickness period (in months)	6
Total value of the claim (£250 x 6 months)	£1,500
8% p.a. simple interest on each payment, calculated as:	
• Interest on first month's claim = £250 x 8% x 30/12 (8% p.a. simple interest on £250 claim over 30 months (time elapsed since the first payment that would have been covered by the claim) plus	
• Interest on second payment made = £250 x 8% x 29/12 (etc)	
• Total interest = £250 x 8% x (30 + 29 + … + 26 + 25)/12 (Last claim on the policy would have been made 25 months ago)	
Total interest	£275
Total compensation representing the value of the claim	**£1,775**
Compensation representing the value of the claim is less than the compensation otherwise payable in accordance with DISP App 3.7.3G, i.e. the total paid by the complainant for PPI policy payments with interest.	
As described in DISP App 3.5.4G, the redress should be the greater of the above two types of compensation. In this scenario, the redress is the total paid by the complainant for PPI policy payments with interest.	
Total redress should be	**<u>£3,850</u>**

Scenario 2: Duration of the claim is 18 months	
Unemployment/Accident/Sickness period (in months)	18
Total claims on the policy (£250 x 18 months)	£4,500
8% p.a. simple interest on each payment, calculated as: • Interest on first month's claim = £250 x 8% x 30/12 (8% p.a. simple interest on £250 claim over 30 months (time elapsed since date of claim) • Interest on second payment made = £250 x 8% x 29/12 • Total interest = £250 x 8% x (30 + 29 + … + 14 + 13)/12 (Last claim on the policy would have been made 13 months ago)	
Total interest	£645
Total compensation representing the value of the claim	**£5,145**
Compensation representing the value of the claim is greater than the compensation otherwise payable in accordance with DISP App 3.7.3G, i.e. the total paid by the complainant for PPI policy payments with interest.	
As described in DISP App 3.5.4G, the redress should be the greater of the above two types of compensation. In this scenario, the redress is the amount equivalent to that which would have been payable by the insurer had the claim been accepted plus interest at 8% p.a.	
Total redress should be	**£5,145**

Example 5 The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan and the PPI policy are live, and the complainant has previously successfully claimed on the single premium PPI policy.

As described in DISP App 3.7.3G and DISP App 3.7.9G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI including historic interest where relevant (plus simple interest on that amount) less the amount the complainant would have paid for the alternative regular premium PPI policy.

In this example, this is the sum of the complainant's PPI policy payments made via the loan repayments less the price of the alternative regular premium PPI policy. The simple interest is calculated on the difference between the actual PPI policy price and the alternative policy price for each payment made by the complainant outside the claim period, from the time each actual PPI payment was made to the time the compensation is paid.

The firm may deduct from the compensation an amount equivalent to those regular premiums paid during the claim period. This is because under the terms of an alternative regular premium product, the premiums would still have been payable by the complainant during the claim period.

Loan and policy details:	
Monthly loan payment	£200
Price of monthly PPI policy payments (including interest)	£50
Term of policy (in months)	60
Time since first payment (in months)	20

Alternative policy details:	
Price per £100 of alternative regular premium PPI policy	£9
Resulting monthly alternative regular premium PPI policy price for current loan (based on £200 monthly loan repayments)	£18
Monthly difference between actual (£50) and alternative (£12) monthly payments	£32

<u>Claim details:</u>	
Unemployment/Accident/Sickness period (in months)	6
Time since first payment covered by the claim (in months)	10

<u>Compensation calculation:</u>	
Difference between actual and alternative PPI payments (where the complainant made the premium payments and no claim was being paid), i.e. from T-20 months to T-11 months and from T-4 months to present, T being the calculation date)	£448
8% p.a. simple interest on the difference between actual PPI policy price and the alternative policy price for each payment made by the complainant outside the claim period	£35
Less the sum of:	
Regular premiums which would have been paid during the claim period under the alternative regular premium PPI policy contract (£18 x 6 months) and	£108
8% p.a. simple interest on the regular premium payments which would have been made by the complainant during the claim period under the alternative regular premium PPI policy contract	£5
Total compensation	**<u>£370</u>**

As per DISP App 3.7.10 G, the firm should, where possible, arrange for the loan to be restructured. For this example, in addition to the above compensation to be paid to the complainant, the loan balance must be adjusted as if the PPI policy never existed and the future loan repayments would be £200 for the remainder of the term of the loan.

The customer should be given the option of maintaining the existing cover at the price of the alternative regular premium PPI cover for the remaining term of the loan at the alternative cost of £18 (based on the reference price of £9 per £100 of cover, applied to the monthly loan repayments of £200).

Example 6 The complainant would not have purchased a PPI policy at the outset. The credit card and the protection contract are live.

As described in DISP App 3.7.3G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI the PPI including historic interest where relevant (plus simple interest on that amount).

In this example, this is the sum of the complainant's previous PPI policy payments (with interest) added to the credit account. The simple interest is applied for each month that the notional credit card balance would have been positive. The notional credit card balance for each month is calculated by adding the running PPI cost balance to the actual credit card balance for that month.

A detailed month-by-month example of how the compensation is calculated is shown on the following page.

<u>Credit card and policy details:</u>	
Calculation date	Month 20
Credit card APR	20%
PPI cost (per £100 of credit card balance)	£0.69
Interest is calculated monthly (not daily)	

<u>Compensation calculation (see details on following page):</u>	
Total PPI premiums for 20 months plus	£73.49
Historic interest paid on all these premiums (at 20% APR) plus	£4.14
8% p.a. simple interest on those PPI premiums paid that, if they had not been paid, would have made the customer's credit card balance, for those months, positive.	£2.60
Total compensation	**<u>£80.23</u>**

Month	Monthly Transactions A	Monthly payment B	Running actual credit card balance C (A+B)	Monthly cost of PPI D (based on C and price)	Running PPI balance at start of month E (D + previous month G)	Compound interest on PPI accrued in month F (based on E and interest rate)	PPI balance carried over G (E+F)	Running PPI redress balance H (Cumulative total of D and F)	Notional credit card balance (if PPI had not been taken out) I (C+H)	8% simple interest (based on I where in credit)
1	-£500	£200	-£300	-£2.07	-£2.07	-£0.03	-£2.10	£2.10	-£297.90	n/a
2	-£900	£500	-£700	-£4.83	-£6.93	-£0.12	-£7.05	£7.05	-£692.95	n/a
3	-£400	£200	-£900	-£6.21	-£13.26	-£0.22	-£13.48	£13.48	-£886.52	n/a
4	-£500	£200	-£1,200	-£8.28	-£21.76	-£0.36	-£22.12	£22.12	-£1,177.88	n/a
5	-£300	£500	-£1,000	-£6.90	-£29.02	-£0.48	-£29.51	£29.51	-£970.49	n/a
6	-£400	£100	-£1,300	-£8.97	-£38.48	-£0.64	-£39.12	£39.12	-£1,260.88	n/a
7	-£800	£400	-£1,700	-£11.73	-£50.85	-£0.85	-£51.70	£51.70	-£1,648.30	n/a
8	-£200	£400	-£1,500	-£10.35	-£62.05	-£1.03	-£63.08	£63.08	-£1,436.92	n/a
9	-£100	£1,600	£0	£0.00	£0.00	£0.00	£0.00	£63.08	+£63.08	£0.42
10	-£300	£300	£0	£0.00	£0.00	£0.00	£0.00	£63.08	+£63.08	£0.42
11	-£500	£500	£0	£0.00	£0.00	£0.00	£0.00	£63.08	+£63.08	£0.42
12	-£250	£250	£0	£0.00	£0.00	£0.00	£0.00	£63.08	+£63.08	£0.42
13	-£300	£300	£0	£0.00	£0.00	£0.00	£0.00	£63.08	+£63.08	£0.42
14	-£400	£100	-£300	-£2.07	-£2.07	-£0.03	-£2.10	£65.18	-£234.82	n/a
15	-£400	£100	-£600	-£4.14	-£6.24	-£0.10	-£6.35	£69.43	-£530.57	n/a
16	-£550	£400	-£750	-£5.18	-£11.52	-£0.19	-£11.72	£74.80	-£675.20	n/a
17	-£250	£1,000	£0	£0.00	£0.00	£0.00	£0.00	£74.80	+£74.80	£0.50
18	-£400	£200	-£200	-£1.38	-£1.38	-£0.02	-£1.40	£76.20	-£123.80	n/a
19	-£300	£300	-£200	-£1.38	-£2.78	-£0.05	-£2.83	£77.63	-£122.37	n/a
				-£73.49		**-£4.14**				**£2.60**

Example 7 **The complainant would have purchased an alternative regular premium PPI policy at the outset. The loan was redeemed and the PPI policy was cancelled 12 months ago, having run for three years at the point of cancellation.**

As described in DISP App 3.7.3G and DISP App 3.7.9G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI including historic interest where relevant (plus simple interest on that amount) less the amount the complainant would have paid for the alternative regular premium PPI policy.

In this example, this is the sum of the complainant's PPI policy payments made via the loan repayments less the price of the alternative regular premium PPI policy. The simple interest is calculated on the difference between the actual PPI policy payment and the alternative policy price for each payment, from the time each actual PPI payment was made to the time the compensation is paid.

As described in DISP App 3.7.4(3)G, the firm should also pay to the complainant the difference between the actual loan balance at the point of cancellation and what the loan balance would have been if no premium had been added (plus simple interest) minus any applicable cancellation value.

<u>Loan and policy details:</u>	
Loan amount	£4,700
PPI premium	£850
Total loan	£5,550
APR	10%
Monthly loan payment (without PPI)	£100
Monthly PPI payments	£18
Total monthly payment	£118
Term of PPI policy (in months)	60
Duration of payments before the loan was redeemed: (in months)	36
Duration since loan redemption and PPI policy cancellation: (in months)	12
Actual cost of redeeming the loan at 36 months (gross of any PPI rebate):	£2,555
Notional cost of redeeming the loan at 36 months (if PPI had not been added to loan):	£2,164
Difference between actual and notional loan balance at point of redemption:	£391
PPI rebate paid to loan at redemption (assuming that at 36 months the rebate is 14% of the original premium i.e. 14% of £850 in this example):	£119

Redress is calculated in two parts: the monthly overpayments and the overpayment on redemption of the loan.

<u>Monthly overpayments calculation:</u>	
Cost per £100 of alternative regular premium PPI	£9
Therefore, monthly cost for current loan	£9
Monthly overpayment (difference between actual PPI payments and alternative payments)	£9
Compensation for the total difference in PPI payments (monthly overpayment of £9 x duration of payments which is 36 months)	£324
8% p.a. simple interest on the overpayments (from the date of each actual PPI payment until the date of calculation):	£71
Total compensation for overpayments to the point of calculation:	**<u>£395</u>**

<u>Overpayment on loan redemption calculation:</u>	
Compensation for overpayment on loan redemption (differences in balances of £391 less PPI rebate of £119):	£272
Plus 8% p.a. simple interest over period since loan was redeemed which is 12 months:	£22
Total compensation for overpayment on loan redemption:	**£294**

Total compensation (£395 + £294):	**<u>£689</u>**

The firm need not provide future cover as the customer cancelled the PPI.

Example 8 The complainant would have purchased an alternative regular premium PPI policy at the outset. The firm finds it mis-sold a previous single premium PPI policy to the complainant which was subsequently cancelled to consolidate or refinance the connected loan.

As described in DISP App 3.3.14G and DISP App 3.8.3G, the firm should consider the sales of previous single premium PPI policies to the complainant in respect of re-financed loans that were rolled up into the loan covered by the PPI policy that is the subject of complaint. Where there were previous breaches or failings the redress to the complainant should address the cumulative financial impact on the complainant.

<u>First loan and policy details:</u>	
Loan amount	£9,400
PPI premium	£1,700
Total loan	£11,100
APR	10%
Monthly loan payment (without PPI)	£199.72
Monthly PPI payments	£36.12
Total monthly payment	£235.84
Term of PPI policy (in months)	60
Duration of payments (in months)	12
Time since loan refinanced (in months)	36

Loan 1 - Redress is calculated in two parts for loan 1:

1. As described in DISP App 3.7.3G and DISP App 3.7.9G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI the PPI including historic interest where relevant (plus simple interest on that amount).

   In this example, this is the sum of the complainant's PPI policy payments made via the loan repayments less the price of the alternative regular premium PPI policy. The simple interest is calculated on the difference between the actual PPI policy payment and the alternative policy price for each payment, from the time each actual PPI payment was made to the time the compensation is paid.

2. As described in DISP 3.7.4 (3) G, the firm should also pay the difference between the actual loan balance at the point of cancellation and what the loan balance would have been if no premium had been added minus any applicable cancellation value. Note that it is not appropriate to add simple interest to this amount as it forms part of loan 2.

The above two parts are calculated as follows:

Historic monthly overpayments calculation for loan 1	
Cost per £100 of alternative regular premium PPI	£9
Therefore, monthly cost of alternative regular premium PPI for loan 1 (based on monthly loan repayment without PPI of £199.72)	£17.97
Monthly difference (actual PPI payment of £36.12 – alternative regular premium price of £17.97)	£18.15
Compensation for the total difference in PPI payments (monthly difference of £18.15 x duration of payments of 12 months)	£218
8% p.a. simple interest (on historic monthly payments for 12 months and the 36 months since loan 1 was refinanced)	£62
Total monthly overpayment compensation payable for loan 1	**£280**

Overpayment on loan redemption calculation for loan 1	
Actual redemption value of the loan after 12 months (including any PPI rebate)	£9,298.86
Notional redemption value of the loan after 12 months (if PPI had not been added to loan):	£7,874.70
PPI rebate paid to loan at redemption (assuming that at 12 months the rebate is 65% of the original premium i.e. 65% of £1,700):	£1,105
The overpayment value (actual redemption value - notional redemption value - PPI rebate):	**£319.16**
This figure is refinanced into loan 2 so any further loss is calculated with reference to loan 2's duration and APR. 8% p.a. simple interest is not added. The amount is carried over into the loan 2 calculation.	

<u>Second loan and policy details:</u>	
Loan amount	£14,200
PPI premium	£2,800
Total loan	£17,000

APR	10%
Total monthly repayment (based on £14,200) including the following monthly PPI payments:	£361.20
- monthly PPI payments for loan 2	£59.49
- residual monthly PPI payments for loan 1 (see below for calculation)	£6.78
Monthly loan payment without PPI from loan 2	£301.71
Monthly loan payment without PPI from loan 1 or 2	£294.93
Term of PPI policy (in months)	60
Duration of payments (in months)	36

Loan 2 - Redress is calculated in two parts for loan 2:

As described in DISP App 3.7.3G, the firm should pay to the complainant a sum equal to the total amount the complainant paid for the PPI the PPI.

In this example, this is the sum of:

1. The monthly payments on the residual cost of PPI carried forward from loan 1 calculation (plus simple interest).

2. The total amount paid to the loan account in respect of the PPI policy for loan 2 including historic interest, less the amount the complainant would have paid for the alternative regular premium PPI policy (plus simple interest). The simple interest is calculated on the difference between the actual PPI policy payments and the alternative policy price for each monthly payment made by the complainant, from the time each actual PPI payment was made to the time the compensation is paid.

Monthly payments on the residual cost of PPI carried forward from loan 1 calculation	
The residual PPI on redemption of loan 1 as a % of loan 2 (Overpayment value of £319.16 / loan 2 amount of £14,200)	2.25% (rounded)
Loan 2 monthly payment used towards paying off residual cost of PPI on loan 1 (residual PPI of 2.25% x monthly payment without PPI on loan 2 of £301.71)	£6.78
Compensation for the overpayment on residual loan 1 PPI payments (loan 1 residual PPI of £6.78 x duration of 36 months)	£244 (rounded)
8% p.a. simple interest on historic payments	£30
Total monthly overpayment compensation payable for residual loan 1	**£274**

Historic monthly overpayments calculation for loan 2	
Cost per £100 of alternative regular premium PPI	£9
Therefore, monthly alternative regular premium PPI cost for loan 2 (based on monthly loan repayment without any PPI of £294.93)	£26.54
Monthly difference (actual PPI payments of £59.49– alternative regular premium PPI cost of £26.54)	£32.95
Compensation for the total difference in PPI payments (monthly difference of £32.95 x duration of payments of 36 months)	£1,186
8% p.a. simple interest (on historic monthly payments):	£146
Total monthly overpayment compensation payable for loan 2	**£1332**

Compensation payable on loan 2 (Monthly residual payments from loan 1 of £274 + Historic monthly overpayments for loan 2 of £1332)	**£1606**
Total compensation payable on both loans (loan 1 of £280 plus loan 2 of £1606)	**£1886**

In addition, as per DISP 3.7.4G the firm should, where possible, arrange for the loan to be restructured. For this example, in addition to the above compensation to be paid to the complainant:

1. any remaining residual PPI balance from the earlier refinanced loan should be removed; and

2. the future loan repayments would be £294.93 for the remaining term of loan 2; and

The customer should be given the option of maintaining the existing cover at the price of the alternative regular premium PPI cover for the remaining term of loan 2 at the alternative cost of £26.54 (based on the referent price of £9 per £100 of cover, applied to the monthly loan repayments of £294.93).

Implementing approaches for customers to pay for future cover

The four approaches for customers to pay for future cover

Approach A - set up a new payment arrangement for regular premiums

- The customer makes regular premium payments from a new payment arrangement. So, if the customer opts to maintain cover, the firm sets up a new payment arrangement, a direct debit for example, to collect a monthly payment based on the alternative referent price until the end of the single premium policy term. If the policy is cancelled before the end of the policy term, then the customer's payments stop.

Approach B - Withhold part of the redress to fund regular premiums

- In summary, the customer makes regular premium payments from part of the redress which the firm retains.

- The firm compensates the customer for his previous PPI payments and removes the single premium PPI from the customer's loan balance in line with DISP App 3.7.3 G and DISP App 3.7.4 G. But if the customer opts to maintain cover on a regular premium basis, the firm would calculate how much redress to hold back to cover the customer's future regular premiums to the end of the original policy term. We would generally consider a fair offer should include some sort of discounting to reflect the fact that the firm, rather than the customer, holds the money. (This is particularly the case where the compensation payment for the customer's previous PPI payments is not sufficient to fund the future regular premiums and so part of the loan balance effectively funds the future regular premiums). If the customer cancels the policy before the end of the original term, the customer would, upon cancellation, be paid a pro-rata refund of the redress amount retained by the firm. An example of how this approach works in practice is provided below.

Approach C - Regular premiums collected through loan repayment

- In summary, the customer makes regular premium payments through the existing loan repayment mechanism.

- The firm compensates the customer for his previous PPI payments and removes the single premium PPI from the customer's loan balance in line with DISP App 3.7.3 G and DISP App 3.7.4 G. But, if the customer opts to maintain cover on a regular premium basis, the firm would add an amount to the loan balance to collect the future regular premiums. If the customer cancels the policy before the end of the original term, the loan balance would be adjusted so that post-cancellation the balance would not include any PPI cover. An example of how this approach works in practice is provided below.

Approach D – Non-referent price for maintaining cover

- In summary, the customer does not make future regular premium payments.

- The firm calculates compensation in line with DISP App 3.7.3 G and DISP App 3.7.4 G equal to:

- the sum of the customer's previous PPI payments plus
- the cost of removing the single premium PPI from the customer's loan balance less
- the current cancellation value.

- This compensation would be offered to the customer. The customer can decide whether or not to apply it to his outstanding loan balance. If the customer decides to apply it to reduce the loan balance the firm should also pay any charges that arise, for example early repayment charges). The firm must also give the customer the option to cancel or retain the cover. If the customer cancels the cover, he would receive the cancellation value due to him according to the original policy terms (this value may well be automatically applied to the loan balance). But, if the customer opts to maintain cover, the cancellation value effectively becomes the price of the future cover. If the customer subsequently cancels before the end of the original policy term, the customer would receive, upon cancellation, a cancellation value in line with the policy's cancellation terms.

Worked examples

1. Consider Example 3 on page 4 above, which requires the firm to give the option of maintaining the cover at a cost of £18 per month. The following details should be considered supplementary to the information in Example 3.

Loan details	
Original total loan	£11,500
PPI premium	£2,300
APR	11%
Cancellation value of the PPI after 20 months	£1,035
Actual loan balance after 20 months	£8,342.12
Notional loan balance after 20 months (if single premium PPI was not added)	£6,673.66

	Loan balance with single premium PPI removed.	Loan balance (if cover continues and is added to the loan balance)	Difference in loan balances
After 20 months	£6,673.66	£7,272.50	£598.84
After 32 months	£4,921.14	£5,362.05	£440.91
After 44 months	£2,965.82	£3,230.54	£264.72
After 56 months	£784.25	£853.36	£69.11

2. The section below takes each of the approaches and explains how they work in practice

Approach A - set up a new payment arrangement for regular premiums

3. As per Example 3, the firm must offer the customer £685 as compensation for the single premium PPI payments made. The firm must also offer to adjust the loan balance to £6,673.66, so credit the balance with £1,668.46 (assuming that the customer incurs no further charges) to remove the PPI from the loan.

4. The firm must also offer the customer the option of retaining cover on a regular premium basis. If this approach is adopted it would require the firm to set up a new payment arrangement, such as a direct debit to collect the regular premium of £18.

Approach B - Withhold part of the redress to fund regular premiums

5. As per Example 3, the firm must offer the customer £685 as compensation for the PPI payments made, unless the customer opts to retain cover (as discussed in the following paragraph). The firm must also offer to adjust the loan balance to £6,673.66, and credit the balance with £1,668.46 (assuming that the customer incurs no further charges) to remove the PPI from the loan, unless the customer opts to retain cover (as discussed in the following paragraph).

6. The firm must offer the customer the option of retaining cover on a regular premium basis. If this approach is adopted it would require the firm to hold £720[1] of the redress (i.e. the regular premium amount of £18 for the remaining term of the policy - 40 months), but discounted at a fair commercial rate. The impact of this is, if the customer accepts the offer, the customer would not receive the £685 compensation payment as this would be held by the firm to fund future regular premium payments. The firm would credit the loan with £1,633.46 (i.e. £1,668.46 less (£720 - £685). If the customer subsequently cancels the regular premium PPI before the end of the policy term, the firm must pay the customer a pro-rata refund of the £720 held (plus any additional interest incurred by the customer if PPI was not fully removed from the loan balance). This should be clearly explained in any offer and the firm could include a table outlining the future cost of cover such as:

If you cancel after…	You will receive…[2]	And the equivalent monthly cost is…
…12 months from the date of this offer	£504	£18 per month
…24 months from the date of this offer	£288	£18 per month
…36 months from the date of this offer	£72	£18 per month

Approach C - Regular premiums collected through loan repayment

7. As per Example 3, the firm must offer the customer £685 as compensation for the PPI payments made. The firm must also offer to adjust the loan balance to £6,673.66, so credit the balance with £1,668.46 (assuming that the customer incurs no further charges) to remove the PPI from the loan.

8. The firm must also offer the option of retaining the cover on a regular premium basis. If this approach is adopted it would require the future loan repayments to be adjusted to £218 (i.e. the monthly loan repayment without the single premium PPI of £200 plus the regular premium amount of £18). How this is achieved is up to the firm. We see two options (for which the firm would need to consider the Consumer Credit Act implications discussed in paragraphs 21 to 27 below):

[1] If this figure is discounted by 4% the firm would actually hold £630, but we have used £720 to better illustrate the impact on the loan balance redress.

[2] ie 720 x 28/40 = 504
720 x 16/40 = 288
720 x 4/40 = 72

9. First, the firm adjusts the loan repayment amount to £218, but only credits the loan balance with £200. The £18 reflects the payment for the regular premium policy. If the customer subsequently cancels the regular premium PPI cover, then the firm must reduce the loan repayment amount back to £200.

10. Second, the firm adjusts the customer's loan balance to drive a repayment amount of £218. Consider the table below. The second column shows what the customer's loan balance would be without any PPI. The third column shows what the loan balance would be if the firm was to adjust the loan balance to drive a repayment amount of £218. The fourth column shows the difference in the two balances and therefore is the amount that the firm would have to either add to or subtract from the loan balance if the customer opted for regular premium cover or subsequently cancelled the cover.

	Loan balance with PPI removed.	Loan balance (if cover continues and is added to the loan balance)	Difference in loan balances
After 20 months	£6,673.66	£7,272.50	£598.84
After 32 months	£4,921.14	£5,362.05	£440.91
After 44 months	£2,965.82	£3,230.54	£264.72
After 56 months	£784.25	£853.36	£69.11

11. So, in this example if the customer opts to maintain cover on a regular premium basis, the loan balance would increase from £6,673.66 to £7,272.50 to drive a repayment amount of £218 over the remaining term. If the customer subsequently cancels the regular premium PPI and **keeps** the loan, say after 44 months, the firm would reduce the loan balance to £2,965.82 which would lower the repayment amount back to £200. If the customer subsequently cancels the regular premium PPI before the end of the policy term and **redeems** the loan, the amount related to the regular premium PPI must be removed from the redemption amount. So, after 44 months this would be £264.72. This should be clearly explained in any offer and the firm could include a table outlining the future cost of cover and the impact on the loan balance, such as:

If you cancel after…	Your loan will be credited with…[3]	And the equivalent monthly cost is…
…12 months from the date of this offer	£440.91	£18 per month
…24 months from the date of this offer	£264.72	£18 per month
…36 months from the date of this offer	£69.11	£18 per month

Approach D – Non-referent price for maintaining cover

12. As per Example 3, the firm must offer the customer £685 as compensation for the PPI payments made. The firm must also offer to compensate the customer by the difference between the actual loan balance after 20 months and the notional loan balance after 20 months (if PPI had not been added), so £1,668.46; however, the firm may deduct from the compensation amount the current cancellation value, which is £1,035 on this

[3] ie the differences in the loan balances above

example. So in summary, the firm's redress offer is: £685 + £1,668.46 - £1,035 = £1,318.46. The firm should explain to the customer that he has the option of using the redress to reduce his loan balance. If any fees are incurred as a result of the customer exercising this option, for example early repayment charges, the firm should also offer to pay these fees.

13. The firm must also explain to the customer that he has the choice of either retaining the policy, and therefore keeping the cover at the price implied by the original policy's cancellation terms, or, cancelling the policy and receiving the cancellation amount. If the customer does cancel the policy, then his future payments should be as they would be if no PPI was added (i.e. £200 in this example).

14. If the customer chooses to retain the cover, then the cancellation amount would effectively become the cost of the future cover. This means that the cost of the future cover will not always equal to £9 per £100 of benefits. In this example, the policy has 40 months to run. The cancellation amount is £1,035. So, the monthly cost of cover would be £25.87 per month (assuming that the customer retains the policy for the full term of 40 months: 1035 ÷ 40), compared to £18 for the other three approaches.

15. We closely considered the impact of this in deciding whether this approach produced fair customer outcomes, which is discussed in detail below. In summary, we believe the outcome for customers is fair; however, the offer must be presented fairly so that the customer is clearly able to understand the cost of the cover for the remaining term if this approach was adopted by the firm. The firm could, for example, include a table outlining the future cost of cover based on the cancellation value at the time of offer and the remaining term such as:

If you cancel after…	You will receive…[4]	And the equivalent monthly cost is…
…12 months from the date of this offer	£575	£38.33 per month
…24 months from the date of this offer	£115	£38.33 per month
…36 months from the date of this offer	£0	£28.75 per month

16. We include this option due to the difficulties that brokers (those that broker the loan and the insurance, rather than just the insurance) might have in implementing the previous three approaches, being unable to change the loan terms and hold redress payments due to client money requirements. As such, this approach is reserved for the broker segment of the industry. If other firms wish to apply this approach, they must be able to demonstrate why they were unable to implement the previous three approaches.

Do these options provide fair customer outcomes?

[4] Assuming cancellation terms of: 65% in year 1, 45% in year 2, 25% in year 3, 5% in year 4 and 0% in year 5 equivalent monthly costs are calculated as:

(1035-575)/12 = 38.33
(1035-115)/12 = 38.33
(1035-0)/12 = 28.75

17. We considered whether the difference in the above approaches would provide different customer outcomes. Where these outcomes differed we considered whether we felt that the outcome remained fair for the customer. To test this risk we modelled the consumer outcome using each of the above implementation approaches, but changed variables such as the time of complaint, the policy and loan features, and the length of time the customer retains the cover on a regular premium basis. We found that:

   - Approaches A, B and C provide the same amount of redress throughout the period of the policy, though when the customer actually receives this redress varies for approach B (as some money is retained by the firm to pay for future regular premiums).

   - Approach D offers the same redress as approaches A, B and C at the point of complaint, but potentially a different amount if the customer chooses to retain the cover. The price of future cover will depend on three variables: the price of the original cover, the cancellation terms set out in the original policy and when the customer actually cancels.

18. Given the above findings, we closely considered whether it was appropriate to allow firms to take Approach D. We felt it important to have an approach that could be implemented by brokers. We felt that the risks of a potentially different customer outcome for approach D from A, B and C could be sufficiently mitigated if firms clearly explain the nature and consequences of the offer. We have limited use of approach D to brokers because of the potential for different customer outcomes to approaches A, B and C.

19. In making any offer under any of the approaches, we expect firms to act reasonably, treat customers fairly and meet the spirit of these proposals. This is particularly the case when a firm intends to apply approach D where the price of future cover differs materially from the alternative regular premium PPI referent price.

Open letter, including revised appendix to it (listing common PPI sales failings)

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COMMON POINT OF SALE FAILINGS FOR PPI SALES

Today the FSA has published guidance for the proper handling of PPI complaints. In consultation with stakeholders on these proposals and from our on-going supervisory work with firms and other intelligence, we have become concerned that one reason many firms are not handling PPI complaints correctly is because they are not applying the appropriate standards for the sale of this product. This is despite our having repeatedly reminded firms of these standards in numerous speeches, thematic reports and other publications over recent years. In order to remind your members of the appropriate standards, we have set out, in the appendix to this letter, common failings at the point of sale which result in poor outcomes for consumers. These failings have come to our attention, through thematic work, mystery shopping, and enforcement actions. They are not intended to be exhaustive.

As I am sure you will agree, there is no excuse for these failings and we will continue to take robust action – including disciplinary and other formal action as appropriate – when we identify them.

The FSMA regulatory framework covering the sale of general insurance commenced on 14 January 2005, so our Principles for Business and conduct of business rules have applied to PPI sales made on or after that date. In the FSA's view, the general principles of fair conduct by firms when selling PPI before 14 January 2005 have much in common with our standards after this date (see, for example, relevant extracts from GISC and ABI codes set out in the appendix). Firms should have regard to the list of failings when considering their point of sale obligations for earlier sales, including in the context of assessing complaints about such sales.

Yours sincerely

Christina Sinclair
Head of Department
Retail Policy and Conduct Risk Division

COMMON TYPES OF FAILINGS IN PPI SALES

General failings in the conduct of the sale

1. The firm:

- pressured the customer into taking a payment protection policy; or
- assumed the customer would want the payment protection policy from the outset (e.g. by automatically including it in a loan quotation); or
- led the consumer to believe that the payment protection policy had to be taken in order to obtain the loan (or other goods or services) or would improve his prospects of doing so; or
- made the sale without the customer's explicit agreement to purchase the payment protection policy; or
- did not disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading, that:
    - the payment protection policy was optional; or
    - the purchase of the payment protection policy involved the purchase of an insurance policy.

2. The firm did not disclose to the customer, in a way that was clear, fair and not misleading, the duration of the cooling-off period or that the customer could cancel the policy without penalty within the cooling-off period (and under ICOBS did not do so in good time before the conclusion of the contract).

3. The firm did not explain whether it was selling on an advised or non-advised basis.

4. The firm did not provide the written documents required under the FSA's rules (such as, for example, a policy summary, statement of price, or statement of demands and needs) and, where relevant, did not stress to the customer the importance of reading the material.

5. The firm provided misleading or inaccurate information about the policy.

Failings around eligibility, exclusions and limitations

6. The firm did not take reasonable steps to ensure the customer only bought a policy for which he

was eligible to claim benefits.

7. While arranging the policy, the firm was aware (or ought reasonably to have been aware) that parts of the cover did not apply but did not so disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading.

8. The firm did not disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading, the significant exclusions and limitations that would tend to affect the decisions of customers generally to buy the policy.

Failings specific to non-advised sales

9. Where seeking to sell on a non-advised basis, the firm:

- failed to make it clear it was only providing information on the policy; or
- gave advice to the customer regarding the policy (e.g. expressed an opinion on the merits of buying the policy).

Failings specific to advised sales

10. The firm advised on a policy without:

- taking reasonable care to properly establish the customer's demands and needs; for example, not seeking information from the customer on:
    - existing means the customer already had of protecting the loan (including existing insurance, benefits from employer, and assets such as savings and investments); any pre-existing medical conditions which might be excluded under the policy; whether the policy would be affordable in light of the customer's income and outgoings; and whether the customer's circumstances were likely to change; or
    - (for single premium policies) whether there was a prospect that the customer would repay or refinance the loan before the end of the term of the policy; or
- taking reasonable care to ensure that the policy was suitable for the customer's demands and needs taking into account all relevant factors, including level of cover, cost, and relevant exclusions, excesses, limitations and conditions.

11. The firm advised on a policy without disclosing to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading:

- that any of the customer's demands and needs would not be met; or
- that any part of the cover did not meet a demand or need; or
- any exclusions and limitations which were particularly relevant to that individual customer.

Failings around price disclosure

12. The firm did not disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading:

- the total (not just monthly) cost of the policy separately from any other prices (or the basis for calculating it so that the customer could verify it) and, for sales of regular premium policies, this included providing the total cost of the premiums; or
- (for a policy of over one year with reviewable premiums) the period for which the quoted premium was valid, and the timing of premium reviews; or
- (for sales under ICOBS) price information calculated in a way to enable the customer to relate it to a regular budget.

Additional failings specific to single premium policy sales

13. The firm sold the customer a policy where the total cost of the policy (including any interest paid on the premium) would exceed the benefits payable under the policy (other than benefits payable under life cover).

14. The firm failed to disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading:

- that the premium would be added to the amount provided under the credit agreement, that interest would be payable on it and the amount of that interest; or
- that the term of the cover was shorter than the term of the credit agreement and the consequences of such mismatch.

15. The firm failed to disclose to the customer, in good time before the sale was concluded, and in a way that was clear, fair and not misleading, that the customer would not receive a pro-rata refund if the customer were to repay or refinance the loan or otherwise cancel the single premium policy after the cooling-off period.*

* Although it would ordinarily have been a failing not to have disclosed this information to customers, firms might fairly have concluded that such disclosure was not necessary in

particular circumstances. Such circumstances are not likely to have been common, because this information was relevant whenever there was a prospect that the customer would repay or refinance the loan before the end of the term of the policy. When considering whether disclosure should have been provided, information on customers' general behaviour and information on the particular customer of which the firm was aware (or ought reasonably to have been aware) were relevant.

Face-to-face and telephone sales – clear, fair and not misleading communication

The Principles require firms to communicate information to the customer in all situations in a way that is clear, fair and not misleading. In sales primarily conducted orally, it was not enough just to provide important information in writing. So, we have found it to be a failing where the information was not communicated fairly during the sales discussion, by, for example:

- an oral explanation; or
- specifically drawing the customer's attention to the information on a computer screen or in a document and giving the customer time to read and consider it.

In addition, the requirement to pay due regard to a customer's information needs and communicate information in a clear, fair and not misleading way required the firm to provide balanced information when making reference to a policy's main characteristics (whether orally or in writing). So, we have found it to be a failing if, where the firm described the benefits of the policy orally, it did not also provide an adequate description of the corresponding limitations and exclusions in a way that was clear, fair and not misleading, for example orally. Further, ICOBS requires that, if a firm provides information orally during a sales dialogue with a customer on a main characteristic of a policy, it must do so for all the policy's main characteristics.

RELEVANT EXTRACTS FROM INDUSTRY CODES

The General Insurance Standards Council (GISC) promised in its Code that its members would:

- *act fairly and reasonably when we deal with you [the customer];*
- *make sure that all our general insurance services satisfy the requirements of this Private Customer Code;*
- *make sure all the information we give you is clear, fair and not misleading;*
- *avoid conflicts of interest or, if we cannot avoid this, explain the position fully to you;*
- *give you enough information and help so you can make an informed decision before you make a final commitment to buy your insurance policy.*

The GISC Code provisions further included that:

> *"3. We will give you enough information and help so you can make an informed decision before you make a final commitment to buy your insurance policy."*

> *"3.2. We will make sure, as far as possible, that the products and services we offer you will match your requirements …*
> - *If it is practical, we will identify your needs by getting relevant information from you.*
> - *We will offer you products and services to meet your needs, and match any requirements you have.*
> - *If we cannot match your requirements, we will explain the differences in the product or service that we can offer you.*
> - *If it is not practical to match all your requirements, we will give you enough information so you can make an informed decision about your insurance."*

> *"3.3 We will explain all the main features of the products and services that we offer, including …*
>
> - *any significant or unusual restrictions or exclusions;*
> - *any significant conditions or obligations which you must meet."*

> *"3.4 We will give you full details of the costs of your insurance.*
>
> *3.5 If we give you any advice or recommendations, we will:*
>
> - *only discuss or advise on matters that we have knowledge of;*
> - *make sure that any advice we give you or recommendations we make are aimed at meeting your interests; and*
> - *not make any misleading claims for the products or services we offer or make any unfair criticisms about products and services that are offered by anyone else."*

The Association of British Insurers (ABI) codes (which pre-dated GISC) also set out relevant requirements. For example the ABI General Insurance Business Code of Practice for all Intermediaries (1989) (the ABI Code) said that it *"shall be an overriding obligation of an intermediary at all times to conduct business with utmost good faith and integrity."*

The ABI Code stated as one of its general sales principles that the intermediary shall "ensure as far as possible that the policy proposed is suitable to the needs of the prospective policyholder." It also included requirements about "Explanation of the Contract". It said the intermediary shall "explain all the essential provisions of he cover afforded by the policy or policies he is recommending so as to ensure as far as is possible that the prospective policyholder understands what he is buying; [and] draw attention to any restrictions and exclusions applying to the policy."

PUB REF: 002089

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