

# News flash

## An Industry Under Attack – Three Times Table

**The FSA are definitely doing their job. In the interests of ensuring consumers are treated fairly, there has been a ‘blitz’ by the Financial Services Authority (‘FSA’) and the Office of Fair Trading (‘OFT’), who have teamed up for a two-pronged attack on firms allegedly mis-selling payment protection insurance. On 30 January 2007, the FSA fined the UK’s largest store card issuer, GE Capital Bank, £610,000, and total fines in this area have now reached £1.3 million in only 5 months. As the financial services industry takes another ‘hit’, Nilam Sharma, Misha Nateghi and Kirsten Addison-Smith report on what is being billed as the biggest mis-selling scandal since endowments.**

### What is Payment Protection Insurance (‘PPI’)

PPI is designed to protect mortgage, credit card or loan repayments when individuals are unable to work due to accident, illness or redundancy. Typically, PPI is purchased at the time of the credit agreement, with both being arranged by the lenders. Premiums are paid in addition to the consumer’s monthly credit repayments. Lenders are retail banks and building societies, although increasingly high-street shops and car dealerships are selling PPI to customers.

PPI is not mandatory in the sense of being a prerequisite to a consumer obtaining credit. However, many retailers encourage hard-sell tactics to ensure PPI is also purchased by the consumer, and have incentivised schemes for employees who meet successful sales targets.

About 7 million PPI policies are sold every year, with premiums bringing in about £5.5 billion for providers last year alone<sup>1</sup>. However, consumer watchdogs have complained that aggressive sales tactics, coupled with failures to provide enough information, have led to widespread mis-selling.

### Who is complaining?

Following its own investigation, the Citizens Advice Bureau (‘CAB’) made a ‘super-complaint’ to the OFT in September 2005, which **alleged that policies were being mis-sold to consumers who would never be eligible to make a claim.** Consumers often failed to realise that common conditions, e.g. back pain and stress, were excluded because the small print was rarely explained at the point of sale. The complaint also criticised **high premiums, low pay-out rates** on claims, and the **aggressive selling techniques** employed by retailers.

In an effort to reform these practices and protect consumers, the ‘super-complaint’ requested the OFT conduct a market investigation and work together with the FSA to develop a joint strategy for regulation of the PPI industry.

### Regulatory Response – OFT, FSA, Competition Commission...

The OFT launched an extensive market study and reported its findings in October 2006<sup>2</sup>. The OFT concluded that consumers were being given an unfair deal when purchasing PPI because they were not given enough information to make an educated decision; and sales practices were hindering competition. **On 8 February 2007<sup>3</sup>, the OFT exercised its powers to refer the PPI industry to the Competition Commission.**

The OFT is not the only UK regulator with an offensive strategy. The PPI industry has also been identified as a top priority by the FSA, who issued a study on their investigations into the market<sup>4</sup>. The FSA identified 3 key areas of widespread concern:

- 1) Lack of clear information during the sales process, e.g. PPI is optional, misleading information on costs of cover;
- 2) Customers were not made aware of the situations in which they could not claim, i.e. insufficient information/disclosure; and

<sup>1</sup> OFT, PPI: Report on the market study and proposed decision to make a market investigation reference, October 2006, page 14.

<sup>2</sup> As above.

<sup>3</sup> Financial Times, 9 February 2007.

<sup>4</sup> FSA, ‘The Sale of Payment Protection Insurance – results of follow-up thematic work’, October 2006.



- ▶ 3) Policies were not always sold in the best interests of the customer, i.e. suitability.

Consequently, the FSA indicated it would implement a programme for urgent remedial action, including formal discipline against firms who fell below the required standards. Margaret Cole, Director of Enforcement at the FSA said, **“We are determined to see significantly better practice in PPI sales and will crack down where firms fail to treat their customers fairly.”**<sup>5</sup>

Several firms have already been ‘named and shamed’ by the FSA. Besides GE, the FSA has also imposed fines on Loans.co.uk (£455,000), Redcats (£270,000) and Regency Mortgage Corporation (£56,000). The main failings of these firms were breaches of Principles 2, 3 and 6<sup>6</sup>. In particular, the FSA agreed with the CAB allegations that consumers had been sold policies who either already had cover in place or were ineligible to make a claim. The FSA also penalised firms for failing to provide customers with sufficient information about the PPI terms and conditions.

In January 2007, the FSA launched a third phase in its crackdown on PPI sales, due to be completed June 2007, which will include mystery shopping and firm visits.

In addition, the regulators as a whole (with the approval of the Financial Ombudsman) are encouraging consumers to claim compensation if they feel they have been sold PPI unfairly. **It is estimated that compensation payouts could exceed £10 billion if claims are upheld**<sup>7</sup>.

#### A co-ordinated attack

As an aside, the investigation and enforcement work in this area is a good example of joint regulatory strategies working in practice. Both the OFT and FSA have a mission to protect consumers: the OFT by considering the unfair competitive effects on the market, and the FSA by taking action against firms who act irresponsibly and mislead consumers.

**In April 2006, the OFT and FSA announced their intention to collaborate on matters of joint regulatory interest**<sup>8</sup>, recognising they had different, but complementary, powers and statutory objectives. A closer working relationship would also reduce administrative burdens on firms, improve the information available to consumers and deliver risk-based regulations.

This approach fits into an emerging theme of regulators collaborating and communicating to achieve common objectives i.e. protect consumers and ensure the financial and

corporate markets are kept clean, orderly and efficient. The FSA has also recently warned retail investors of the potential dangers of relying heavily on property funds, over-diversifying portfolios and criticised the practices of mortgage lenders and the advice they give to borrowers.

Similarly, the OFT has launched investigations into alleged price-fixing in industries such as holiday travel, retail sports kits, and toys, placing an emphasis on involving the media in educating consumers about their rights and the financial markets.

These consumer warnings are expected to increase in frequency as regulators continue to devote considerable resources to ensuring consumers are protected, treated fairly and given the right information to make appropriate decisions.

#### Impact

The financial services industry and their Insurers will have short memories of the recent run of mis-selling scandals: Pensions, Splits, Precipice Bonds and Endowments. Care must be taken when completing proposal forms and questionnaires, so that agreed Policy terms and conditions protect both insureds and insurers. Once again the threat of compensation claims, adverse publicity, higher premiums and deductibles, as well as the repeat arguments on aggregation are very familiar to all. One more word of caution; all parties also need to be mindful of the increasing number of co-ordinated and multiple regulatory investigations. This begs the question: when is a regulatory investigation really over?

<sup>5</sup> ‘FSA fines GE Capital Bank’ press release, 30 January 2007.

<sup>6</sup> Principle 2: A firm must conduct its business with due skill, care and diligence.

Principle 3: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.

<sup>7</sup> Financial Times, 4 February 2007.

<sup>8</sup> OFT Report, page 28.

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