EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

EIOPA-BoS-13/116
28 June, 2013

Background Note on Payment Protection Insurance

Contents

Part I – Comparative analysis of consumer protection issues regarding PPI

1. Some characteristics of PPI products

1.1. Risk coverage and underlying loan products

1. ***Risks covered: Accident, Sickness, Unemployment, Life.*** Payment Protection Insurance (PPI) is an insurance product designed to provide coverage for the consumer of a financial obligation in case they are unable to fulfil a payment. The risks covered by PPI generally include accident, sickness and unemployment, and for certain products often life.[1]

2. ***Related 'damage to property' coverage.*** PPI generally covers risks that are related to the person having a financial obligation; however, it is sometimes combined with coverage that is related to the underlying property. Thus, although generally PPI is understood to provide coverage for the risks listed above, in some cases a more general coverage is understood under payment protection. However, it is worth mentioning that in Italy and Spain mortgages are often sold together with insurance covering damage to the property as well.

3. ***Underlying loan products.*** The payment obligation PPI provides coverage for is generally associated to a loan product.[2] Loan products that are most frequently associated with PPI are different types of consumer credit (most notably credit cards and personal loans) or mortgage loans.

4. ***Alternative PPI products.*** There might be products that have different names but serve very similar purposes, with some products appearing as contractual clauses instead of a separate insurance product. To the extent they share some of the same characteristics as PPI, these newer products could pose some of the same risks, unless undertakings take particular care with their product design and sales practices.[3]

5. ***This background note generally covers both mortgages and consumer credits***. This background note covers both mortgages and unsecured loans (consumer credits). It must be pointed out that mortgage-PPI has in certain aspects different characteristics than PPI providing coverage for consumer credit (CC-PPI). However, these characteristics might differ from country to country and also from product to product in a given country. The table below is an indication of likely differences; these differences are reflected in the analysis and country case studies as well.

---

[1] PPI providing life coverage differs from general life insurance in being adjusted to the loan contract; contracts often have banks as beneficiaries. Mortgage insurance generally includes life coverage.

[2] There are some products that provide coverage for other type of payments. (e.g. utility payments.)

[3] This issue has been addressed most extensively in the UK; see chapter 12.

Table 1. Differences between PPI related to mortgage and consumer credit (CC)

	Mortgage-PPI	**CC-PPI**
Accident, Sickness, Unemployment Coverage	Likely	Core part of the product
Life coverage	Very likely	Unlikely
Benefits	Likely to be full amount of the loan	Likely to be a lump sum
Duration of coverage	Very likely to adjust to loan	Likely to be fixed in a certain number of moths
Premiums paid	Monthly, sometimes single	Monthly, often single
Takes consumer differences into account	Possibly	Unlikely

1.2. Use and some characteristics of PPI

6. ***PPI can serve legitimate consumer needs***. EIOPA acknowledges that PPI products, when properly designed and sold, serve legitimate consumer needs. Yet, EIOPA also acknowledges that, in a number of jurisdictions, significant cases of misselling have occurred, to the detriment of consumers and negatively affecting the reputation of the insurance sector as a whole.

7. ***Product complexity and differentiation.*** PPI combines coverage for a number of different risks and the numerous limitations and exclusions may prove challenging for consumers.[4] A part of this complexity is sometimes not reflected in offers for the consumers. Although consumers may represent very different risks, and may only need coverage against certain risks, (especially in the case of consumer credit) PPI tends to be sold as a "*one-size-fits-all*" product, without any differentiation regarding the consumer. In the case of *mortgages* a *more differentiated* product structure and individualised offers are more likely.

8. ***Advised vs. non-advised sales.*** Given the complexity of the coverage and the sometimes extensive lifetime of the product (especially in the case of mortgages), some countries may only allow the distribution of certain PPI products on an advised basis. However, given that sometimes the products manifest in rather simple offers, some jurisdictions also allow for non-advised sales.

9. ***PPI issues must be assessed on a product-by-product basis.*** Whereas this note lists the most common issues that have arisen around PPI, it is generally true that any PPI intervention must take into consideration the specific characteristics of the local products concerned, i.e it must happen on a case-by-case basis.

[4] There is a unique understanding of coverage for certain products in Spain, as PPI for unemployment or temporary disability only provides coverage for either unemployment or temporary disability, depending on the labor situation of the policyholder (see more in the chapter about Spain)

2. Consumer protection issues with PPI

10. ***Overview.*** Payment protection insurance has been on the agenda for many different reasons in different jurisdictions. An issue that certainly drew a lot of public and media attention is mis-selling, where breaches of business conduct rules resulted in significant consumer detriment, most notably in the UK. However, apart from mis-selling, there are further market imperfections that resulted in regulatory and supervisory intervention in a number of countries.

2.1. Issues in the distributor-customer relationship (mis-selling)

11. ***Providing misleading information at the point of sale.*** When buying PPI, consumers often receive a lot of misleading information that distort their choice. This distortion may materialize in consumers purchasing PPI in cases where they did not have to; or consumers purchasing PPI policies that represent a suboptimal choice for them.

12. ***Examples of misleading information.*** There might be very different pieces of information that influence a decision by the consumer. Some examples of misleading information are: (the list being obviously not exhaustive):

a) Misleading the consumer into believing that taking out PPI is *compulsory by law, where applicable*
b) Misleading the consumer into believing that PPI is an integral part of the loan product
c) Making the false impression that taking out PPI improves the chances of obtaining the loan
d) Not disclosing the main features of the policy to the customer on time (or not disclosing it at all)
e) Misleading the consumer about whether the fees paid are in relation to the insurance or credit product

13. ***Eligibility issues.*** Distributors have often not checked whether the given policy is suitable for the customer given their demands and needs. PPI distributors often marketed policies to consumers who were *not eligible to claim benefits* at all. These issues frequently involved selling unemployment cover for self-employed or medical insurance to people who were not able to claim benefits because of some pre-existing medical condition.

14. ***Suitability issues.*** Further, even if being eligible to claim benefits, the product was *not always suitable* for the consumer, and thus undertakings have not acted in the best interest of the consumer. This might have included selling

PPI for very small loans or credit card users who generally repay the outstanding balance in full every month.[5]

2.2. Market imperfections

15. ***Market imperfections***. Although there is limited information available to make general statements on Europe, PPI markets seem to be a highly profitable in a number of countries. It seems that some market imperfections[6] are quite frequent for PPI, and they might result in consumers being unable to take advantage of a properly functioning market.

2.2.1. Distorted consumer choice due to cross-selling

16. ***Tying.*** PPI is generally distributed together with a credit product. Sometimes distributors require that the consumer purchasing the loan purchases the insurance product from a designated (often the same) company (or group). The situation where the acquisition of a given insurance product with the credit product is made mandatory by the loan provider is generally referred to as a *tying practice*.[7]

17. ***Potential effects of tying.*** Tying practices result in a situation where consumers have no choice between different insurance policies – if they wish to obtain the loan from a given company, they have to purchase an insurance policy chosen by that loan provider. This is likely to leave consumers ending up with a product that is not best suited for their needs, as the policy may offer suboptimal coverage or may prove to be too expensive.[8]

18. ***Bundling.*** There might be other forms of packaged distribution where the packaged services are available separately, but not necessarily on the same terms. This practice is generally referred to as *bundling*. This could mean for example a price reduction for credit products if purchased together with PPI, as credit risk is reduced with the purchase of an insurance product.

19. ***Potential effects of bundling.*** Bundling practices may have the same harmful effects as tying practices. They are generally considered less harmful, as they necessarily leave some choice for the consumers, however, they might have the same distorting effects for consumer choice.

---

[5] Eligibility and suitability issues have been examined e.g. in Ireland, the Netherlands and the UK, see the respective case studies.

[6] The terms 'market imperfections' and 'market failure' are generally used to describe where the allocation of goods and services by the free market is not efficient, and could potentially be improved by regulatory intervention.

[7] Insurance with a loan may also be obligatory by law.

[8] These detrimental effects could theoretically be offset by fierce competition for the packaged product (credit +insurance), however market developments indicate that this is unlikely to be the case.

20. ***Cross-selling with no rebates.*** Even when there is no difference between the conditions for the packaged product and the same products sold separately, cross-selling can have an effect on consumer choice. Market characteristics, especially the lack of transparency may result in a situation where the mere fact of selling two or more products together creates considerable market power for distributors.

21. ***Market power in distribution for loan providers.*** Market power is the economic concept of the ability of a firm to profitably raise the market price of a good or service over marginal cost and thus has a great effect on consumer choice. The most obvious distribution channel for underwriters is through loan providers and this is likely to result in considerable market power (economic strength) for loan providers. This market power is likely to be further strengthened with the application of tying or bundling practices. In PPI markets consumers are often mainly engaging with the loan product offered and not with the accompanying PPI product or its cost. This can lead to loan providers having a potentially captive audience who do not shop around for alternative insurance cover and thus do not drive down costs through competition. Loan providers are thus potentially able to exert market power and charge excessive prices for PPI and make super-normal profits from it. [9]

22. ***Competition for distributors puts an upward pressure on commissions.*** Market power for loan providers results in a situation where PPI underwriters are more likely to compete for distributors and not directly for consumers. This is often reflected in a business model where a loan provider issues a tender for PPI underwriters. Among other factors, the profitability for the banks is an important factor in these tenders, which have exerted an upward pressure for commission levels.[10]

2.2.2. Group insurance contracts

23. ***Group insurance contracts may have an effect on market power.*** There is evidence that some distributors (credit providers) enter into a general agreement with insurance providers. This might have an effect on the market power described above, as in certain cases the insurance element becomes a part of the credit contract, leaving consumers no choice in choosing PPI. On the other hand, group contracts may result in more favourable offers from insurers, but the pass through of these benefits to consumers is not confirmed.

24. ***The effect of vertical integration.*** Credit providers, the most important distributors of PPI sometimes sell insurance coverage from a company belonging

[9] Market power of economic strength is a key concept in competition law (antitrust). However, antitrust intervention is likely only when market power amounts to a dominant position in the market; on the other hand, market power may have a considerable distorting effect on consumer decisions also in cases where the intervention thresholds for competition law are not met.

[10] UK Competition Commission (2009).

to the same group. This may lead to higher commissions, although a market study in the UK found that vertical integration was a less important element in the very high market power distributors have enjoyed in the PPI market.

25. ***Uncertainties around beneficiaries.*** Group insurance may result in a situation when there is no contractual relationship between the consumer and the insurance company at the time of contract signing, and as a result of this, consumers might be deprived of their choice whether they want to take out PPI at all. Further these uncertainties may make claims more burdensome for consumers as well.[11]

2.2.3. Information asymmetry

26. ***Lack of information on PPI prices level and comparability.*** A further issue making consumer choice more difficult is the fact that consumers do not receive, or only receive relatively late their personal quote, i.e. the individual price information. The *lack of individual price information* makes the comparison of offers from different providers very difficult.

26. ***Limited financial literacy on PPI.*** Generally, consumers showed limited financial capability when purchasing PPI. Many consumers often do not realize that PPI is an independent product and separate to the loan. Consumers were therefore not engaging with or understanding the PPI product because they were focusing on the loan product. Consumers often believe that purchasing the insurance policy is compulsory, or that doing so would improve their chances of obtaining credit.

2.2.4. Product design issues

27. ***Selling PPI with single premium.*** In some countries, many firms have sold PPI with a single premium, meaning that the consumers had to pay a fixed amount at the beginning of the credit contract. Consumers sometimes were not aware that the premium will be added to the loan amount, and interest would be payable on that. The single premium design caused further problems with early termination of the underlying credit products, as a refund for the insurance policy was difficult to obtain.

28. ***Refund issues.*** A lot of uncertainties have arisen around cancellation of the policies, where consumers should be entitled to a certain refund. Undertakings tend to follow diverging policies when determining rate of refunds. Consumers also often found the refund process very burdensome.

29. ***Limitations in coverage.*** In many instances, product design issues made consumer detriment more likely. PPI products were often designed to provide

[11] Consumer protection issues around group insurance have been experienced in France, Hungary and Portugal; see the respective case studies.

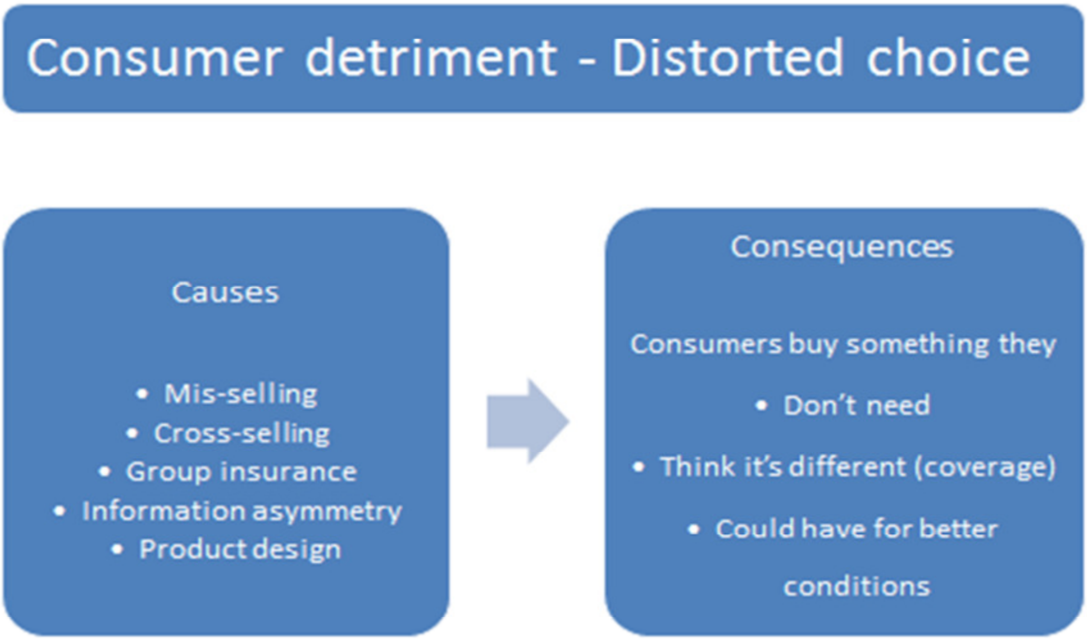
only very limited coverage, which are likely to have contributed to frequent occurrence of poor consumer choice.

30. ***Duration mismatch.*** Some PPI products had a duration mismatch, i.e. the duration of the insurance cover was shorter than the duration of the underlying credit product. This is less frequently the case for mortgages, however occurs very frequently for consumer loans.

31. ***Unfair terms.*** An example of unfair terms in the contract is when consumers are given a very limited time period after an event (for example, 6 months after an accident, illness or unemployment) in which they can make a claim. Another example is terms that prevent consumers from receiving any refund of the premium if they want to cancel the PPI policy for any reason, for example if they repay the associated loan early[12], and they are no longer able to claim under the insurance, or simply do not want to have the cover any more.

32. ***Overview***. The following picture gives an overview about the causes of potentially distorted consumer choice in PPI, and gives an overview about the potential consequences.

Causes for distorted consumer choice in PPI



[12] Some insurance contracts terminate with the repayment of the loan. However, in many cases insurance contracts require further action from consumers to terminate after loan repayment.

3. Examples of regulatory and supervisory actions for better functioning markets in PPI

33. ***Overview.*** This chapter gives an overview about regulatory and supervisory action for better functioning PPI markets. It lists the types of market intervention and then discusses the measures applied according to the market problems discussed previously.

3.1. Types of market intervention

34. ***Supervisory enforcement action***. Generally, non-compliance with the rules governing consumer relations are best tackled by enforcement actions targeting the poor behaviour of the supervised undertakings. Failings in the distributor-consumer relationship have been targeted by supervisory action.

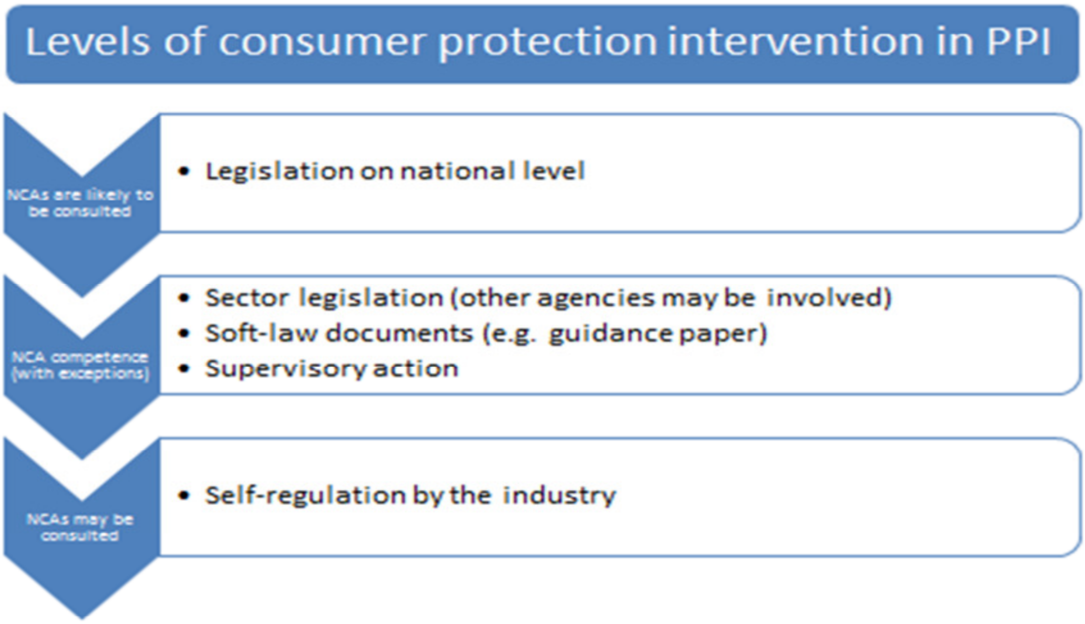
35. ***Sector legislation or guidance.*** Some of the issues around PPI were so widespread and amounted to such level of complexity, that in order to achieve clarity, a supervisory guidance or normative action was necessary.

36. ***Legislative action.*** The large number of market imperfections made PPI an area where regulatory intervention became frequent. Legislative actions on different levels have been introduced to correct for market imperfections.

37. ***Industry self-regulation.*** There have been examples of industry self-regulation, where undertakings decided to impose restraints on their activities by themselves, in order to ensure to compliance and the better functioning of markets.

38. ***Consumer protection intervention and NCA role.*** The following picture gives an overview about types and levels of consumer protection intervention, and gives an indication of what roles NCAs could probably play in different types of interventions.

Levels of consumer protection intervention in PPI



3.2. General measures against mis-selling

39. ***Supervisory actions enforcing compliance.*** The most common tools to tackle any kind of mis-selling issues are increased supervisory actions. However it must be borne in mind that this is a very resource-intensive measure, and that certain problems may justify the use of more general measures.

40. ***Ensuring proper complaint-handling by firms.*** Since consumers are likely to address firms with their issues first, it might prove very useful to ensure that their complaints are handled properly at this level. Some jurisdictions have addressed complaints-handling explicitly for PPI, with the UK issuing supervisory guidance on the issue.

41. ***Requesting firms to review their sales.*** Given that the number of contracts affected by a certain problem may be enormous, some countries requested their PPI providers to review their sales for a given period, according to certain criteria. This is a still on-going process in Ireland, for example.

3.2.1. Measures against selling to unsuitable consumers

42. ***Guidance on identifying suitability of consumer.*** As mis-selling problems often involved sales to unsuitable consumers, supervisors might improve the functioning of the market by issuing guidance on this topic based on the experience available. There has been a supervisory guidance on this topic by the Netherlands.

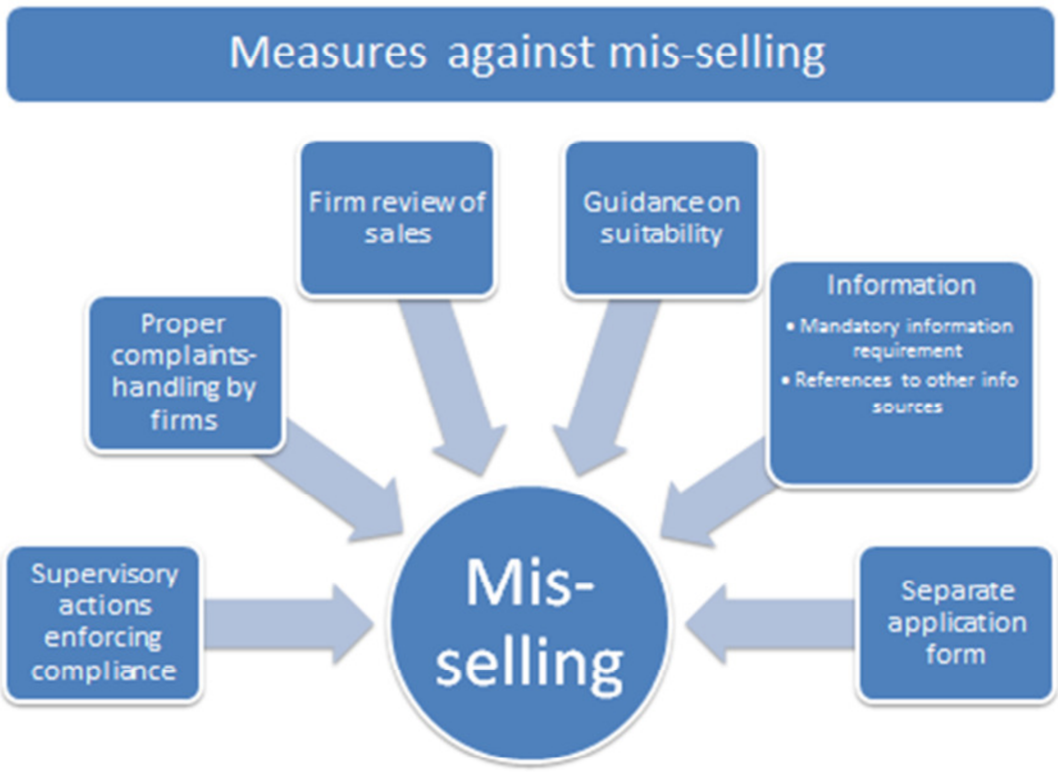
3.2.2. Measures against misleading information

43. ***Mandatory information requirement on certain topics.*** The fact that consumers are presented with certain misleading information often stems from certain omissions, e.g. distributors not mentioning that PPI may not be compulsory or that PPI is a separate product. These issues can be tackled with requiring mandatory information on certain topics. For example, in the UK an offer now must explicitly state that PPI is not mandatory, and that it is available from other providers as well. French and Italian regulation also requires to provide general information on risks and payoffs.[13]

44. ***Including references to information sources.*** A further measure enhancing the effect of mandatory information requirement is to include references to other information sources. This is likely to be the case for information that may not be available at the point-of-sale, such as information on other offers or comparison measures.

45. ***Raising consumer awareness by separate application forms.*** To ensure that consumers easily realise that the loan and PPI are separate products, the use of a separate application form is required in Ireland and Italy.

Overview of measures against mis-selling



[13] ISVAP Regulation 40 (2012), Lagarde law France (2010)

3.3. Measures against market power arising from cross-selling

46. There have been several types of measures that are aimed to help consumer choice by limiting market power arising from several types of cross-selling.

47. ***Prohibition of tying.*** The mandatory purchase of PPI from a given provider in some jurisdictions triggered special regulation that explicitly prohibited these tying practices for PPI and loan products. The 2010 changes in the French legislation made sure that loan providers are not allowed to request mandatory purchase of insurance from the same provider or group.[14] Furthermore, Portuguese law[15] prohibits certain *exclusive agreements* as insurance intermediaries (such as banks, which may act as tied agents) are not allowed to impose a condition on the consumers to enter into an insurance contract with a specific insurance undertaking in order to gain access to another offered good or service. This provision tackles *exclusive agreements* (*i.e.* the imposition of the provider for an additional product)[16].

48. ***Ensuring equal assessment of independent PPI policies.*** To ensure that consumers may take advantage of their search for PPI, regulators may prescribe that loan providers must grant equal conditions for the loan irrespective of the PPI provider. An example for that is a recent Italian regulation that, in the case of life insurance, allows 10 days for consumers after receiving a loan and PPI combined offer to come up with an alternative offer; the loan provider has to accept this alternative coverage without changing the conditions of the offer. The recent French legislation provides that lenders cannot refuse equivalent offers from other PPI providers.[17]

49. ***Introducing alternative offers at the loan point-of-sale.*** A measure of improving consumer choice at the point of sale is the requirement on loan providers to present two or more competing offers to the consumer there. This obviously allows for more choice, however it still *may allow for some distortion* by distributors as they may steer customers towards a given offer by not presenting the most competitive alternative offers. The relative popularity of this measure could be explained by the limited number of PPI providers.

50. ***Prohibiting conflicts of interest.*** Another potential way of influencing the availability of offers at the point of sale is to put a prohibition on certain

[14] France “Code de la consummation” Consolidated version (changes introduced in 2010)

[15] Portuguese law on taking-up and pursuit of insurance mediation (Decree-Law no. 144/2006, of 31 July, as amended). Other specific provisions governing the sale of consumer credit and mortgage loan are also relevant in this context

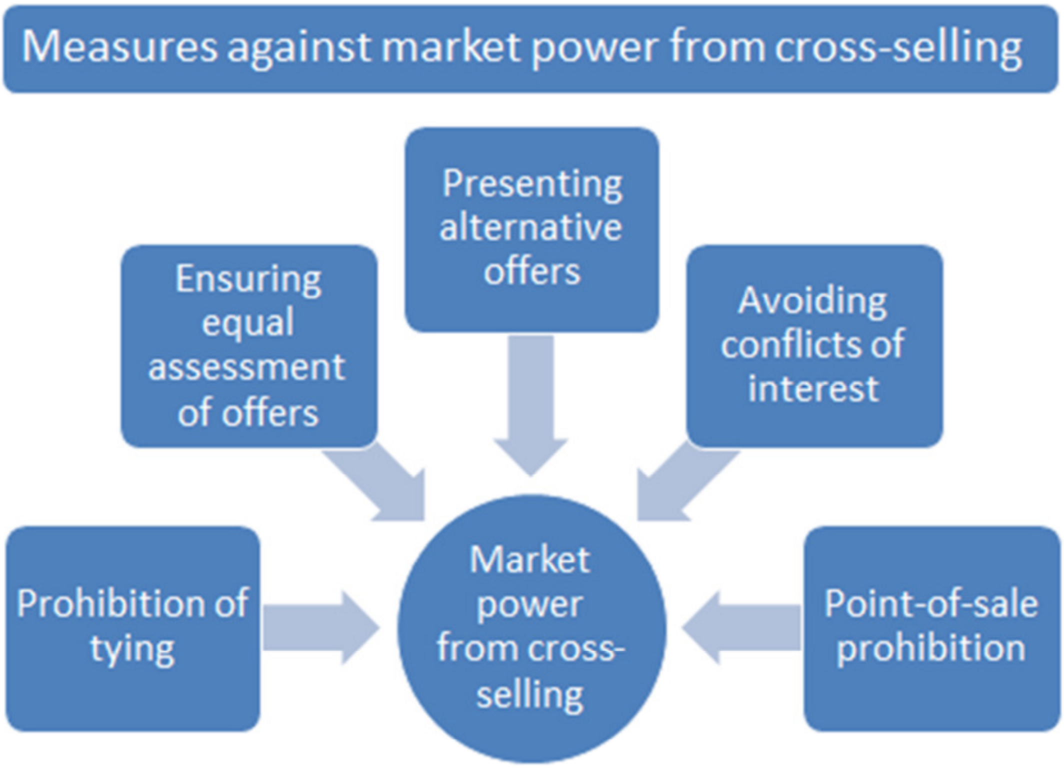
[16] Please note that the mentioned rule is not only applicable in market power leverage situations; it has the broader purpose of consumer protection.

[17] ISVAP Regulation 40 (2012), Lagarde law France (2010)

conflicts of interest. In Italy, for example loan providers are not allowed to be the beneficiary and distributor of the insurance contract at the same time, because it conflicts with the distributor's duty to act in the best interest of the consumer. However, sales commissions are often high both when selling PPI products of firms that belong to the same group or not. For the UK, a study found that vertical integration did not influence commission and price levels.[18]

51. ***Prohibiting PPI sales at the loan point-of-sale.*** To ensure a proper "unbundling" of the loan and the insurance products, the UK has introduced a prohibition of selling PPI at the loan point-of-sale, and requires that PPI is not sold until after seven days after the loan was sold. This measure certainly *limits the market power* on behalf of the loan providers. However it may have a negative effect on sales, as consumers' willingness to enter into an insurance contract may deteriorate with time after signing the loan contract.

Overview of measures against market power from cross-selling



[18] UK Competition Commission (2009)

3.4. Comparability of information

3.4.1. Comparability of offers

52. ***Obtaining a personal quote.*** To ensure that consumers can compare the available offers, an obvious measure is to ensure that they receive personal information. In the case of PPI, the actual financial obligation is often challenging to calculate and assess, which is why considerable emphasis is put on ensuring that consumers receive personal quotes in due time. Italy and the UK are examples of this practice.

53. ***Price disclosure.*** To ensure the comparability of individualized information, there might be rules that prescribe that the information must be presented in a standardized format. Generally these rules require providers to disclose the price of PPI in "monthly euros" (or other currency). These rules may complement the use of a personal quote or may stand alone by themselves – price disclosure in a standardized format may in itself help comparability (see rules in France).

54. ***Other standardized information.*** Apart from price, a standard format for other types of information could obviously further contribute to comparability. Italy applies a standardised format for presenting price and product characteristics making it easier for consumers to compare alternative offers.

3.4.2. Comparison tools

55. ***Comparing at the point of sale.*** Given that selling PPI with a loan product is a major way of distribution, it makes sense to introduce competition at this stage. As already presented among measures against cross-selling, some jurisdictions (Italy for life insurance)[19] require undertakings to present at least two competing offers on PPI for the consumer. Again, the fact that this information covers only a part of the market may allow for some distortion in consumer choice.

56. ***Online tools.*** Online tools play an ever increasing role in ensuring market transparency, and some countries explicitly targeted improved disclosure through these channel. The UK has ordered PPI providers to populate a comparison website run by the FSA, and Italy ordered companies marketing life insurance linked to loan to have a free online quotation service on their website; further IVASS lists all these products at its website.[20]

---

[19] Decree law N.1 of 24.1.2012 in Italy

[20] Competition Commission (2011), ISVAP (2012) Regulation n. 40 of 3 may 2012

3.5. Product regulatory measures

57. ***Minimum content.*** Uncertainties around the scope of coverage can be reduced if regulation actually determines some aspects of the product. In Italy, recent regulation prescribes the minimum content of life insurance contracts related to mortgages and personal loan products.[21]

58. ***Prohibition of single premium policies.*** The information uncertainties (additional interest on premium) and the early termination difficulties led countries to explicitly prohibit the selling of these types of products. Currently, the UK has an explicit prohibition on selling single premium policies.

59. ***Regulating refund process.*** As early termination issues have resulted in many uncertainties, some countries decided to focus on the refund process[22] to ensure a more favourable outcome for consumers. Refund regulations may allow for deduction of certain administration costs, but generally they aim at a full pro rata refund of the premium.

60. ***Price maximum on PPI advice fee.*** Based on a very special regulatory environment, there has been a self-regulatory price cap negotiated on PPI advice fee in the Netherlands. This was largely based on the fact that intermediaries tried to circumvent the ban on consumer credit advice fee bans by charging excessive fees on PPI advice.

[21] ISVAP (2012) Regulation n. 40 of 3 may 2012

[22] There are detailed self-regulatory rules set by UNESPA in Spain, for example.

Part II –Case studies

61. The following country case studies are set out in the alphabetical order of the names of the countries.

4. Rules affecting PPI in the Consumer Credit Directive

62. ***Rules on PPI for consumer credits.*** The Consumer Credit Directive[23] adopted in 2008 contained several rules that affect certain ancillary products which are distributed together with credit products. PPI, as an insurance product is seen as one of these products, so the rules of the directive carry relevance for PPI linked to consumer credit. It must be pointed out, that some countries decided to apply some special (usually stricter) rules regarding PPI when transposing the directive.

63. ***Pre-contractual information on whether PPI is necessary.*** According to the Consumer Credit Directive, credit providers must give adequate pre-contractual information if purchasing insurance is necessary. The information shall specify if there is "an obligation, if any, to enter into an ancillary service contract relating to the credit agreement, in particular an insurance policy, where the conclusion of such a contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed."[24]

64. ***Total cost for credit includes premiums for mandatory insurance as well.*** In cases where insurance is mandatory for obtaining credit (or obtaining it on the conditions marketed), the indicators depicting the total cost of credit should include insurance premiums in their calculation as well.[25] If the cost of that service cannot be determined in advance, the obligation to enter into that contract shall also be stated in a clear, concise and prominent way, together with the annual percentage rate of charge.[26]

5. PPI in France

5.1. PPI market specialities in France

65. ***Mortgages.*** Mortgage protection insurance is not legally mandatory but is often made mandatory by credit institutions in France. Mortgages have been sold

---

[23] *CCD Directive*: Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit agreements for consumers and repealing Council Directive 87/102/EEC

[24] CCD Directive Article 5 (1) (k)

[25] CCD Article 3 (g) reads as follows: 'total cost of the credit to the consumer' means all the costs … the consumer is required to pay in connection with the credit agreement … costs in respect of ancillary services relating to the credit agreement, in particular insurance premiums, are also included if, in addition, the conclusion of a service contract is compulsory in order to obtain the credit or to obtain it on the terms and conditions marketed;

[26] CCD Article 4 (3)

together with insurance as a package until recently, where new measures have been introduced to improve consumer choice.

66. ***Coverage***. Mortgage protection insurance is very closely related to life insurance as it pays off the whole debt in case of death. Mortgage protection insurance is a differentiated product, where price may vary according to the borrower's status and condition.

5.2. Regulatory and supervisory action in France

67. ***Case law.*** Some case law decisions have set out requirements in the area of consumer protection in relation to PPI. When distributing PPI, credit institutions have to check the adequacy of the insurance contract to the consumer's needs.

68. ***Rules in the French Insurance Code.*** The French Insurance Code provides that insurance intermediaries have the duty to give an advice to their customers, in the form of a personal recommendation taking into account the demands and needs of consumers, when distributing insurance products, which includes PPI.

69. ***Rules in the French Consumer Code.*** The French Consumer Code contains important provisions on mortgage protection insurance. Key elements of the regulatory framework include:

- **Prohibition of tying / Freedom of choice**: Lenders are not allowed to refuse equivalent cover by any insurer even when it does not belong to the same group as the bank providing the loan. All refusals must be justified. Moreover, lenders are not allowed to offer more favourable credit conditions to creditors who choose PPI contract from the same group where the bank belongs.[27]
- **Information on freedom of choice:** The Consumer Code requires explicit information that consumers have the freedom to choose the insurer: the law requires lenders to make a written offer to natural persons, also stating that the borrower is free to choose his insurance company.[28]
- **General information requirement for PPI:** A standardised information document must be provided together with the loan offer listing all potential risks and the main terms and conditions of the insurance.

[27] "Code de la consommation" Consolidated version 01/01/ 2013 Articles L312-9. *Le prêteur ne peut pas refuser en garantie un autre contrat d'assurance dès lors que ce contrat présente un niveau de garantie équivalent au contrat d'assurance de groupe qu'il propose.* and *Le prêteur ne peut pas modifier les conditions de taux du prêt prévues dans l'offre définie à l'article L. 312-7, que celui-ci soit fixe ou variable, en contrepartie de son acceptation en garantie d'un contrat d'assurance autre que le contrat d'assurance de groupe qu'il propose.*

[28] "Code de la consommation" Consolidated version 01/01/ 2013 Articles L312-7 and L312-8

Subsequent modifications to these are only possible with the consent of the borrower.[29]

- **Price disclosure in monthly euros:** When offering PPI with a consumer loan, the lender or credit intermediary must inform the borrower of the standard cost of insurance, using a numerical example in euros per month.[30] More detailed provisions on price disclosure for mortgage loans are set out in a report from the Consultative Commission of the Financial Sector (CCSF) providing for a standardized information sheet[31].

70. ***The Lagarde legislation.*** The current framework is a result of the **Lagarde law[32]**, which was aimed at transposing the Consumer Credit Directive with further consumer protection measures. The relevant provisions of the law entered into force from September 2010. Some provisions were already a widespread practice according to a publication by the French Banking Association.[33]

6. PPI in Hungary

71. ***Group insurance contracts.*** The Hungarian Financial Services Authority has highlighted a potential concern for consumers in its 2010 Consumer Protection Risk Report. According to the report, most of the existing PPI agreements in Hungary were concluded in the form of group insurance contracts, where the insurance contract is established between the insurance company that assumes the risk and the financial institution that grants the loan.

72. This results in a situation when there is no contractual relationship between the consumer and the insurance company at the time of contract signing, and since the participation in the group coverage is incorporated to the loan agreement between the consumer and the bank, consumers might be deprived of their choice whether they want to take out PPI at all.[34]

7. PPI in Ireland

7.1. PPI market specialities in Ireland

73. ***Size of the market and products affected.*** It is estimated that around 340,000 Payment Protection policies were sold between 2007-2012 in Ireland. These policies are sold in connection with personal loans, car finance, credit

[29] "Code de la consommation" France Consolidated version 01/01/ 2013 Articles L312-9.
[30] "Code de la consommation" France Consolidated version 01/01/ 2013 Articles L311-6 III.
[31] http://www.banque-france.fr/ccsf/fr/telechar/publications/rapport_annuel_2008_2009/CCSF_2008-09_ichapitre_4.pdf
[32] LOI n° 2010-737 du 1er juillet 2010 portant réforme du crédit à la consummation (Consumer credit law)
[33] Federation Bancaire Francaise (2011) Fiche 13/04/2011
[34] PSZAF (2010) The HFSA's Consumer Protection Risk Report, H2 2010 p. 37-38.

cards and mortgages[35]. In Ireland, life insurance is sold separately to Mortgage PPI; therefore Mortgage PPI does not include life coverage. However, typically CC-PPI does include life coverage. For benefits, PPI benefits include the payment of a number of monthly credit repayments. It is only in the case of death that a lump sum is paid as a benefit in CC-PPI

7.2. Market problems in Ireland

74. ***Recent issues.*** PPI insurance has been subject to a number of supervisory reviews, regulatory actions and some complaints in Ireland. These mostly have focused on the sales process, with the most recent issues being the following:

a) **Focusing on eligibility instead of suitability** – Undertakings did not always use the information gathered from consumers to assess the suitability of PPI to the consumers. Instead they focused only on assessing consumers' eligibility for PPI.

b) **Timing of information provision** – key information such as terms and conditions were not given to consumers until after they had purchased PPI.

c) **Scope of key information** – Key information was not brought to the attention of consumers, for example, policy restrictions regarding employment cover for contract workers were not brought to the attention of consumers.

75. ***Earlier issues***. Other, more historic issues that were addressed prior to the current Consumer Protection Code include the following:

d) **Sales practices**: In addition to suitability and information disclosure issues, there were several other issues around sales practices such as the provision of explicit information on PPI as an insurance product. (Undertakings sometimes did not reveal that the purchase of PPI was optional, or the price of the product was not disclosed.)

e) **Refund** in case of cancellation – If the underlying loan was repaid or the insurance policy itself was repaid, the rules of refund were not sufficiently clear

f) **Trainings** – Sales personnel lacked sometimes lacked the sufficient training

These issues are further elaborated below in the section describing regulatory and supervisory actions.

[35] In Ireland Mortgage PPI does not include life cover. Borrowers purchase a separate life insurance policy when taking out a mortgage, for example, a mortgage protection policy.

7.3. Regulatory and supervisory actions regarding PPI

7.3.1. Consumer Protection Code

76. ***Codes of conduct in Consumer Protection.*** The Central Bank of Ireland has a number of statutory codes of conduct. The Consumer Protection Code 2006 set out the requirements that regulated firms must comply with when dealing with consumers.[36] The Consumer Protection Code 2006 has been revised, and the Consumer Protection Code 2012 came into effect on 1 January 2012.[37]

77. ***Legal nature of the Consumer Protection Code in Ireland.*** The provisions of the Consumer Protection Code are *binding* on regulated entities and must, at all times, be complied with, when providing financial services. When finding contravention, the Central Bank of Ireland has the power to administer sanctions.[38]

78. ***PPI Rules in the Consumer Protection Code.*** Ireland's Consumer Protection Code contains a lot of provisions that apply regardless of the type of financial services provided. The rules on information provision, knowing the consumer, suitability and record keeping have proven to be very relevant for PPI.[39]

79. The Consumer Protection Code also includes some provisions specifically on Payment Protection Insurance.[40] These rules target two areas:

a) **Premiums disclosure**: the payment protection premium must be excluded from the initial repayment estimate of the loan advised to the consumer, which provision was kept in 2012 as well.
b) **Application forms**: while the 2006 Code allowed for combined application form (with requiring a tick box that PPI was optional), the 2012 Code specifically requires *separate application forms* for the payment protection insurance and for the loan.

7.3.2. Supervisory reviews of PPI in Ireland

80. ***2007 Payment Protection Insurance Review***. The Financial Regulator's review of PPI in 2007 focused on three key areas, namely sales practices, refund procedures, and staff training. The review found that[41]:

[36] Central Bank of Ireland (2012) Consumer Protection Code 2006
[37] Central Bank of Ireland (2012) Consumer Protection Code 2012
[38] Central Bank of Ireland (2012) Consumer Protection Code 2012 p. 3.
[39] These rules are in Chapters 4, 5 and 11 of the 2012 Consumer Protection Code.
[40] Chapter 4 points 6-8 in the Consumer Protection Code 2006 and 3.24 in Consumer Protection Code 2012
[41] Central Bank of Ireland (Financial Regulator) (2007) Letter

a) **Sales practices**: There were several issues around sales practices, among others suitability, information disclosure, the provision of explicit information on PPI as an insurance product
b) **Refund process**: It was not sufficiently clear in which cases and to what extent a refund was due in case the policy was cancelled
c) **Training**: Staff was not provided adequate training to ensure they are fully aware of product features

81. ***2009 Review of claims processing did not indicate serious issues.*** A Central Bank[42] review of **claims processing** for PPI policies undertaken in 2009 indicated that, where a claim was declined, this was generally in accordance with the terms and conditions of the PPI policy.[43]

82. ***2011 review focusing on unemployment / redundancy claims.*** The latest review carried out by the Central Bank of Ireland on sales files for PPI policies aimed to determine compliance with the provisions of the 2006 Consumer Protection Code. The study is focusing in particular on instances where the consumer has made an unsuccessful[44] claim under the policy for reasons of unemployment/redundancy. A letter in July 2012 identified issues of concern in this respect the following way. [45]

1) **Suitability** for consumers: While the consumer may have been eligible for PPI by virtue of criteria such as age, residency, and employment status, this does not mean that the PPI was a suitable product for their needs.

2) **Execution only sales**: For sales to be made on an execution only basis, the consumer must have specified the product, the product provider and must not have received any advice. If these conditions are not met, firms must meet the requirements set out in the Consumer Protection Code on assessing the suitability of the product for the consumer.

3) **Timing of key information**: Key information was provided to the consumers only after the consumers have agreed to purchase the policies

4) **Key information** should be **explicitly** drawn to the attention of individual consumers

5) **Record keeping**: Firms are often unable to provide key documentation of their relationship with a consumer

6) **Other general principles**: Other issues mentioned include the requirement to act with due skill, care and diligence in the best interests

[42] The Irish Financial Services Regulatory Authority (Financial Regulator) was the single regulator of all financial institutions in Ireland from May 2003 until October 2010 and was a "constituent part" of the Central Bank of Ireland. It was re-unified with the Central Bank of Ireland on 1 October 2010.
[43] Central Bank of Ireland (2009) Financial Regulator concludes examination of claims handling for PPI policies
[44] More precisely the claim appears to have been declined in accordance with the terms and conditions of the relevant policy.
[45] Central Bank of Ireland (2012) Letter p.1.

of customers; the requirement to seek from customers information which is relevant to the product or service requested; the requirement on firms to make full disclosure of all relevant material information, including all charges, in a way that seeks to inform the customer; and the requirement that firms do not exert undue pressure or undue influence on a customer.

83. ***Review of sales by firms.*** The Central Bank of Ireland expects the firms to conduct a comprehensive review of their sales processes and procedures in place since the introduction of the 2006 Code. Currently, six credit institutions have commenced a review of their sales of PPI policies; these are due to be completed by the end of 2013.

7.3.3. Consumer Complaints

84. ***Moderate number of complaints.*** The Financial Services Ombudsman received 218 complaints about mis-sold PPI in the last 6 months of 2011. Of these – just 115 were investigated further and only 20 were upheld in favour of the consumer, (19 partly upheld) and 78 were not upheld. That is less than 10% of PPI complaints that were upheld. In the first 6 months of 2012 – PPI complaints to the FSO totalled 410.

8. PPI in Italy

8.1. PPI market specialties in Italy

85. The Italian PPI market was 2.4 billion euros in 2010.[46] In addition to PPI, property insurance is often subject to cross-selling in Italy.

8.2. Market problems in Italy

86. ***Market investigations by the Italian Authority.*** The Italian Authority (ISVAP, now IVASS) has carried out an initial investigation on the distribution of payment protection insurance related to mortgages and personal loans in 2008-2009.[47] ISVAP revisited the issue with a second survey on PPI in 2011[48]. The investigation concluded the following[49]:

- **Tying**: Although PPI is not mandatory in Italy, banks practically treat it as a precondition to obtain the credit product.
- **Single premium**: Almost all PPI policies are sold as single premium policies, where the premium is often added to the loan, generating further interests for the benefit of the credit grantor.

[46] ISVAP Press release 6th December 2011
[47] The data submission was requested by the ISVAP Circular Letter of 23 July, 2008.
[48] The data submission was requested by the ISVAP Circular Letter of 29 April, 2011.
[49] ISVAP Press release 6th December 2011

- **Not in the best interest of the consumers**: Banks (or financial intermediaries) use PPI almost exclusively at their own interest, while requiring their clients to bear the costs and the "exorbitant" commissions.
- **High commissions**: Policies that are distributed by banks or financial intermediaries have higher commission rates (44% on average with a maximum of 79%) compared to policies distributed by agents (20%).

8.3. Regulatory and supervisory actions regarding PPI

87. ***Requirements on suitable sales.*** The ISVAP Regulation No 5/2006[50] laying down rules for insurance intermediation contained some general rules on advised sales that are important for PPI as well. These include detailed requirements for gathering in-depth information on the consumer needs and requirements on proposing suitable products, which means that from 2006 onwards the following rules apply in this respect.

> *[Intermediaries, before concluding an insurance contract, must] acquire from customers any information useful to evaluate the adequacy of the contract with regard to the [customer's]… disclosed insurance and pension needs and his risk propensity.*
>
> *Intermediaries shall be required to propose or recommend contracts adequate to meet the policyholder's insurance and pension needs. To that end, before concluding an insurance contract they shall acquire from the policyholder any information they deem useful in relation to the features and complexity of the contract offered, and record and keep such information.*[51]

88. ***Disclosure regulation.*** ISVAP Regulation 35/2010 regulating information obligation and advertisement for insurance contracts contained special provisions for PPI policies regarding cost disclosure and refund.[52]

89. ***Cost (including commission) disclosure.*** According to these rules both in the pre-contractual Information Note, and in the policy itself "the undertaking shall show all the ***costs*** to be borne by the debtor/insured, with the indication of the average part paid to the intermediary as commission."

90. ***Refunds.*** For single premium policies, there is a special rule governing ***refund*** in the case of early termination or switching of the underlying loan/mortgage. The regulation orders that "…undertakings shall return to the debtor/insured the part of the premium paid relating to the remaining period of insurance with respect to the original expiry." It allows for the right to "…retain only the administrative costs actually sustained for the issue of the contract and

[50] Regulation N. 5 of 16 October 2006 regulation laying down provisions on insurance and reinsurance mediation referred to under title ix (insurance and reinsurance intermediaries) and article 183 (rules of conduct) of legislative decree n. 209 of 7 September 2005 – code of private insurance.

[51] ISVAP Regulation N. 5 Article 52 (1)-(2)

[52] ISVAP Regulation N. 35 Articles 49-50

the premium refund, on condition that these are identified and quantified in the proposal, in the policy and in the insurance application form. Those costs must not be such to represent a limit to the portability of loans/mortgages or an unjustified charge in case of repayment."

91. ***Preventing conflicts of interests.*** The ISVAP regulation No. 5[53] of 2006 contained a general conflict of interest provision in its original form, stating that intermediaries shall avoid operations that will lead to conflicts of interests, including "those deriving from group relations, own business relations or from relations with companies of the group".[54] This provision was further enhanced by the ISVAP in December 2011[55,56], as an explicit prohibition was added, stating that "it shall be **prohibited** for intermediaries to directly or indirectly become, (…) at the same time **beneficiary and intermediary** of the relevant individual or collective contract".[57]

92. ***Competing offers on PPI.*** Recent national legislation adopted in 2012[58] contained provisions to stimulate competition regarding life insurance linked to mortgages and consumer credit. The new rules prescribe that if the banks or others financial intermediaries take out a **life insurance** policy to obtain a mortgage or a consumer credit, they must give the client **at least two additional free estimates** of two different undertakings (independent from the loan provider). Customers may also choose another life insurance from a different undertaking which the banks or financial intermediaries have to accept without changing the originally offered conditions for the mortgage or consumer credit.[59]

93. ***Minimum content and standardised format for information.*** Implementing the above mentioned national legislation, ISVAP has adopted another regulation (Regulation 40/2012) on the **minimum content of life insurance contracts** related to mortgages and personal loans. Apart from setting the minimum content, ISVAP also prescribed that **information** must be presented in a **standardised format** to foster comparability. Consumers must also be informed that if a life insurance contract is required for obtaining a mortgage or consumer credit, they have **10 days to present an offer from an alternative insurer**. Should the alternative offer meet the necessary content, it

---

[53] Regulation N. 5 of 16 October 2006

[54] Article 48 of Regulation N. 5 of 16 October 2006 1

[55] ISVAP (2011) Order N. 2946 of 6 December 2011 Provisions on the conflict of interests of insurance intermediaries - amendments to ISVAP Regulation n. 5 of 16 October 2006

[56] ISVAP first attempt to modify Regulation 5 *by Regulation 35* was annulled in 2010 by the Court for procedural reasons.

[57] Article 48 of Regulation N. 5 of 16 October 2006 Para 1bis

[58] The decree law N.1 of 24.1.2012, converted into law N.27 of 24.3.2012.

[59] Ibid, Article 28.

should be accepted by the loan provider without changing any of the conditions in the initial offer.[60]

94. ***Online comparison tools.*** Further to these, the same regulation also envisaged that from September 1st, 2012, the companies marketing these life insurance products should introduce a free online quotation service on their website. Insurance undertakings shall also notify IVASS on the products they market, and these products are then listed on IVASS's website to further facilitate consumer choice.

95. ***Cross-selling regulation in the Consumer Code.*** The Italian Consumer Code considers an unfair trade practice any practice by a financial intermediary requiring the customer to subscribe to an insurance policy sold by the same intermediary or to open an account with the same intermediary in order to grant a loan.[61]

96. ***Complaints.*** Complaints concerning mis-selling practices are under investigation, with particular reference to policies sold to consumers who are not entitled to claim for compensation. These issues frequently involved selling unemployment cover for self-employed or medical insurance to people who were not able to claim for benefits because of some pre-existing medical conditions.

9. PPI in the Netherlands

9.1. Market issues in the Netherlands

96. ***Distorted consumer choice.*** The Netherlands Authority for the Financial Markets (AFM) observed that consumer in PPI markets are not always able to differentiate between good and poor quality in products and services. Reasons for distorted consumer choice included information asymmetry between product providers (and developers) and consumers and limited financial literacy, that did not allow consumers to understand and assess the product taking into account personal risks.

97. ***Poor market outcomes.*** As a result of the consumers' inability to differentiate between good-quality and poor-quality products and services, product providers have opportunity to develop poor-quality products and services. Examples for poor market outcomes are the misselling of *single premium mortgage PPI* and *general failings in PPI sales by intermediaries*.

[60] ISVAP (2012) Regulation n. 40 of 3 may 2012 Regulation concerning the definition of the minimum contents of the life assurance contract referred to under article 28 (1) of Decree-law n. 1 of 24 January 2012, converted into law n. 27 of 24 March 2012.
[61] Italian Consumer Code Law Decree 206/2005 Article 21 para 3

9.2. Regulatory and supervisory action in the Netherlands

9.2.1. Thematic work on PPI in 2009-2010

97. ***AFM thematic work on PPI.*** In 2009 and 2010 the Netherlands Authority for the Financial Markets (AFM) has carried out thematic work on the sale of payment protection insurance. The AFM reviewed several cases of consumer credit and mortgage credit in which payment protection insurance was advised.

98. ***Failings in the advice process.*** The review concluded that there have been the following failings in the advice process:

- **Suitability of products.** Financial service providers have failed to assess whether PPI was in the interest of the client at all. They failed to assess whether the client was capable and willing to bear the risk. In some cases the product was not in the interest of the client at all, for example PPI for a small credit; or, in other cases, existing covers had not been taken into account.
- **Lack of information**. Information provided to the client was not adequate. For example calculations were not based on the personal situation of the client and the costs of the premium were not made clear to the client. Further, the relevant information often had not been laid down in the advice file.
- **Illegal commissions.** The commission paid by the product provider were in breach of the inducement rules and thus not in the interest of the client.

99. ***Guidance on PPI.*** The AFM has published guidance with regard to payment protection insurance. In the guidance the AFM has indicated what steps have to be taken by a financial service provider to end up with a suitable advice. The AFM has provided examples of a good advice process. For example the AFM has indicated that in the case of small consumer credits a payment protection insurance is usually not in the interests of the client. The reason is that the costs of such an insurance (costs of advice and the premium) are not in relation to the risk that is being covered by the product. Furthermore the rules for responsible lending ensure that consumers are capable of bearing small loses with respect to small consumer credits. Also the AFM has indicated that a service provider must do the following: check the existing covers, base the calculation on the personal situation of the client, check what risk the client is willing and capable to take, base the advice on the risk appetite, calculations and interests of the client, and motivate whether the client should choose a premium or a purchase price.

100. ***Administrative fines.*** The AFM imposed administrative fines on companies for providing unsuitable advice to clients wishing to enter into credit protection insurance policies. The Financial Supervision Act (Wft) requires financial enterprises to provide consumers with suitable advice. They must

therefore obtain information concerning the consumer and take this into account when providing advice. This means they must act in the interests of the client.

9.2.2. AFM investigation on advisor fees for consumer loan PPI

101. ***Further AFM work in 2013 on cost of advice.*** In 2012 and in the first half of 2013 the AFM has looked at the fees charged by independent advisors for PPI advice. The study focused on PPI sold with consumer loans through advisors; AFM found that in some cases the fees were significant and not in the interest of the consumer.

102. ***Background on Dutch rules for remuneration.*** As from the 1st of January 2013 a ban on commissions has been introduced. This ban applies to financial service providers advising and mediating in complex financial products, for example unit-linked insurances, annuities, mortgage credit and payment insurance products to consumers. Further as from 1 January 2012, a regulation is in place with respect to adviser charging stating that adviser charges should not be deemed unreasonable given the nature and scope of the financial service that is rendered. For PPI this means that a fee has to be charged to the consumer for advising on the PPI. With respect to the consumer credit the adviser is paid by the product provider on the basis of a monthly commission.

103. ***Excessive PPI advice fee when mediating in consumer loans.*** AFM found that advisors used the fees earned in PPI advice as a tool to safeguard their business model. This was done by advising consumers on PPI and (in a relatively limited percentage of cases) mediating in the purchase of one or several PPI's. For these activities related to PPI's the advisors charged very substantial fees (the market average seemed to vary between €1.000 and €1.500 with some intermediaries going as high as €3.000 or even €4.000). Extensive talks with individual market players confirmed that the fees charged were disproportionate to the effort on advice and mediation of PPI and as such had to be seen as a disguised (and illegal) fee for advice and mediation in consumer loans.

104. ***Misleading consumers into thinking that the advisor fee is linked to the loan.*** In most cases consumers were directly or indirectly led to believe that the fee that the advisor was due was related to his or her effort in advising and mediating a suitable loan. Consumers appear to be unaware that the fee payable is *only* related to the work the advisor has carried out with respect to the advice on PPI's.

105. ***Limited or absent added value of PPI for consumers.*** Since PPI was merely used to charge a disguised fee for mediation in consumer loans, PPI is actually often not purchased by consumers. In these cases consumers merely pay a fee for the advice and as such do not receive any added value. In a substantial amount of cases were PPI is actually purchased, the relatively limited loan amount means that the benefits of the PPI are smaller than the costs.

106. ***Maximum fees on PPI.*** The AFM work on the cost of advice in 2012-2013 has resulted in significant reductions in the fee levels that consumers are charged for advice and mediation in PPI. At the end of 2012 the largest trade organisation for advisors of consumer loans has lowered the maximum fee in their code of conduct from €1.500 to €500. By actively engaging in one-on-one dialogue with numerous of the most active advisors in the field of consumer loans the AFM has convinced these parties that it is of great importance that any fee charged for activities performed in relation to PPI is directly correlated to the actual time spend on those activities and cannot be a disguised means of obtaining compensation for work done with respect to the actual consumer loan. Most of the advisors have since confirmed to AFM that they have changed their business model.

10. PPI in Portugal

10.1. Guidelines on PPI compliance

107. ***Guideline on compliance.*** Given the importance and economic and social function of the product, and based on the findings of an analysis carried out regarding this matter, the Portuguese authority (ISP) issued a guideline ("*Circular*") in March 2012 on the legal obligations regarding PPI.[62] The guideline contains recommendations addressed to insurers[63], which focus on four main areas: *(i)* product design, *(ii)* pre-contractual information and clarification, *(iii)* drafting (language) of the policies and *(iv)* underwriting practices.

108. ***Suitability and switching (refund) in product design.*** The guideline stresses that insurers should take the target market characteristics into account when designing the product. The profile and needs of consumers should be reflected in the eligibility criteria[64] as well as on the contractual clauses (notably the ones concerning coverage limitations and exclusions, deductibles, grace periods and maximum compensation limits). Also, the guideline points out that sometimes there are undue obstacles to switching coverage to another insurer (especially by means of the specific content of certain termination clauses, or when the contractual terms do not provide adequate clarification on the customer's right to get a *pro rata* refund from the original provider).

109. ***Pre-contractual information and clarification.*** The Portuguese guideline highlights the necessity of sufficient, adequate and clear pre-contractual information (notably for the policyholder to assess if the offered

[62] ISP (2012) Circular no. 2/2012. The guideline (Portuguese version) is accessible at: http://www.isp.pt/winlib/cgi/winlibimg.exe?key=&doc=21346&img=5190

[63] The guideline is aimed at drawing special attention to the legal obligations already imposed on insurers which are particularly implied when designing and marketing PPI contracts. Furthermore, it also highlights the potential legal consequences (on insurers) associated with unsound market conduct regarding PPI.

[64] For product underwriting / adhesion.

product matches his needs and to become aware of the type of risks the product actually provides coverage for). Standard contractual clauses must be advised in full to the parties accepting them; failure to do so results in the inexistence of the given contractual clause. Given that PPI provides complex coverage, specific clarification duties apply as insurers shall bring to the policyholders' attention the exact scope of the proposed coverage (for example, exclusions), taking into consideration the needs of the policyholder/insured person.

110. ***Drafting (language used) of insurance policies.*** Generally, the Portuguese law on insurance contracts[65] requires that insurance policies are drafted "in a comprehensible, concise and rigorous manner and in highly legible print using words and expressions used in everyday language provided that the use of legal or technical terms is not essential", and they should avoid the use of vague or ambiguous expressions (specifically in risk exclusion or limitation clauses). In fact, the Portuguese authority suggests that coverage and risk limitation clauses should be drafted with greater care. In particular, ISP recommends that the coverage concerning employment and incapacity for work situations should be determined positively (and not by means of exclusions or limitations).

111. ***Suitability check at contracting.*** Insurers are requested to carry out[66] a proper suitability check before selling the product to the consumer (namely regarding the type of labour agreement, employment background and prior periods of incapacity for work). The guideline recommends that this exercise should be carried out in due time, instead of postponing this assessment to the moment when the customer makes a claim.

10.2. Expected effects and planned steps

112. ***Expected effects.*** In order to assess the degree of compliance with the applicable legal framework, including the aforementioned recommendations, ISP conducted an *ex post* monitoring exercise using a questionnaire addressed at insurers marketing this kind of insurance products. Prospective surveys and further supervisory actions will be also launched. By issuing the recommendations above, the Portuguese authority expects a reduction of the conflicts associated to this type of insurance product and to achieve greater efficiency in claims setting. It hopes that the guideline may contribute to better consumer satisfaction (and consequent reduction of the number of complaints associated to PPI) and improved reputation of PPI insurers.

[65] *"Regime Jurídico do Contrato de Seguro"* (approved by Decree-Law no. 72/2008, of 16 April).

[66] Directly or, where applicable, through the insurance intermediary, or through the policyholder, for group insurance.

11. PPI in Spain

11.1. PPI market specialities in Spain

113. ***Temporary and permanent coverage.*** Payment protection insurance in Spain usually offers combined coverage, with some policies providing coverage against the risks of unemployment / temporary disability, while others offering coverage against death / permanent total disability.

114. ***Alternative coverage for temporary products.*** In PPI insurance for unemployment or temporary disability[67], the coverage is designed to be alternative. Depending on the labor situation of the policyholder, only one of the coverage will be consider applicable to the specific contract. This has proved to be often misleading for consumers, who often thought they were covered for both risks. This is not the case for permanent coverage.

115. In relation to those products offering life and permanent disability coverage, sometimes failures have occurred in the absence of an adequate statement of pre-existing conditions by the policyholder.

116. ***Amount of coverage.*** Taking also into account the different design of the products, there are two types of payment protection insurance products marketed in Spain as for amount of coverage: for PPI offering coverage for life/permanent disability, some products covers the whole (original) sum of the loan, and the lender is only entitled to benefits not exceeding the outstanding amount; while other policies only cover the outstanding debt, with the lender being the irrevocable beneficiary of the entire policy.[68]

11.2. Regulatory and supervisory actions regarding PPI

11.2.1. PPI requirements for consumer credits

117. ***Special rules for consumer credits.*** The Spanish Law on Consumer Credit[69] regulates pre-contractual information. This law is based on the transposition of the EC Consumer Credit Directive, however contains additional rules to the ones included in the directive.

118. ***Pre-contractual information to help comparability.*** According to the rules, the creditor shall provide the necessary information enabling the consumer to compare offers and make an informed choice when choosing a credit product.

---

[67] For PPI offering coverage for unemployment/temporary disability, the insurance company will be paying the loan instalments for the duration of the contingency and in any case, with the limit set in the policy coverage.

[68] DGFSP (2009) Information on website

[69] Ley 16/2011, de 24 de junio, de Contratos de crédito al consumo.

119. ***Information on refund.*** In addition to the essential elements of the contract, the credit agreement documents must contain information if insurance is necessary to obtain a given credit; and if there is insurance that the consumer has a right of refund for insurance premiums according to the rules governed by the insurance policy.[70]

120. ***Termination of contract and refund rules.*** PPI policies that are sold with consumer credits for an undefined term shall expire when the underlying credit is repaid. If there is PPI, in the case of early repayment the consumer is entitled to a refund of the remaining (unused) premium.[71] Generally, consumers are entitled to a pro rata refund of the premium.[72] For life insurance in most cases, the law regulates the unilateral power to terminate the contract without giving any reason and without penalty within 30 days of the delivery of the policy. [73]

11.2.2. PPI related to mortgages

121. ***Rules applicable to mortgages.*** A Circular by the Spanish National Bank[74] establishes rules for PPI related to mortgages. The Circular represents binding sector legislation, and contains extensive rules for pre-contractual information and refund in case of cancellation.

122. ***Extension of pre-contractual information requirements to mortgages.*** The Circular requires that pre-contractual information requirements are extended to those credit agreements that are excluded from the scope of the Spanish Law on Consumer Credits. The pre-contractual information should include that when there are ancillary services (in particular insurance) the acquisition of the credit (or the acquisition of the credit at certain conditions) is subject to the purchase of ancillary services. They should also be presented with the conditions that apply when they do not purchase these ancillary services.[75]

123. ***Cancellation and refund.*** In the case of early termination of a mortgage contract, the consumer is entitled to receive refunds for the unused premiums.[76]

124. ***Ensuring effective protection.*** Additionally, in cases where the loan or mortgage is linked to PPI, the undertaking must have procedures in place to

[70] Ley 16/2011 Article 16 2. (o), (r)
[71] Ley 16/2011 Article 27. 4. and Article 30. 6.
[72] Ley 16/2011 Article 28 3.
[73] For more detail see Spanish Law on Insurance Contracts (1980) Article 83a.
[74] National Bank of Spain (2012) Circular Nº 5/2012 de 27 de junio (BOE de 6 de julio) Transparencia de los servicios bancarios y responsabilidad en la concesión de préstamos
[75] Ibid, points 2.5. (l)
[76] Norma decimal 1. b.

ensure that the products offered can effectively protect the debtor, taking into account the policyholder's circumstances and personal characteristics.[77]

11.2.3. Self regulation by the Insurance Association (UNESPA)

125. ***Non-binding best practices by UNESPA.*** Recently, the Spanish Insurance and Reinsurance Association (UNESPA) has issued non-binding best practices addressed to insurance underwriters[78] on pre-contractual information for products that include PPI. The guidance is a supplement to the general good practices on transparency to be followed by insurance undertakings.

126. ***Minimum information content.*** The insurance undertakings that adhere to the self-regulation commit themselves to provide consumers with a certain minimum information content that is laid down in the annex of the self-regulation; these rules shall apply from June 30th, 2013. The insurance undertakings also commit themselves to modify the texts used in their insurance policies. The information should include a reference that the product is marketed as an independent product and/or together with a loan product, and indicate that to which of these categories the given policy belongs. The guideline also lay down minimum information content for policies both for unemployment and temporary disability (separately).

127. ***Price disclosure and refund.*** The best practices allow for single premium policies, with detailed rules on disclosure. The refund process on single premium policies is also regulated.

128. ***Limitations of coverage and exclusions.*** Information about limitations in coverage must be explicitly stated in the policy and consumers must explicitly accept them.

11.2.4. Supervisory actions

129. ***Complaints about extent of coverage.*** A frequent cause of complaints to the Spanish Authority was that policyholders believed they are covered against both unemployment and temporary inability, whereas the coverage was alternative depending on the situation of the insured. [79] DGSFP published its views on this issue with the aim to provide clarification to policyholders[80.] The Spanish Supervisory Authority also conducted *on-site* inspections with the aim to identify potential mis-selling conducts and increase transparency on the distribution process.

130. ***Complaints about single premium.*** DGSFP published some case studies with the aim to enhance financial literacy on the issue. The DGFSP consumer

---

[77] Ibid Annex 6 Point 11

[78] Unespa (2013)

[79] DGSFP (2009) Consumer protection report 2009 p. 29.

[80] DGSFP (2009) Consumer protection report 2009 p. 29.

protection report from 2009 also states a case study where [81] the policyholder had a six-year PPI cover associated to the mortgage. After the loan was repaid earlier (21 moths), the policyholder required refund, which was objected on the basis that the policyholder made a claim based on unemployment before. The case was decided in favour of the complainant.

12. PPI in the United Kingdom

12.1. PPI market in the United Kingdom

125. ***Size of the market, profitability.*** Gross written premium of PPI sold in the UK in the years 2001-2009 inclusive was around £34bn[82], though sales at lower volumes had taken place throughout the 1990s. Analysis by the UK Competition Commission (CC) showed, for distributors of PPI, in the years 2003-2007, pre-tax profits that were between 50 and 60% of the GWP sold.[83] These profits reflected high levels of commission from, and also often profit sharing arrangements with, the insurer.

126. ***Claim ratios.*** A market study by the CC found that the claim ratios were between 11 and 28 per cent of the gross written premium, depending on the product.[84]

12.2. Description of market problems

131. ***Enforcement actions from different authorities.*** Payment Protection Insurance has been under scrutiny by different authorities in the United Kingdom. A good summary of the UK problems is presented in the FSA 2010 Policy Statement and in the CC's Market Study.

132. ***Classifying PPI issues by the FSA.*** The FSA has classified the common types of failings in PPI sales the following way.[85]

a) General failings in the conduct of the sale
b) Failings around eligibility, exclusions and limitations
c) Failings specific to non-advised sales
d) Failings specific to advised sales
e) Failings around price disclosure

[81] DGSFP (2009) Consumer protection report 2009 p. 83.
[82] FSA CP10.6 (March 2010) Annex 3 para 10; and the main report by the Competition Commission (CC) of 29 January 2009 (Market investigation into payment protection insurance), Table 2.4 (p26)
[83] http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/542_4_4.pdf
[84]. Competition Commission (2009) para 2.
[85] A detailed description of these failings can be found in Appendix 4 of the FSA (2010) Policy Statement.

f) Additional failings specific to single premium policy sales.

133. ***Market power in distribution.*** The CC market study found that PPI providers (distributors, intermediaries, stand-alone providers) did not face significant competitive pressure, possibly allowing them to make supra-competitive profits. PPI underwriting (insurance companies) on the other hand were making reasonable, but not excessive rates of return, suggesting a significant level of competition. The vertical integration of the two activities, however, was not found to further contribute to the lack of effective competition.[86]

12.3. Regulatory / Supervisory responses

134. ***Remedies introduced by the Competition Commission.*** As a conclusion of its investigation, the CC proposed remedies on distributors, intermediaries and where relevant underwriters.[87] After legal challenges from market participants, the CC published its final Order on 24th March 2011.[88] The most important areas of remedies are listed below.

a) **Prohibition on selling PPI at the credit point of sale.** Prohibition on selling PPI at the point of sale of the credit until after seven days after the credit sale or, if later, seven days after the supply of a personal PPI quote.

b) **Prohibition on selling single-premium PPI policies**. Premiums can be charged monthly or annually. Where an annual premium is paid by a consumer, then a rebate must be paid to consumers in direct proportion if the consumer terminates the policy during the year, and no charges for early termination are allowed.

c) **Provision of a personal quote**. This provision is expected to help consumers get information that is tailored to their individual needs.

d) **Information provision** in marketing materials on the following:
   - The monthly cost of PPI per £100 monthly benefit
   - PPI is optional
   - PPI is available from other providers
   - Reference to information sources

e) Provision of **information to regulatory agencies**, to help monitoring market activity, and disclosure of claims ratios.

f) Provision of an **annual statement.**

[86] Competition Commission (2009) paras 5-71 and chapter 2 and 4.
[87] Competition Commission (2009) para 7, paras 79-89 and chapter 10
[88] Competition Commission (2011) a short summary can be found in the press release Competition Commission (2011b)

135. ***Legal nature of the Competition Commission remedies.*** Competition Commission orders have a regulatory effect on the market as these orders are enforceable in the courts by civil proceedings.[89]

136. ***Policy Statement by the FSA.*** In August 2010 the FSA published finalised:

- Handbook text (Guidance and Evidential Provisions) and supporting material (including examples of fair redress calculations) concerning the fair assessment and, where appropriate, redress of Payment Protection Insurance (PPI) complaints;

- statements on root cause analysis of PPI complaints and firms' obligations toward non-complainants potentially affected by recurrent sales problems;

- an open letter that listed common failings in PPI sales; the letter reflected the concern 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.

137. ***Enforcement action by the FSA.*** The FSA has conducted 28 enforcement cases (with fines) concerning PPI. 26 of these during (2006-2012) concerned poor PPI selling practices (largest fine £7mn) [90]. 2 other cases (in 2013) concerned failings in the handling of complaints about PPI sales (largest fine £4.3m).

138. ***Refund on mis-sold policies.*** According to FSA statistics, firms have paid out compensation exceeding £8.9 bn since January 2011.[91] The FSA has also issued guidance on PPI consumer contact letters in July 2012, describing the FSA's view on the fair and clear content of communications sent by distributors to customers who they think may have been affected by recurrent sales failings.[92]

12.4. Recent market developments

139. ***New forms of protection.*** Recently, according to the UK Supervisory authorities, some firms have developed, or are seeking to develop, new forms of protection that aim to meet similar consumer needs to payment protection insurance (PPI). These protections can take a form of an insurance policy, such

[89] Competition Commission (2006) In Chapter 7 Enforcement powers and procedures; para 7.8 reads as follows.: "…*Any person to whom an undertaking or order relates owes a duty of compliance to any person affected by a contravention of the undertaking or order. Any person who has sustained loss or damage through a company's contravention of the undertaking or order may bring an action before the courts. The CC and the OFT may also bring proceedings for the enforcement of undertakings and orders accepted or made by the CC. (…)"*

[90] FSA (2008) Final Notice to Alliance & Leicster plc

[91] FSA(2013) information on monthly refund and compensation

[92] FSA (2012) Finalised Guidance on Customer Contract Letters

as *short-term income protection* (STIP), or other, potentially non-insurance forms where the terms of a credit agreement are modified on the occurrence of specified events. (E.g. debt freeze or *debt waiver)*.

140. ***Regulatory response: Guidance document on Payment Protection Products.*** In January 2013, the FSA and the OFT jointly finalised guidance on payment protection products. The FSA and OFT recognise that the market for payment protection products continues to develop, and that some of the issues which previously contributed to poor outcomes for PPI may be less evident in the current market (e.g. more flexible/modular products may help consumers to buy protection which better aligns with their needs). However, the FSA/OFT wanted to help ensure that firms mitigate the risks appropriately, and design and sell products that are not only commercially viable but also deliver good consumer outcomes. By setting out the regulators' views at an early stage, firms can be aware of relevant regulatory requirements and expectations and can factor these into their business planning and processes.

141. ***Key messages of the guidance.*** The FSA and OFT key messages included:

- When designing new payment protection products (or reviewing the design and distribution of existing products) firms should
    1. identify the target market for the protection,
    2. ensure that the cover offered meets the needs of that target market, and
    3. ensure that the product does not create barriers to comparing, exiting or switching cover.
- Firms should be able to demonstrate that they have sound product governance arrangements in place.
- Firms should be aware of the relevant statutory provisions and how these may apply in relation to credit agreements with debt freeze/waiver or similar products or product features.
- In particular, there should be adequate transparency to consumers regarding the nature, price and implications of such products.
- Firms should ensure that they treat actual and potential customers fairly and do not engage in unfair or improper business practices.

References

Central Bank of Ireland (2006) Consumer Protection Code 2006
http://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Consumer%20Protection%20Code.pdf

Central Bank of Ireland (2007): Letter Re: Payment Protection Insurance Review 27 February 2007
http://www.centralbank.ie/regulation/processes/consumer-protection-code/compliance-monitoring/Documents/Payment%20Protection%20Insurance%20Review-%20Industry%20letter%2027%20February%202007.pdf

Central Bank of Ireland (2009) Financial Regulator concludes examination of claims handling for Payment Protection Insurance policies- press release http://www.centralbank.ie/press-area/press-releases/Pages/FinancialRegulatorconcludesexaminationofclaimshandlingforPaymentProtectionInsurancepolicies.aspx

Central Bank of Ireland (2012) Consumer Protection Code 2012
http://www.centralbank.ie/regulation/processes/consumer-protection-code/documents/consumer%20protection%20code%202012.pdf

"Code de la consummation" France Consolidated version 01/01/ 2013
http://www.legifrance.gouv.fr/affichCode.do;jsessionid=DD1311A36E7BC0F5ADF3E7D5F3D3410A.tpdjo03v_1?cidTexte=LEGITEXT000006069565&dateTexte=20130121

Competition Commission (2006) General Advice and Information March 2006
http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/rules_and_guide/pdf/cc4

Competition Commission (2009): Market investigation into Payment Protection Insurance 29th January, 2009 http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2009/fulltext/542.pdf

Competition Commission (2011a): Payment protection insurance market investigation order 2011
http://webarchive.nationalarchives.gov.uk/+/http://www.competition-commission.org.uk/inquiries/ref2010/ppi_remittal/pdf/PPI_Market_Investigation_Order_(2011).pdf

Competition Commission (2011b): PPI CC publishes final order 2011
http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/press_rel/2011/march/pdf/13_11_ppi_cc_publishes_final_order.pdf

Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit agreements for consumers and repealing Council Directive 87/102/EEC http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF

DGFSP (2009): Information on website Seguros de vida a prima única para la amortización de préstamos. http://www.dgsfp.mineco.es/reclamaciones/documentos/SPH2%20%20Seguros%20de%20vida%20a%20prima%20%C3%BAnica%20-

Federation Bancaire Francaise (2011) Fiche 13/04/2011 Loi du 1 juillet 2010 portant réforme du crédit à la consummation
http://www.fbf.fr/web/Internet2010/Content.nsf/0/1D58AE780D5086ABC125777500393E8C?OpenDocument

Financial Services Authority (2008) Final Notice to Alliance & Leicster plc
http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

Financial Services Authority (2010): The assessment and redress of Payment Protection Insurance complaints Policy Statement 10/12 http://www.fsa.gov.uk/pubs/policy/ps10_12.pdf

Financial Services Authority and Office of Fair Trading (2011): Guidance consultation Payment protection products FSA/OFT joint document, including FSA product risk report and OFT guidance November 2011 http://www.fsa.gov.uk/pubs/guidance/gc11_26.pdf

Financial Services Authority (2012) Finalised guidance payment protection insurance customer contract letters (PPI CCLs) – fairness, clarity and potential consequences http://www.fsa.gov.uk/static/pubs/guidance/fg12-17.pdf

Financial Services Authority (2013) information on monthly PPI refund and compensation http://www.fsa.gov.uk/consumerinformation/product_news/insurance/payment_protection_insurance_/latest/monthly-ppi-payouts

France LOI n° 2010-737 du 1er juillet 2010 portant réforme du crédit à la consommation (Lagarde law)

Instituto de Seguros de Portugal (2012): CIRCULAR N.º 2/2012, DE 1 DE MARÇO D*everes legais de diligência dos seguradores relativamente aos "seguros de proteção ao crédito" http://www.isp.pt/winlib/cgi/winlibimg.exe?key=&doc=21346&img=5190*

ISVAP (2006): Regulation N. 5 of 16 October 2006 Regulation laying down provisions on insurance and reinsurance mediation referred to under title ix (insurance and reinsurance intermediaries) and article 183 (rules of conduct) of legislative decree n. 209 of 7 September 2005 – code of private insurance. http://www.ivass.it/ivass/imprese_jsp/PageDocumenti_regolamenti.jsp?&nomeSezione=NORMATIVA&ObjId=220097

ISVAP (2008) Circular of 23 July, 2008: http://www.ivass.it/ivass_cms/docs/F21749/LetteraCircolareMutui.pdf

ISVAP (2010) Regulation N. 35 of 26 May 2010 Regulation on the information obligations and the advertising of insurance products, amended by isvap order n. 2880 of 25 February 2011. http://www.ivass.it/ivass_cms/docs/F4930/Regulation%2035.pdf

ISVAP (2011) Provvedimento n. 2946 del 6 dicembre 2011 disposizioni in tema di conflitto di interesse degli intermediari assicurativi - modifiche al regolamento isvap n. 5 del 16 ottobre 2006 http://www.ania.it/export/sites/default/documenti/bf37ecaa-24b1-11e1-a317-f3c446ddba06___Provv._n._2946_del_6_dicembre_2011.pdf

ISVAP (2011b) Press release Comunicato stampa del 6 dicembre 2011 http://www.isvap.it/isvap_cms/docs/F16610/isvcs308.pdf

ISVAP (2011c) Circular of 29 April, 2011 http://www.ivass.it/ivass_cms/docs/F8343/lettera_circolare_mutui_2011.pdf

ISVAP (2012) Regulation N. 40 of 3 may 2012 Regulation concerning the definition of the minimum contents of the life assurance contract referred to under article 28 (1) of Decree-law n. 1 of 24 January 2012, converted into law n. 27 of 24 March 2012. http://www.ivass.it/ivass_cms/docs/F5091/Regulation%2040.pdf

National Bank of Spain (2012) Circular Nº 5/2012 de 27 de junio (BOE de 6 de julio) Transparencia de los servicios bancarios y responsabilidad en la concesión de préstamos http://www.bde.es/f/webbde/SJU/normativa/Circular-5_2012.pdf

Portuguese Law on Insurance Contracts *"Regime Jurídico do Contrato de Seguro"* (approved by Decree-Law no. 72/2008, of 16 April) https://www.okteleseguros.pt/OKPortal/EntryGetFile.aspx?FileCode=69

PSZAF (2010): The HFSA's Consumer Protection Risk Report, H2 2010
http://www.pszaf.hu/data/cms2325056/CP_riskreport_2011H1.pdf

Spanish Law on Consumer Credit (2011): Ley 16/2011, de 24 de Junio, de Contratos de crédito al consumo. http://noticias.juridicas.com/base_datos/Admin/l16-2011.html

Spanish Law on Insurance Contracts (1980) Ley 50/1980, de 8 de octubre, de Contrato de Seguro
http://noticias.juridicas.com/base_datos/Privado/l50-1980.t3.html

Unespa (2013): Guia de buenas prácticas en materia de transparecia en la información previa en la contratación de los seguros que incluyan la garantía de proteccion de pagos por desempleo o incapacidad temporal http://www.unespa.es/adjuntos/fichero_3533_20130301.pdf **