



Payment Protection Insurance

Protecting profitability in a highly regulated environment



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Balancing the cost and risk of increased regulation against the potential revenue stream

This point of view provides guidance on how to effectively direct resources and investment so that firms continue to deliver compliant protection products which address consumers' needs while defending important revenue streams.

Payment Protection Insurance (PPI), commonly sold to consumers to protect loan and credit card repayments in the event of their sickness, unemployment or death, has been much scrutinised over the last two years by the Financial Services Authority (FSA)¹, the media and consumer groups. These organisations have been quick to highlight the perceived poor sales practices of firms involved.

The Office of Fair Trading (OFT)² is also investigating PPI, looking at low claims ratios, high commission rates, wide price differentials, possible cross-subsidisation to keep Annual Percentage Rates (APR) artificially low, lack of shopping around by consumers and little competitive pressure on prices.

These issues fall within the boundaries of the FSA's Treating Customers Fairly (TCF) initiative, particularly with regard to misleading information, what can and cannot be claimed for and the suitability of single premium products for some customers.

PPI is a significant income stream for the financial services sector, with an estimated total market size of £5.5bn annually³ and representing anywhere between 5% and 25% of banking profits⁴. As highlighted in Defaqto's recent PPI study, 'changes to the PPI market will seriously impact lenders' income streams over the next two to three years'⁵.

References

- 1 FSA, The Sale of Payment Protection Insurance – results of follow-up thematic work, October 2006
- 2 OFT, OF869 – Payment Protection Insurance, October 2006
- 3 Mintel UK Creditor Insurance, November 2005
- 4 Credit Suisse First Boston entitled PPI – time for a change, September 2005
- 5 Defaqto, Payment Protection Insurance, February 2006

Why do firms need to take action now?

The FSA has issued a number of fines for mis-selling under their TCF initiative and, given its increasing impatience with the industry's lack of responsiveness, will continue to act against firms who fail to meet their regulatory obligations. Daily media attention, and the requirements for firms to redevelop their products and sales practices, have impacted PPI sales to a point where loan APRs are rising to cover the reduction in profits.

While the long-term consequences of this scrutiny are uncertain, it is safe to assume that regulatory compliance costs will increase significantly for firms who operate in the PPI market. Further, the FSA has also stated that it will closely monitor related protection product groups such as Critical Illness and Permanent Health Insurance.

Huntswood believes PPI, and related protection products, have the potential to be viable and attractive consumer products for the long-term. However, both the structure of these products and existing sales processes need to be addressed and possibly refined. Forward thinking firms are already taking action to mitigate intervention from the FSA, while also using PPI as a driver for broader TCF improvement.

How are protection product providers addressing the FSA's requirements?

Figure 1: Satisfying the FSA's expectations



Product providers are addressing the FSA's expectations in a number of ways. Activities being undertaken can be classified into four main areas, as shown in Figure 1 and described further in the following section.

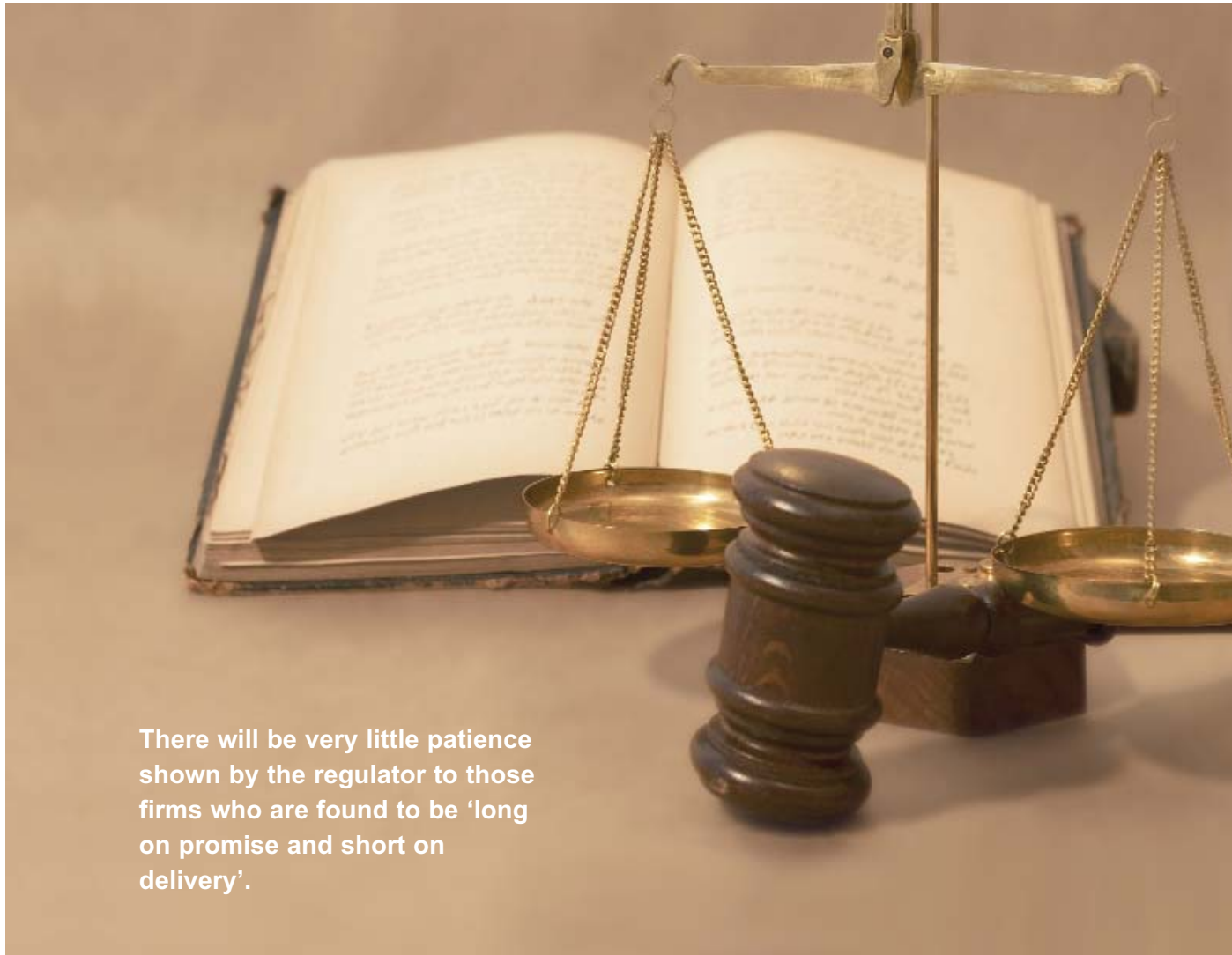
1. Governance and commitment

The Chief Executives of all firms involved in the sale or underwriting of 'at risk' products will have already made commitments to the FSA. These commitments will typically span multiple product and delivery channels, and in most instances will include wide-ranging programmes of work, to be undertaken over an extended period.

The execution of these commitments needs to be periodically reviewed, to ensure that the firms' Senior Management can have confidence that the actions have been successfully undertaken and achieved the forecast result.

Firms should also be actively completing internal and external reviews of their remedial commitments. There will be very little patience shown by the regulator to those firms who are found to be 'long on promise and short on delivery'.

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It is essential to conduct a thorough analysis of PPI products to identify those customers who are potentially at risk.

2. Review of past practices

A basic principle of financial services regulation is that in instances where a firm has failed in its duty of care to a customer, the firm will quickly take action to remedy the situation.

This process should commence with a review of past business, using risk based sampling to identify where sales breaches may have occurred. It is essential to conduct a thorough analysis of the product portfolio to effectively identify those customers who are potentially at risk. This analysis should include preliminary customer contact, which will need to be approached sensitively to avoid needlessly creating liabilities or false expectations amongst the customer population. Having identified the potential population at risk, firms will need to give due consideration to how the remediation phase will be completed.

There are three discrete types of mis-sale: those who have been mis-sold, and have had an unsuccessful claim; those who have been mis-sold and are yet to claim; and the remaining group where it is unclear whether they have been mis-sold.

Given compensation liability is typically greatest for those customers who have been mis-sold and have had claims rejected, priority should be given to those customer who have been mis-sold but have yet to claim. Firms should then focus on reducing the number of unsuccessful claims.

Firms must therefore determine what a mis-sale looks like, as well as the severity of breaches in the original sales process. Firms must then decide if additional work on the file is required, if the customer needs to be recontacted, or if there is clear evidence that the policy was unsuitable at the point of sale. If the latter, consideration must then be given to how redress can best be managed. This process can prove highly problematic, for example, what if the customer has since developed a new medical condition rendering them uninsurable in respect of a new, more suitable product?

Finally, the approach adopted by firms with regard to remediation must inform any tactical response with regard to future product sales.

3. Tactical redesign

Following the FSA's October 2006 paper, outlining thematic work undertaken with regard to PPI, firms should have already instigated remedial action to improve processes. Suitability and eligibility must be the core criteria for compliant policies, given the abundant examples of customers being sold products under which they are unlikely ever to be able to make a successful claim.

It is good practice to implement a robust sales quality and effectiveness programme. This should monitor the messages insurance advisers are giving to potential customers, whether this adheres to the FSA's TCF principles, and if the product itself is suitable.

There is also a widespread myth that sales need to be scripted - they don't, they just need to be controlled. Removing unnecessary burdens from the sales process can quickly increase its effectiveness, and allow advisers to focus on better understanding customers' needs and selecting appropriate products to satisfactorily address those needs.

There are some instances where the sale of PPI has been halted and this is particularly prevalent for single premium policies. In these circumstances it is clearly important to undertake the tactical redesign of sales processes as a matter of urgency.

While this approach may not suit all companies, those firms that do not halt sales need to balance the risk of increasing their liabilities against their ongoing revenue stream. If halting sales is not the preferred approach, additional controls will be essential to maintain compliant sales processes.

Many organisations are undertaking reviews of their selling practices, and this can evidently yield a number of benefits. One firm saw the 'compliance' of PPI sales improve by 100% as a result of active call monitoring, supported by immediate training interventions with the sales team. Any redesign will need to be informed not only by the FSA and OFT review findings, but also by the experiences of the firm in question. Redesign should focus on the customer experience when making claims or complaints, in particular instances where claims or complaints have not been upheld.

A conversion rate of 90% may look impressive, but if 50% of those sales are cancelled prematurely this can misrepresent profitability.



4. Strategic positioning

Forward thinking organisations are now revisiting processes, with the aim of creating broader opportunities for business performance improvement. This holistic approach to redesigning how PPI and other protection products are managed should cover not only sales processes, but also reward strategies, training provision and outsourcing opportunities. These areas are described in more detail in the following section.

Sales processes

Sales of PPI products are achieved through a number of channels, with the highest volumes being generated by call centres. All firms need to have absolute confidence in their Training & Competence (T&C) regime. However, many sellers of General Insurance products are new to operating in a regulated environment and their T&C schemes are relatively immature. This issue represents more than just a change to training provision. The key is to instil a compliance culture within the organisation, and this cannot be achieved overnight.

Competent staff are better able to understand the boundaries of their responsibilities, particularly where compliance controls are in place, thus improving their efficiency and reducing their exposure to regulatory risk.

Where sales processes include decision trees and scripts, it is essential for firms to have the most appropriate controls in place to ensure that operators adhere to the prescribed process. This will prevent operators from deviating into areas where they are neither competent nor approved to give advice.

Firms should consider the overall customer experience when determining script structure and content. Whilst rapport building is an essential part of any customer

focussed activity, Huntswood has witnessed call durations ranging from 15 minutes to 1 hour, with significant variances in the level of non-value added conversation.

Firms can tend to concentrate on conversion rates as a measure of success within a sales environment, with persistency of these sales often overlooked. Management information that focuses predominantly on conversion rates does not present an accurate overall picture of how successful a sales channel is. For example, a call centre that has a conversion rate of 90% may appear impressive, but if 50% of those sales are cancelled prematurely, for example during the cooling-off period, then profitability is misrepresented.

Over the long-term, firms need to improve sales effectiveness, using the lessons learned from a comprehensive review of sales practices. Particular focus needs to be given to the structure of products and exclusions attached to them, considering what proportion of the firm's customers the product would be suitable for. This information should influence the product design process and is an integral part of the firm's TCF programme. Without it, the firm should arguably not be operating in the market.

Reward strategies

The FSA has stated that it considers remuneration strategies to be a fundamental aspect of a firm's approach to embedding TCF. Many firms that operate call centres have reward strategies which, unless rigorously scrutinised, can inadvertently encourage inappropriate sales behaviour, with conversion rates often linked to employee's remuneration.

By concentrating on the quality of the business that is written, firms will create greater value in the future as more policies will remain in force for longer. From this position customer retention is much easier and will engender future sales opportunities.

Huntswood believes that a company's long term strategy should clearly focus on the customer experience and successful retention activities as opposed to high volume selling practices. This will encourage a more sustainable sales model.

Training provision

The importance of training, delivered to employees at all levels, cannot be overstated. Not only is it a regulatory requirement for a firm to ensure that all staff are 'competent', but training can also be used as an important facet in a firm's overall sales delivery strategy. Employees who receive ongoing development are more likely to feel a greater sense of responsibility for their behaviour towards customers, whilst also having confidence in their knowledge and capability to effectively service customer requirements.

It is also important that firms' senior management teams fully understand their FSA obligations. Some of Huntswood's clients regularly hold refresher courses for their key personnel to ensure that these responsibilities are understood, and that regulatory developments are communicated and cascaded effectively.

Firms need to consider the options available when delivering training from a cost / benefit perspective, in order to maximise the success of the training against logistical and resource costs. Despite advances in technology and the ascendance of computer based training (CBT) and eLearning solutions, there are still circumstances where face-to-face, classroom style training is more appropriate.

Outsourcing opportunities

For many of Huntswood's clients, outsourcing - whether wholesale or on an individual interim basis - continues to be the most attractive option for cost reduction, performance improvement and control. By harnessing the expertise and economies of scale afforded by outsourcing vendors, firms can improve the effectiveness of various elements of their overall operation.

From individual functions such as claims and case management to full business process outsourcing (BPO) services, there are numerous opportunities to control and reduce costs within a business. Whilst ultimate responsibility cannot be outsourced, the implementation of robust service level agreements can ensure that risks and responsibilities are actively and effectively managed.

Attrition rates within call centres exceed many other professions, and the costs incurred through high levels of staff turnover (particularly sunk costs such as recruitment and training) have to be absorbed by the business. By using an outsource service provider these costs, along with the non-tangible costs of staff turnover, can be agreed and contained within the outsourcing contract.



Strategic thinking for success

The core of current activity for large scale PPI providers includes responding to the FSA on progress, implementing remediation programmes and initiating the process of tactical enhancements to products and internal procedures.

A small number of pragmatic providers are beginning to invest in a strategic redesign of their PPI business. This has been brought about by the timescales now being imposed on the industry by the media, the FSA, and the OFT's referral to the Competition Commission for market investigation.

However, programmes which are tactically-led can present a number of problems, for example allowing reactive cancellations of policies by customers who need PPI cover. They can also overlook a number of possible business opportunities, including the reduction of policy cancellation rates, alliance strategies and strategies for increasing market share and generating a better return on investment through future proof business redesign.

Delivering rapid and lasting results

Huntswood firmly believes that PPI will continue to be an important product in the insurance marketplace, bringing much valued benefits to customers. However, firms will need to reassess how they distribute this product to ensure that historic failings are not repeated.

In future, a significant improvement in the customer experience must be demonstrated. Firms will have to instil customer confidence by giving them knowledge and certainty that they have been sold the right product. It is on this basis that success will ultimately be judged.

The personal finance marketplace is becoming increasingly competitive, and Huntswood strongly believes that a successful long term strategy must promote improved retention and greater product persistency. This will require firms to review their sales procedures from a customer experience perspective, with far greater emphasis being placed on the suitability of sales and customer confidence instead of sales volumes.

Resources and reward strategies continue to be almost exclusively aligned with the drive to increase new business, with little resource available to concentrate on long term customer relationships. This imbalance represents a high risk strategy and will invariably result in missed opportunities to improve bottom-line performance.

Huntswood believes that it is the responsibility of senior management to raise the importance of these areas and to formulate an action plan to address them.

For firms where PPI sales constitute a large portion of overall profit it is essential that this planning takes place sooner rather than later. It will be the visionary firms that will have a successful future in this marketplace.

Huntswood recommends that all investment made in improving PPI business should be geared towards delivering benefits, particularly implementing best practice and increasing competitive advantage. This methodology is summarised in Figure 2 below.

For firms who enjoy a large portion of their profits from PPI sales, it is essential that this planning takes place sooner rather than later.



Figure 2: Increasing competitive advantage

	Past Weaknesses	Tactical Compliance	Competitive Advantage
Activity	1. Governance and commitment		4. Strategic positioning
Our Approach	2. Review of past practices	3. Tactical redesign	
Benefits	<ul style="list-style-type: none"> Reduce liability (in the order of 20%) Improve efficiency and time in dealing with liability Stop policy cancellations, reaffirm fit for purpose and retain customers 	<ul style="list-style-type: none"> Enable sales to continue with a compliant product offering Promote confidence in market Develop strategy to increase market share in period of uncertainty 	<ul style="list-style-type: none"> Develop a benefits model to maximise investment from activity Implement Principle Based Regulation design relating to TCF Implement holistic effectiveness review and improvement programme covering sales, rewards, training and competency Review and implement outsourcing where compelling
Credentials	<ul style="list-style-type: none"> Effected successful remediation for leading division of a UK Retail Bank Developed approach to remediation for division of a leading global player Project managed workstreams of numerous PPI programmes 	<ul style="list-style-type: none"> Close intervention led to increased compliance of contact centre sales for UK Retail Bank Revised complaints procedures for leading division of UK Retail Bank Updated scripts and rolled out training for UK Card Services company 	<ul style="list-style-type: none"> Roll out of new T&C framework for UK Retail Bank

In conclusion

Potential mis-selling of PPI is a significant problem for a number of firms, as PPI often represents an important revenue stream and remediation activity can prove costly.

The aspiration for affected firms should therefore be to instil fair sales practices, particularly in relation to appropriate product selection, to protect future profits. Firms should also be instigating historic sales reviews and remediation activity where appropriate.

Firms' approach to implementing TCF should therefore consider the sale of PPI as a priority.



How Huntswood can help

Huntswood has successfully advised and assisted a number of clients that had identified potential risks with PPI sales. Our insight, experience, flexibility and breadth of service has enabled us to successfully identify and reduce risk exposure, manage remediation, promote increased customer retention and future revenues, and develop a TCF compliant approach going forward.

We offer a range of solutions to support PPI remediation and sales. These include:

- 1-2 week rapid PPI product risk assessment and action plan
- PPI redesign and performance improvement programme
- Outsourced customer services for rapid, best practice customer remediation and retention
- Reviews / healthchecks of existing procedure manuals and modus operandi within firms for the detection of criminal activity.

Huntswood's clients are acknowledged as setting the standard in both the PPI and TCF arena. We are thought leaders in the provision of TCF advice, assessment, programme design and implementation. Huntswood has created not only successful TCF programmes for our clients, as acknowledged by the FSA, but is also helping to drive lasting cultural change and deliver competitive advantage.

For more information please contact us on **0800 583 0794** or email askhuntswood@huntswood.com

About Huntswood

We work with clients where we are sure we can improve their performance and reduce their risk in highly regulated, highly complex, customer sensitive environments.

Huntswood is a professional services organisation providing expert consultancy and bespoke outsourcing solutions to clients throughout the UK. Our knowledge and experience within regulated industries enables us to support services to the financial services, utilities, telecoms and transportation industries, in both the public and private sector.

Huntswood delivers strategic advantage to its clients. We interact with 350,000 of our clients' customers each year, handling around £250 million of our clients' monies in the process. Our people have on average 14 years relevant experience gained from diverse backgrounds such as industry, regulators and other blue-chip organisations.

Huntswood is a Sunday Times Fast Track 100 company achieving a ranking in the top third of Britain's fastest-growing private companies. In November 2006 Huntswood was named as the 7th fastest growing business over the last 5 years in the Thames Valley.

Please visit www.huntswood.com for further information.