

Institution: University of Bolton
Unit of Assessment: 04 Psychology, Psychiatry and Neuroscience
Title of case study: The psychology of consumer credit risk management: Impact on the UK payment protection insurance (PPI) market
<p>1. Summary of the impact (indicative maximum 100 words)</p> <p>The research group investigated UK borrowers' payment protection insurance (PPI) decision making using randomised-groups experiments and a novel cognitive process-tracing methodology. This contributed to the design and interpretation of a consumer survey, a key element of the Office of Fair Trading's 2006 market study of PPI, via the involvement of the principal investigator as consultant. The survey played a major role in the referral of PPI to the competition commission and subsequent major changes implemented by the FSA to the regulation of the PPI market and associated consumer support. This has been of direct benefit to millions of UK borrowers and has also had a major impact on the competitiveness of the UK personal insurance market.</p>
<p>2. Underpinning research (indicative maximum 500 words)</p> <p>The research developed over three projects. The first was a project grant under the ESRC's Risk and Human Behaviour programme (£80,000 over 27 months): <i>Inconsistent decisions involving risk and uncertainty: Process tracing studies</i> (1996-1999, with Janis Williamson, University of Bolton). This evaluated a novel cognitive process tracing method (reference 1) that was applied in a study of consumer credit and risk management decision processes (references 2, 3). The second was sponsored by the Co-operative Bank: <i>The psychology of consumer credit decision making and payment protection insurance</i> (with Sandie McHugh, University of Bolton, 2005 – 2006). The third followed this up, supported by the University of Bolton's Strategic Research Investment Fund (also with Sandie McHugh, Honorary Research Associate). These two projects together comprised a series of questionnaire-based experiments of consumer credit and payment protection insurance decisions (references 4, 5, 6). The research has had policy and practical impact regarding two main issues: (1) borrowers' decision making for choice of credit product and repayment levels, focussing on the role of cost and loan duration information; (2) credit risk management, including decisions to purchase PPI. This case study concerns the impact of our research on the second issue.</p> <p>Insights included: the identification of a range of credit risk defusing operators adopted by borrowers, including PPI purchase; the finding that total credit cost information moderates the influence of Annual percentage Rate (APR) information on credit decisions; findings revealing the insensitivity of PPI decisions to changes in cost and level of cover; and evaluation of the relative impact on PPI decisions of disposable income, education, cognitive appraisal of PPI and emotion-based factors.</p>
<p>3. References to the research (indicative maximum of six references)</p> <ol style="list-style-type: none"> Williamson, J., Ranyard, R. & Cuthbert, L. (2000a). Conversation-based process tracing methods for the study of naturalistic decisions: an evaluation study. <i>British Journal of Psychology</i>, 91, 203-221. Williamson, J., Ranyard, R. & Cuthbert, L.J. (2000). Risk management in naturalistic insurance decisions: Evidence from a process tracing study. <i>Decision, Risk & Policy</i>, 5, 19-38. Ranyard, R. Hinkley, L. & Williamson, J. (2001). Risk management in consumers' credit decision making: A process tracing study of repayment insurance choices. <i>Zeitschrift Für Sozialpsychologie</i> 32, 152-161. McHugh, S., Ranyard, R., & Lewis, A. (2011). Understanding and knowledge of credit cost and duration: Effects on credit judgements and decisions. <i>Journal of Economic Psychology</i>, 32(4), 609-620. doi: 10.1016/j.joep.2011.02.005 Ranyard, R. & McHugh, S. (2012). Bounded rationality in credit consumers' payment protection insurance decisions: The effect of relative cost and level of cover. <i>Journal of Risk Research</i>, 15, 937-950. DOI: 10.1080/13669877.2012.686050. Ranyard, R., & McHugh, S. (2012). Defusing the risk of borrowing: The psychology of payment

protection insurance decisions. *Journal of Economic Psychology*, 33, 738-748. DOI: 10.1016/j.joep.2012.02.002

4. Details of the impact (indicative maximum 750 words)

In June 2005 Ranyard, principal investigator on this research, was invited to participate in a seminar on *Consumer Detriment* at the OFT. His presentation, *Consumer credit and payment protection insurance decisions: Seeking benefit and avoiding detriment*, described relevant findings from project 1 and preliminary findings from project 2, and discussed their policy implications. Following this, in 2006 the OFT carried out a market study of PPI in the UK and commissioned Ranyard as consultant on the study, to 'examine the findings from the consumer survey with a view to considering the psychological factors which might influence the consumer's decision to buy or not to buy PPI and, in the light of the survey findings, how might the consumer be supported and what might be done to facilitate informed PPI decision making'. He also 'contributed to the design of the consumer survey' (report 1 below, paragraph 2.13). The market study was published in October 2006, with the PI's independent report published as Annex C. Among other things, his report highlighted the importance of disclosing the total cost of PPI and problems for borrowers associated with the joint sale of PPI with credit products. Following the OFT's market study several important changes related to these points were implemented, the first stage of the process described in a report by the FSA in October 2006 (see below). They emphasised that they wanted to see total cost disclosure, citing the PI's research (paragraph 6). In January 2009 the Competition Commission published its final report (report 3 below) which included the following action that was incorporated into regulations in 2010: 'A requirement on distributors and intermediaries to provide a 'personal PPI quote', clearly stating the cost of the PPI policy'. Proposals to prohibit the joint sale of PPI were also made, and this came into force on Good Friday 2012.

5. Sources to corroborate the impact (indicative maximum of 10 references)

Report 1:

Payment protection insurance

Report on the market study and proposed decision to make a market investigation reference October 2006 (OFT869)

Extracts from the report

Academic input

2.13 We commissioned an academic with a particular knowledge of PPI- Rob Ranyard, Professor of Psychology at the Department of Psychology and Life Sciences, University of Bolton to examine the findings from the consumer survey with a view to considering the psychological factors which might influence the consumer's decision to buy or not to buy PPI and, in the light of the survey findings, how might the consumer be supported and what might be done to facilitate informed PPI decision making. Professor Ranyard also contributed to the design of the consumer survey. Professor Ranyard's report can be found at **Annexe C**.

The Annexes to this report are available on our website at

www.of.gov.uk/Business/Market+studies/payment.htm

http://www.of.gov.uk/shared_of/reports/financial_products/of869annxec.pdf

Annexe C

The Psychology of Consumer Credit Risk Management: The Case of Payment Protection Insurance in the UK

October 2006 (OFT869c)

From Annex C

Report produced by Rob Ranyard, University of Bolton. This report was commissioned for the market study. It is the responsibility of the authors and any views expressed in it are those of the authors and not necessarily of the OFT.

Report 2:

Financial Services Authority

The Sale of Payment Protection Insurance – results of follow-up thematic work

October 2006 (PUB REF: 2748N: 0117042862)

Extract from the report

Impact case study (REF3b)**6 The sale of PPI – Results of follow-up thematic work****The outcomes we want to see:**

Customers understand the true cost of the product before they buy. They know the monthly and total cost of the PPI and where a single premium is included within the credit, how much interest they are paying. Firms do not just rely on the written Statement of Price. (ICOB 5.5.14R and Principles 6 & 7). OFT research⁷ notes the importance of disclosing the total price of PPI and how this influences consumer behaviour.

7 Payment Protection Insurance: market study report October 2006 – Summary of Dr Rob Ranyard's work

(Note that the whole OFT survey was also used for this report)

http://www.fsa.gov.uk/pubs/other/ppi_thematic.pdf

Document 3:

The impact of the above report is summarised here:

<http://www.cml.org.uk/cml/policy/issues/1552>

Document 4: FSA press release 2010:

<http://www.fsa.gov.uk/library/communication/pr/2010/132.shtml>

FSA confirms measures to reform PPI market and protect consumers

FSA/PN/132/2010

10 Aug 2010

The Financial Services Authority (FSA) today published a policy statement confirming its package of measures to protect consumers in the Payment Protection Insurance (PPI) market.

The package will ensure customers are treated more fairly when complaining about PPI and better when buying the product; it includes:

- new handbook guidance to ensure complaints are handled properly, and redressed fairly where appropriate;
- an explanation of when and why firms should analyse their past complaints to identify if there are serious flaws in sales practices that may have affected complainants and even non-complainants; and
- an open letter setting out common sales failings to help firms identify bad practice.

Firms must implement the measures by 1st December 2010, with the time in between to prepare for implementation such as training staff to a higher level. The FSA will be monitoring firms closely to ensure the new standards are adhered to.

Dan Waters, the FSA's director of conduct risk, said:

"Today is the culmination of months of hard work and now, with these measures, we look forward to consumers being treated fairly whether they are buying or complaining about PPI.

"Since we took over the regulation of PPI we've carried out 24 investigations and three thematic reviews, issued warnings, halted the selling of single premium PPI with unsecured personal loans, visited over 200 firms, and handed out some very significant fines. Now, with this package of measures we're confident we can mend a market that has been broken for too long.

"This remedy is fair to consumers and the industry alike. The onus is now on the industry to ensure it treats all customers fairly. We will be monitoring the implementation of our guidance closely to ensure real change is delivered."

The policy statement follows consultation that saw significant levels of highly detailed feedback from PPI providers, sellers, trade groups and consumer bodies.

The measures follow up on the FSA's commitment to reform the market and build on the agreement the FSA secured from the industry in 2009 to stop selling single premium PPI on unsecured loans. The FSA has also taken action against 24 firms and individuals for PPI failings with fines totalling approximately £13 million.

Document 5

http://www.competition-commission.org.uk/assets/competitioncommission/docs/2011/media-centre/13_11_ppi_cc_publishes_final_order.pdf