LIFE INSURANCE

Response to Draft Report into Competition in the Australian Financial System

MLC Life Insurance submission to the Productivity Commission

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MLC Life Insurance welcomes the opportunity to respond to the Productivity Commission's *Draft Report into Competition in the Australian Financial System*.

MLC Life Insurance's response is limited to addressing the issue of add-on insurance sold via authorised deposit-taking institutions (ADIs). We seek to aid the work of the Productivity Commission in this regard by informing it on issues relevant to the Consumer Credit Insurance (CCI) market, based on our experience as a market participant. We also provide feedback on *Draft Recommendation 14.1 – Deferred Sales Model for Add-On Insurance*.

Background – some features of MLC Life Insurance CCI products

MLC Life Insurance is the manufacturer of three CCI products distributed via National Australia Bank (NAB) – NAB Mortgage Protect, NAB Personal Loan Cover and NAB Credit Card Cover. These products are simple in design with a fixed set of benefits covering life, disability, involuntary unemployment and critical illness[1]. Sales and service responsibilities for these products are split between MLC Life Insurance and NAB. In simple terms, MLC Life Insurance is responsible for designing and manufacturing the products, ongoing customer service post sale, and assessing and paying claims. NAB is responsible for product distribution.

MLC Life Insurance understands the imperative for customers to receive value from all the products we manufacture, including CCI products. In recent years we have undertaken CCI customer research, which has confirmed the appeal and relevance of these products to certain customer segments and informed the product design and customer engagement enhancements we have since introduced. The research included focus group testing with current customers, past customers and customers who chose not to take up insurance. We have also undertaken an independent analysis of our CCI claims ratio and introduced a target claims ratio that we believe is fair. Examples of the enhancements we have made to provide greater customer value include:

- Increasing the total benefits payable by benefit type, such as increasing the number of months we will pay an unemployment or disability claim.
- Increasing the number of critical illness conditions covered and making the definitions easier to satisfy at claim time.
- Increasing claim limits such as increasing lump sum benefits and extending claim benefits after a critical illness benefit has been paid.
- Amending products to enable casual employees to more easily satisfy claim criteria.
- Reducing pre-existing exclusion periods for NAB Mortgage Protect and NAB Credit Card Cover.
- Shortening qualifying periods and removing waiting periods.
- Increasing the standard and frequency of communications to customers.
- Improvement in claim processing times by implementing 'pay and finalise' processes that assess and approve claim lodgements quickly, reducing paperwork requirements thereby fast tracking claim payments.
- Helping customers identify opportunities to claim. For example we work closely with NAB's Deceased Estates Team to cross-reference decreased estates data with our insurance data. Where a match is found we proactively initiate a claim against the policy.

[1] NAB Mortgage Protect covers life, disability and involuntary unemployment only.

As a result of these enhancements we are seeing the claim acceptance rates on NAB Mortgage Protect and NAB Credit Card Cover improve, and are moving towards the target claims ratio referenced above.

Additionally, in 2016 we made our Best Doctors service accessible to all our CCI product holders. Best Doctors is a medical second opinion service made available to all MLC Life Insurance CCI and retail life insurance customers and their families, connecting them to expert doctors who can provide advice on the diagnosis and treatment plan. This service is completely confidential, comes at no additional cost to the customer and is not dependent on the customer experiencing a claimable event in order to access the service.

Differences between add-on insurance sold by car dealerships and CCI sold by banks

MLC Life Insurance notes the significant differences between add-on insurance sold by car dealerships and CCI sold by ADIs. In particular, we note that many of the issues identified by the Productivity Commission and by the Australian Securities and Investments Commission (ASIC) relate only to add-on insurance sold by car dealerships, and not to CCI products, including:

- Negative and low value policies — some add-on products see loss ratios below 10%.
- Unnecessary additional 'extras' cover — for example, cover for identity theft leading to credit card fraud despite this being already covered by most credit card providers.
- Overlapping and unnecessary cover — policies that insure the same risk twice, or insure against events already covered by warranties.
- Incidences of reverse competition —where insurers compete not for the consumer but for the retailer's favour, fuelling commissions of up to 79%. In comparison CCI issuers are limited to commissions of 20%.

We also note that ASIC has made numerous other findings in relation to life insurance sold by car dealerships in ASIC Report 471, *The sale of life insurance through car dealers: Taking consumers for a ride*, that indicates such insurance is poor value for consumers when compared to similar products sold via ADIs.

We believe the differences between car yard add-on products and ADI distributed CCI products, as documented by ASIC and the Productivity Commission, represent grounds for the Productivity Commission to differentiate between the two in its final report, and for this differentiation to be reflected in recommendations made in the final report.

Issues raised in respect of CCI products

The *Draft Report into Competition in the Australian Financial System* makes a number of findings about CCI that shine a light on historical and current issues within the CCI market. Offered below are our perspectives on the key issues identified.

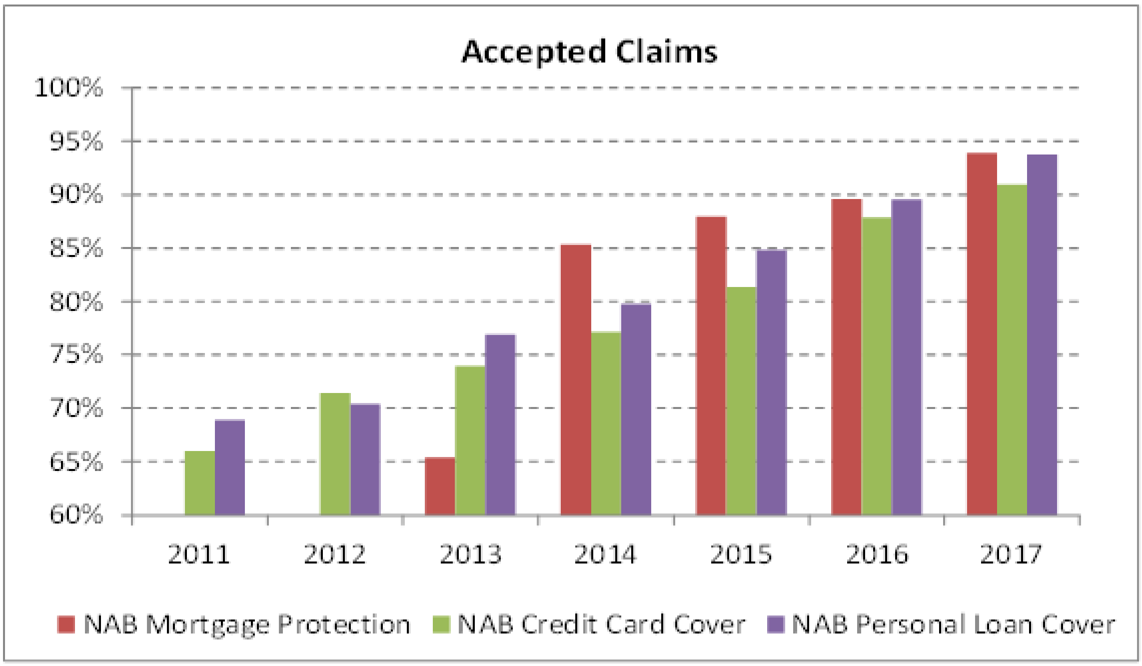
Low claim acceptance rate

The *Draft Report into Competition in the Australian Financial System* states on page 399:

> *'only 85% of consumer credit insurance claims are accepted. This is well below the average rate for retail insurance policies of 96%'.*

We understand the basis for the Productivity Commission's concern in this respect, and note from our own experience that it is possible for CCI providers to address this issue. Since 2011 we have reviewed and re-engineered our claims processes as they relate to CCI products to make them more consumer-centric.

Together with product enhancements, the net effect is an increase in the percentage of claims accepted to above 90%. The table below indicates the steady progress we have made since 2011 to achieve this acceptance rate.



Poor levels of consumer understanding

Along with our distributor NAB, MLC Life Insurance recognises that consumer understanding of their product is an issue of vital importance. Consistent with the recommendations made by ASIC in Report 256 *Consumer credit insurance: A review of sales practices by authorised deposit-taking institutions*, MLC Life Insurance and NAB have been acting jointly to increase consumer awareness about the benefits, limitations, exclusions and premiums of our CCI products. For assurance of the effectiveness of these actions, MLC Life Insurance monitors monthly lapse rates to identify areas of concern relating to consumer understanding.

Our customer communication approach is designed to achieve two goals:

- to ensure customers are aware of their CCI purchase
- to reinforce the features and benefits of the product they have purchased.

As an example, new NAB Mortgage Protect customers would typically receive the following communications:

1. A quote summary via their email.
2. The insurance application via their internet banking account.
3. A welcome pack which includes a letter, policy schedule, product disclosure statement, financial services guide and Best Doctors flyer.
4. A welcome SMS sent 1-2 days after the policy start date.
5. A welcome call made between days 14 and 30 of their policy start date.
6. A Best Doctors flyer 60 days after policy commencement to reinforce features and benefits of Best Doctors service.
7. A policy renewal every twelve months.

Whist in early days for our mortgage insurance portfolio (the product was upgraded in December 2017) the combination of product enhancements and a customer centric approach to communication has resulted in improvement of our 60-day and 90-day lapse rates by 27% and 21% respectively.

Additionally, the commencement of the Life Insurance Code of Practice (LICOP) in July 2017 has seen the introduction of a number of new communication and other obligations that apply to life insurance, including CCI products, which are specifically addressed in LICOP. LICOP also codifies a number of rights for life insurance customers. We firmly believe that the LICOP will lead to improved consumer understanding and outcomes across the CCI sector.

CCI selling practices

Like the Productivity Commission, we recognise there has been progress in improving selling practices in the CCI industry, but that the industry needs to ensure standards continue to improve. Recent and forthcoming self-regulatory and regulatory changes mean we expect this improvement to occur, even in the absence of a deferred sales model.

Section 3 of the LICOP imposes product design obligations on life insurers requiring products to cover genuine risks that generally affect the customers buying the product, to ensure that products are suitable for the customers buying them, and to redesign the products if this is found not to be the case. Outwardly simple, these obligations form a new and robust layer of manufacturer-level protection against mis-selling.

Building on these improvements are the Australian Government's pending design and distribution obligations for financial products, presently the subject of Treasury consultation. We expect that, once finalised and implemented, these obligations will ensure that product issuers and distributors appropriately design, target and distribute financial products so that the risk of mis-selling is mitigated. In particular, the requirement for products to have a target market determination, and for distributors to make reasonable efforts to ensure dealings in a product are consistent with the determination, will mitigate against mis-selling in the future.

Associated with the design and distribution obligations are proposed new product intervention powers for ASIC, also a subject of current Treasury consultation. The proposed powers will give ASIC the capability to take action when it believes products are not complying with the design and distribution obligations.

We recommend the Productivity Commission take the above developments into account when considering CCI policy responses. Taken together we anticipate the LICOP, the design and distribution obligations and the ASIC product intervention powers will provide consumer protections and support consumer value in the CCI industry.

Policy initiatives that would support consumer value across the CCI industry

The MLC Life Insurance and NAB initiatives noted above have acted together to deliver value to consumers from CCI products. However, we appreciate that from a public policy perspective the actions and experience of individual organisations are insufficient to address the industry level issues raised by the Productivity Commission, ASIC and others and that as a consequence the Commission will wish to pursue a policy response.

The Productivity Commission's proposed policy response is for a deferred sales process to be introduced to address the issues identified. We believe this approach is not the most effective approach to resolving the issues, which are better addressed through measures that identify and target the root causes. We suggest the introduction of industry self-regulation to ensure that all CCI products sold in Australia, and the process by which they are sold, meet a set minimum standard. These standards could set:

- The required breadth of coverage, such as the number of critical illness conditions covered or the types of employment that are deemed sufficient to be able to successfully claim.
- Minimum and maximum waiting periods and pre-existing condition periods.
- The standards of communication and disclosures that must be met at time of sale and throughout the life of the policy; for example: plain language communications, along with sanctions for failing to meet the communication standard.
- Minimum training standards for employees involved in the distribution of CCI products.
- The rights of customers at claim time.
- Ongoing monitoring of performance such as sales lapse rates.

Such a product regulation would need to be flexible in order to remain relevant to the market over time and would need to extend to both issuers and distributors. Each goal is best realised through industry self-regulation, ideally under the auspices of one or more industry associations.

Comment on recommendation 14.1 – deferred sales model for add-on insurance

Draft Recommendation 14.1 – Deferred Sales Model for Add-On Insurance states:

> *The Australian Securities and Investments Commission should proceed as soon as possible with its proposal to mandate a deferred sales model for all sales of add-on insurance by car dealerships.*
>
> *Following implementation, the Australian Government should establish a Treasury-led working group to extend the deferred sales model to all add on insurance products in a practical timeframe.*

We think there is a valuable role that a Treasury-led working group could play in analysing CCI industry issues and developing appropriate policy responses, however we do not think that role should be to merely implement a deferred sales model. We submit that the Treasury-led working group should address specific concerns relating to CCI products, which would allow for them to be viewed in context, distinct from add-on products sold by car dealerships. This would allow for more precise policy recommendations that minimise the risk of unintended consequences, such as the social cost of reducing the number of Australians with adequate insurance coverage.

We further suggest that moving to a deferred sales approach will have negative consequences for customers. These relate to at least three areas:

1. It forces the customer to have multiple interactions with the ADI or the insurance company as opposed to their needs being addressed in a single interaction.
2. Due to uncertainty around our ability to subsequently contact the customer, there is a heightened risk that the customer never considers insurance and doesn't become insured. In the case of NAB Mortgage Protect, this raises the risk of leaving the customer uninsured for what might be both their home and their largest financial asset.
3. Today's average borrower is typically highly geared with limited access to other liquid assets and exposed to risk if an insurable event were to occur. CCI mitigates this risk, as well as providing the tangible benefit of peace of mind that they are covered if an event was to occur.

In raising these risks we also note the Productivity Commission's own advice to regulatory bodies to consider the impacts to competition when they make a regulatory change. We would echo that advice, but in the context of encouraging the Commission to consider the negative unintended consequences that may follow a move to a deferred sales model when other effective policy responses are possible.