Cover•More

COVER-MORE GROUP SUBMISSION
TO
QUALITY OF ADVICE REVIEW

JUNE 2022

Cover-More Group

Cover-More Group (Cover-More) is Australia's leading travel insurance and assistance provider. Cover-More was established in Sydney in 1986 and was acquired by Zurich Insurance Group in 2017. Prior to the COVID-19 pandemic, Cover-More served more than 15 million customers with operations in 16 countries. Our head office remains in Sydney and we currently employ a global workforce of 1,500 people, with more than 500 staff based in Australia.

In 2019[1], around four million Australians travelled internationally with a Cover-More travel insurance policy. We provided assistance to more than 35,000 travellers who were injured, fell ill or encountered trouble overseas and conducted around 400 acute medical interventions and emergency evacuations of Australian travellers. Our medical assistance and travel risk management team, which is headquartered in Australia, comprises more than 150 doctors, nurses, paramedics, security professionals, emergency call centre operators and support personnel.

Throughout the COVID-19 pandemic, Cover-More continued to provide travel insurance and medical assistance to Australians who needed to travel overseas for compassionate or work-related reasons.

Quality of Advice Review

Cover-More welcomes the opportunity to provide feedback on the matters set out in the Quality of Advice Review (**"Review"**) Issues Paper.

The most relevant topic in the Review's scope for Cover-More is the consideration of the legislated exemption to the ban on conflicted remuneration for the sale of general insurance (**"GI"**) products.

The exemption was put in place in 2012 as part of the Future of Financial Advice (**"FOFA"**) reforms. This exemption reflected a recognition that the key features of GI products were distinct from those financial products that were the impetus for the FOFA reforms. As the explanatory memorandum to the legislation noted:

> *"Basic banking products and general insurance are recognised as being simple in nature and are more widely understood by consumers. This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, a modified best interests obligation more appropriately balances the benefits to consumers with the compliance costs to providers."* [2]

As well as being generally well understood by consumers, GI products do not have an investment component, are of fixed duration and are typically distributed without the provision of personal advice.

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[1] 2019 is used for reference as it is the most recent year for which meaningful statistics are available, due to the impact of COVID-19 on travel.

[2] Revised Explanatory Memorandum to the Corporations Amendment Bill (Further Future of Financial Advice Measures) Bill 2011, p16

Travel insurance

In addition to these features, travel insurance has inherent characteristics that distinguish it from other GI products:

- Its benefits to the consumer are not confined to potential events during the period of travel, such as lost baggage or medical expenses, but apply from the point of purchase. If circumstances change in the intervening period, for example if a natural disaster occurs at the destination, or the consumer sustains an injury and is unable to travel, or is no longer in paid employment and needs to cancel, the consumer is covered;

- The potential claim, for example as a result of a medical event during the period of travel, can be a significant multiple of the value of the primary product purchased; and

- Its coverage extends across a wide range of risk areas and jurisdictions.

In view of the risks associated with under-insurance, particularly where international travel is concerned, substantive and collaborative efforts by government, industry and consumer groups are directed at raising awareness of the importance of purchasing travel insurance.

The COVID-19 pandemic has underscored the importance of travel insurance. The Department of Foreign Affairs (**"DFAT"**) has continued to engage with travel insurers and the Insurance Council of Australia throughout the course of the pandemic, in recognition of the industry's integral role in the resumption and ongoing sustainability of international travel by Australians. In some jurisdictions, proof of travel insurance with COVID-19 coverage has become an entry requirement for travellers, e.g. Indonesia, Thailand, Japan.[3]

The Smartraveller website administered by DFAT has modified its advice to reflect the heightened importance of travel insurance, adding the statement *"If you're going overseas, travel insurance is as important as a passport"* to supplement its longstanding guidance that *"If you can't afford travel insurance, you can't afford to travel."* [4]

Cover-More's products

Cover-More offers a range of products to Australian consumers for domestic and international travel for single trips, or multiple trips over a 12-month period, with many different levels of cover available. Single-trip insurance accounts for the vast majority of policies purchased. Insurance for international travel dominates sales of both single-trip and multi-trip policies, with the historically lower proportion of domestic policies a function of Australia's universal healthcare system, although COVID-19 related risks have seen an increased uptake of domestic policies reflecting the ongoing importance of travel insurance.

Cover-More strives to continually adapt our products to consumers' needs and to provide greater choice. In recent years, consumers have increasingly sought coverage for activities undertaken overseas such as heliskiing and use of high engine capacity motorcycles, and we have responded by developing products to meet those needs. Cover-More has also been a market leader in expanding the availability of coverage to Australian travellers with mental health conditions. Cover-More was the first Australian travel insurance provider to introduce a service that enables Australian travellers overseas to consult by telephone with an Australian-based doctor, instead of engaging with medical authorities overseas where language and cultural barriers may exist. Cover-More recently launched an app aimed at leisure travellers

[3] www.smartraveller.gov.au/destinations
[4] www.smartraveller.gov.au

which, in addition to information concerning their insurance coverage, provides security alerts, COVID-19 notifications, city-based information and an emergency button.

The advent of the COVID-19 pandemic has driven further innovation in travel insurance. Cover-More worked intensively to develop products to cover travellers. In December 2020, we were the first travel insurer in Australia to introduce COVID-19 benefits. These provide coverage for a range of overseas medical expenses, cancellation, accommodation and transport costs associated with disrupted plans arising from pandemic-related circumstances.

Distribution channels

Cover-More travel insurance products can be purchased directly, either online or by telephone, or indirectly through distribution partners who act as our authorised representatives.

Our distribution partners include Flight Centre, Helloworld, Webjet, Virgin Australia, Medibank, Australia Post, CBA, IAG, Coles and many independent travel agents. Some partners, such as travel agents, offer a wide range of insurance products that are customisable according to consumers' planned travel destinations and activities. These products may be bought in conjunction with or without the purchase of travel services such as an airline ticket, cruise or a holiday package. Online purchases of insurance with a travel service are 'integrated' sales. In the case of other partners, products are offered and sales occur in a standalone context, e.g. Medibank, Australia Post and Coles.

These partners play a critical role in Cover-More's product distribution, with 85 per cent of Cover-More travel insurance products sold through indirect channels in 2019. The consumer reach of these distributors in terms of brand, digital and physical presence is vast. They represent an efficient and effective means of facilitating widespread access to travel insurance products for consumers and in doing so, contribute to mitigating under-insurance risks.

Recent data indicates the indirect channel is currently responsible for approximately 75 per cent of Cover-More sales, even though many travel agencies are closed due to COVID-19 related understaffing. Once the retail footprint returns to normal, the indirect channel is expected to account for around 80 per cent of sales, with many consumers expected to seek the assistance of travel professionals in meeting their travel needs, including insurance, in the more complex post-COVID-19 environment. The balance of demand will be taken up by sales in the direct channel.

Cover-More continues to invest in the development of our direct sales channel. This activity has been stepped up significantly over the past two years, in line with the shift to greater use of digital channels accelerated by the COVID-19 pandemic. For Cover-More Direct, we have increased our digital marketing spend to build brand, worked to improve the purchase path experience on our website and developed a more diverse range of products to suit customer needs. In 2021, we launched the Freely app, that aims to broaden our coverage of the market, in particular younger consumers, by providing travellers the ability to manage all their insurance and assistance needs via the app.

While direct sales have risen in line with consumers' familiarity with digital purchasing and increased investment by Cover-More in this platform, indirect channels will continue to play an important role alongside the ongoing evolution of Cover-More's direct distribution offering as their consumer reach will ensure our products are readily accessible to all travellers.

Reforms to the GI regulatory framework

As the Issues Paper notes, a number of reforms to the regulation of the Australian financial system have occurred over the past decade as a consequence of various reviews that have made recommendations to governments. Many of these apply to GI products, including travel insurance.

One of the key reforms arising from the recommendations of the 2014 Financial System Inquiry was the development of the product design and distribution obligations (**"PDDO"**). The PDDO require product issuers to develop a target market determination ("**TMD"**) that specifies the intended market for each of an issuer's financial products. Products must be consistent with the likely objectives, financial situation and needs of customers within each target market. The PDDO also require issuers and distributors to take reasonable steps to ensure that the way they market, advise on or sell products is consistent with the TMD for that product. The Australian Securities and Investments Commission (**"ASIC"**) has wide-ranging powers to enforce the PDDO, from seeking information to issuing stop orders.

In 2019, the Financial Services Royal Commission (**"FSRC"**) recommended a prohibition on hawking of all insurance products. This was intended to ensure that consumers exercised full control over the receipt of information about insurance products that may be suitable for their needs, including the manner in which that information is provided to them, and accordingly over their decisions to purchase those products (or not). Although the sale of travel insurance in conjunction with travel services was not previously considered to constitute hawking[5], this is not the case under the revised approach.

The recommendations concerning PDDO and anti-hawking were accepted by the Australian Government and came into effect in October 2021. To ensure compliance with the updated legislative framework, Cover-More undertook a systematic review of all our products and purchase pathways across both the direct and indirect distribution channels. Product features have been refined for a defined target market, while purchase pathways have been modified so that customers work through a series of questions that identify the specific risks associated with their travel plans. As required by the PDDO framework, consumer outcomes and products are regularly reviewed to identify and address any issues as necessary. Implementation of these changes has been accompanied by the roll-out of training programs for relevant customer-facing staff at Cover-More and authorised representatives.

In combination, the PDDO and anti-hawking reforms have led to product improvement and more accurate selling. Consumers are better placed to choose products with the right level of cover to suit their individual needs and are in control of their decision-making.

Travel insurance was granted an exemption by regulation in 2021 from the application of a deferred sales model (**"DSM"**) to insurance products sold in conjunction with the sale of a primary product or service, on the basis of its unique characteristics. Exemptions were also granted for a small number of other GI products that were similarly judged to represent good value, be well understood by consumers and not subject to pressure-selling tactics, and where an enforced pause in consumers' ability to purchase the product risked under-insurance. The anti-hawking provisions act as an additional safeguard to ensure that sales practices cannot give rise to consumer detriment for these products as a consequence of the absence of an enforced pause through exemptions to the DSM.

A number of other reforms have been implemented in recent years that apply to travel insurance products. These include the extension of unfair contract terms protections to

[5] ASIC, Regulatory guide 38: The hawking provisions, May 2005, p11

insurance contracts, improvements to dispute resolution processes and strengthening of breach reporting requirements under the General Insurance Code of Practice.

Although travel insurance was not an area of focus for the FSRC, or the Parliamentary Inquiries relating to the insurance industry that took place immediately prior to it[6], Cover-More believes that the implementation of the suite of reforms to the regulatory framework will produce enhanced consumer outcomes. It is worth noting that the full benefits are yet to be realised, as several key changes were implemented relatively recently.

Customer value

Following on from the implementation of these regulatory reforms, Cover-More commenced a comprehensive review of customer value in late 2021. Cover-More believes that an overarching focus on value will best position us to deliver innovative and high-quality products at competitive prices that meet consumers' needs on a sustainable, long-term basis.

The review's objective was to rigorously analyse the value of all Cover-More's products sold in both direct and indirect channels, by applying a range of filters e.g. purchase path, geographic coverage, distribution partner, and identifying opportunities to make changes to enhance value.

There is a range of factors that contribute to a product's value proposition, including price, features, accessibility and the claims handling experience. Individual customers perceive various elements differently and each element has certain costs associated with it. For example, payments to distributors impact customer value through the convenience they provide, including to those customers who prefer face-to-face interaction, as well as through the costs they entail. Metrics can be assigned to the various elements and adjusted to improve the overall value of the customer proposition.

In broad terms, this work (which is ongoing) has delivered a range of value improvements through increased benefits and/or price reductions. By way of example, this includes:

- Development of new products available through the direct channel which provide consumers a choice of three levels of cover with differentiated benefits (rather than a single product); and

- Expanded coverage and additional benefits in policies for domestic travel sold through integrated airline channels. Previously, this cover was limited to the cost of the flight ticket booked with the carrier and checked-in baggage. The product now includes coverage for change/cancellation for tickets and all other prepaid non-refundable components such as accommodation and car hire; all baggage for the duration of the trip; and all existing medical conditions.

Remuneration is one of the elements of focus in the customer value work. The improvements to domestic product through the integrated channel path noted above was accompanied by a material reduction in commission rates paid to a major airline partner.

It is also important to note that Cover-More products sold through both channels provide similar customer value, as reflected in relevant claims ratios.[7]

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[6] Senate Economics References Committee, Report of the Inquiry into Consumer protection in the banking, insurance and financial sector, November 2018; and Report of the Inquiry into Australia's general insurance industry, August 2017.

[7] Cover-More submission to Treasury Proposal Paper: Reforms to the Sale of Add-on Insurance Products, September 2019, p3 and confidential attachment 3

Remuneration arrangements

Cover-More remunerates its distribution partners using a structure that applies an agreed rate of commission which is paid on the basis of the sum of the individual premiums sold.

Remuneration arrangements reflect the broad reach of distributors' networks. For Cover-More, the arrangements strike a balance between the need for competitive promotion of our products through these channels to provide a commercial return and avoid consumer risks of under-insurance, while maintaining high-value product offerings that suit travellers' needs.

Rates of commission are also a function of the power of distributors. This is particularly pronounced in the case of airlines, which account for a large proportion of sales of travel services in the Australian market. Accordingly, the tension between consumer accessibility, remuneration and product value is most acute in these arrangements.

It should be noted that commissions are not confined to indirect sales of insurance products. Direct channels utilise affiliates to help drive sales and are paid according to similar remuneration structures. It is also important to remember that there are costs connected with both direct and indirect distribution. Indirect distributors incur overhead costs associated with in-store representation, compliance and training. In the case of the direct channel, although Cover-More does not bear the cost of maintaining a physical retail presence, we outlay considerable expenditure on digital platforms and marketing.

The Issues Paper notes that the starting principle for the consideration of conflicted remuneration in the context of the FSRC was that it will always, by definition, raise the risk of poorer quality advice because it misaligns the incentives of advisers from the interests of consumers.

In Cover-More's view, remuneration arrangements for distributors of travel insurance are unlikely to drive behaviours that are contrary to consumers' interests because:

- the average price of travel insurance premium is low (compared with many other GI products, e.g. home and contents, motor vehicle, landlord insurance);
- in the case of transport providers or travel agents, the price of the premium is low relative to the price of the travel service, so the distributor is principally focused on selling the primary product; and
- the product is largely one-off in nature, i.e. single-trip policies, which means there is negligible scope to incentivise repeat or ongoing sales.

Moreover, the potential for mis-selling or unwanted selling is lower than ever as a consequence of the new regulatory safeguards that apply through the PDDO and anti-hawking provisions.

While Cover-More does not believe that payment of commissions is giving rise to misalignment of interests, potential changes to commissions structures are being reviewed as part of the customer value work detailed above, with various options under consideration.

One possibility is applying variable commission rates that correspond more closely with the costs of service associated with individual aspects of a policy. This would enable more complex policies which take an agent more time to quote, e.g. those that include existing medical conditions and add-ons such as cruise, moped usage etc, to be remunerated accordingly (and conversely for more straightforward policies). However, such an approach could potentially incentivise sales of policy add-ons, which would undermine the PDDO framework that works to provide the customer with the policy that best meets their needs. Flat commissions offer the benefit of neutrality in their interaction with the PDDO.

A cap on total commissions paid on a customer's premium is also an option. However, this approach has the potential to adversely impact older travellers, by effectively disincentivising distributors from appropriately servicing this customer segment, which on average has more complex needs in line with its risk profile.

It is indisputable that arrangements which provide reasonable levels of remuneration to distributors are necessary in travel insurance to encourage uptake of appropriate cover and to reasonably remunerate for services provided. Remuneration that is set too low will lead to under-insurance and consequently poorer consumer outcomes. Cover-More acknowledges that commission structures are imperfect, but it is far from clear that alternative structures would lead to better alignment of adviser and consumer outcomes.

Life insurance remuneration reforms

A number of reforms to conflicted remuneration arrangements in the Australian life insurance industry have been implemented since 2018. These legislated amendments were intended to modify practices within the broader framework of the exemption to the ban on conflicted remuneration that covers life insurance products.

As the Issues Paper highlights, the life insurance framework (**"LIF"**) reforms identified a number of risks to consumers arising from existing commission structures, in particular that they provided an incentive to advisers to recommend unnecessary product replacement. The reforms sought to address this by mandating capped commissions or level commissions subject to clawback provisions where a policy was terminated.

Cover-More considered whether the LIF model may offer approaches that could be applied to conflicted remuneration in travel insurance in the context of the modifications to commissions structures that we are contemplating, noting that upfront commission levels are on average substantially lower than they had been in the life insurance industry prior to the LIF reforms.

As illustrated in the table below, the product characteristics, advice model, remuneration structures and distribution arrangements for travel insurance are significantly different to those of life insurance.

Life insurance	Travel insurance
Complex product	Simpler product
Personal advice model (SOA required)	General advice model (no SOA)
Long policy term (~30 years)	Single-use product
Higher premium	Lower premium
Upfront and trail commissions	Upfront commission, no trail commissions

It should also be noted that although life insurance can provide considerable benefits to consumers, it is not regarded as having the same degree of criticality as products such as travel or CTP insurance because of the relative risks associated with under-insurance – as evidenced by government involvement with respect to the latter products, which support public policy objectives.

Cover-More wishes to make clear we are not offering any views regarding the efficacy of the LIF reforms, and note that their impact on the quality of advice to consumers is a focus for this Review. Rather, we are suggesting that, in view of the stark differences between these insurance types and the lack of evidence of mis-selling of travel insurance, application of a regulatory framework for remuneration arrangements along the lines of the LIF reforms is unlikely to be appropriate for travel insurance.

International comparisons

Commissions are a standard feature of the insurance environment in the international markets in which Cover-More operates: the UK, Europe, USA, Latin America and Asia. In general, remuneration arrangements for distributors are subject to light-handed regulation that focuses on consumer's best interests obligations.

The approach adopted by the UK Financial Conduct Authority (**"FCA"**) in relation to remuneration for distribution of GI products is worth considering in some detail, as it has been the subject of relatively recent review and there are similarities in the frameworks governing the regulation of GI in Australia and the UK.

In November 2019, the FCA issued finalised guidance for GI product insurers and distributors following a wide-ranging thematic review.[8] The guidance sets out expectations for how firms in the GI sector should consider the impacts distribution arrangements and remuneration have on the overall value of a product to the customer, stating that *"… This guidance is part of a broader FCA focus on value".*

The guidance interacts with legislative reforms and FCA rules concerning the distribution of insurance products that were introduced in 2018. These included product design and distribution obligations, a requirement for firms to act in the best interest of the customer and prohibition of remuneration for insurance distributors and their employees that conflicts with their duty to comply with the customer's best interests.

The FCA guidance acknowledges that remuneration may take a variety of forms, including commissions, fees and non-monetary benefits, and outlines relevant considerations for firms in determining whether remuneration is consistent with the customer's best interests rule. Remuneration arrangements may conflict with this duty if they incentivise a seller to offer a product which does not meet the customer's needs, or if remuneration received does not bear a reasonable relationship to the costs or workload involved in distributing the product. If a conflict is identified, it is incumbent upon the firm to amend the remuneration arrangements or risk being in breach of the regulatory framework and facing enforcement action. [9]

Cover-More regards the FCA's policy approach, which aligns with our commercial focus on value as the paramount consideration for consumers, as instructive. It recognises that commissions can play a valid role in remunerating distributors, provided they are structured appropriately, do not unduly affect the value of a product and are consistent with the obligation to act in the customer's best interests. The position also acknowledges that variance in commissions can contribute to competition between distributors, which may have benefits for consumers through service and efficiency improvements (in contrast to caps on commission rates for example).

The FCA's approach suggests that it may be possible for concerns relating to the impact of distribution costs on consumer outcomes that are identified by the Review to be addressed without the application of regulatory remedies, particularly in the context of broader reforms to the GI sector that have occurred in recent years.

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[8] Financial Conduct Authority, FG19/5 The GI distribution chain: Guidance for insurance product manufacturers and distributors, November 2019
[9] *Ibid.*, p12

Summary

The exemption to the ban on conflicted remuneration for GI products legislated in 2012 reflects fundamental differences in the features of these and other financial products.

As far as travel insurance is concerned, these product characteristics are unchanged. Consumer understanding of travel insurance is likely to be higher than a decade ago given increased international travel by Australians.[10] This awareness has been reinforced by ready access to online information regarding travel insurance promulgated by consumer groups, comparison websites and product issuers.[11]

The COVID-19 pandemic has brought the importance of travel insurance into sharp focus. It has also underscored the public interest imperative of encouraging take-up of travel insurance, an outcome which is facilitated by distribution networks with broad consumer reach.

The travel insurance landscape is more competitive than ever, with better informed, digitally-enabled consumers demanding innovative products, enhanced purchasing experiences, more choice and higher quality.

Substantive reforms to the regulatory framework governing GI products have been implemented recently, which provide strengthened protections against mis-selling and unwanted selling.

Commission payments to distributors are a remuneration mechanism that seeks to strike a balance for consumers between availability and value. These cost considerations are no less relevant in the direct channel – they are simply different.

Against this background, Cover-More contends that the current policy settings in relation to remuneration arrangements remain appropriate to contemporary circumstances. The justification for the exemption to the ban on conflicted remuneration as it relates to travel insurance products still holds today, and is arguably clearer.

In our view, whether remuneration arrangements with distributors are producing a mis-alignment of adviser and consumer interests in practice should be the key consideration, rather than a definition.

In the event that instances of consumer harm arising from conflicted remuneration arrangements in travel insurance are identified in the course of this Review, Cover-More would seek to work constructively with stakeholders to identify the most appropriate means to address these concerns.

We believe that a focus by industry and regulators on customer value, in conjunction with the broader regulatory obligations on insurers and distributors, represent an efficient and effective means of placing downward pressure on commissions and maximising consumer outcomes.

Should any reforms be proposed as a result of the Review, engagement with travel insurance industry stakeholders will be important to ensure that any regulatory remedies are designed in a targeted way to address specific problems and deliver clear consumer benefit, and that they do not operate in conflict with public policy objectives.

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[10] Overseas travel by Australians rose by 85 per cent in the 10 years to 2019, while the population grew by 15 per cent. Tourism Research Australia statistics; Australian Bureau of Statistics Demographic Statistics and Historical Population Statistics

[11] Travel insurance reviews, comparisons, information and buying guide | CHOICE; Travel Insurance | Compare Cheap Quotes Online (comparetravelinsurance.com.au); Compare Travel Insurance Policies | Canstar