

### **Short-term income protection—is it a form of PPI?**

1. The purpose of this appendix is to provide details as to the basis upon which we reached the conclusion that short-term IP can be a form of PPI.
2. Short-term IP typically offers cover for accident, sickness and unemployment for up to 12 months. Some policies offer the option of additional benefits such as life, critical illness and carer insurance cover. The customer nominates the amount which they wish to have the benefit of (for example, the amount of a monthly credit repayment or total regular monthly outgoings). In the event of a successful claim, the benefit is paid directly to the customer who is able to choose how that money is utilized.

#### **Review of some short-term IP policies**

##### ***HSBC LifeChoices***

3. In June 2007, HSBC launched a product called LifeChoices, which provides protection not linked to a credit product; the amount insured is nominated by the customer. In the event of a claim the benefit payment is deposited into the customer's nominated account.
4. LifeChoices offers cover similar to that offered by HSBC's MPPI product and its Flexible Life product, and HSBC removed those products from sale at the time LifeChoices was launched.<sup>1</sup> LifeChoices was originally developed to replace HSBC's MPPI policy (and a life insurance policy) with a view to increasing HSBC's sales of mortgage insurance.

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<sup>1</sup>From June 2007, life insurance customers taking out less than £[redacted] of cover were offered LifeChoices.

5. LifeChoices was made available to both mortgage and non-mortgage customers, and was referred to by HSBC as a menu based protection plan which offered:
- a lump sum payable on death or earlier terminal illness (LifeChoice);
  - a lump sum on diagnosis of one of a range of specified illnesses (TraumaChoice);
  - a monthly income to protect mortgage repayments in the event of accident or sickness (SicknessChoice);
  - a monthly income to protect mortgage repayments in the event of unemployment (UnemploymentChoice); and
  - a lump sum payable on total and permanent disability.
6. A customer could choose to combine the cover offered by the LifeChoices product in 12 ways, namely:
- (a) accident and sickness only;
  - (b) accident, sickness and trauma;
  - (c) accident, sickness and unemployment;
  - (d) accident, sickness, unemployment and trauma;
  - (e) life, accident and sickness;
  - (f) life and trauma;
  - (g) life, trauma, accident and sickness;
  - (h) life, trauma and unemployment;
  - (i) life, trauma, unemployment, accident and sickness;
  - (j) life and unemployment;
  - (k) life, unemployment, accident and sickness; and
  - (l) life only.
7. On 4 December 2007 HSBC withdrew advised sales in branches of its PLPPI and CCPPI products. From that date customers were offered the opportunity to discuss their protection needs (not just those relating to the credit product acquired) with a

Financial Planning Manager. LifeChoices became one of the products offered by the Financial Planning Manager to those customers who would previously have been offered PLPPI and CCPPI. HSBC stopped selling PLPPI and CCPPI on the Internet on 13 March 2008. Other brands sold by HSBC also withdrew or began the process of withdrawing PPI from sale.<sup>2</sup>

8. HSBC told us that LifeChoices was PPI in a general wide sense, but that it was rather different from conventional PPI (for instance, because it offered trauma cover, which was similar to critical illness insurance). It said that it was unbundled and the level of cover was determined by the customer; and while it could be sold on a stand-alone basis, it was designed to be sold to HSBC's mortgage customers. However, HSBC subsequently told us that LifeChoices was not PPI; it was not linked to a credit product and the customer was able to select their level of cover from the range referred to in paragraph 6. The premium was paid monthly quite separately from any repayments on a credit product. Customers also bought LifeChoices for reasons other than to protect repayments on a credit product.
  
9. However, as with most PPI policies, LifeChoices offers protection for accident, sickness, unemployment and life, as well as trauma and critical illness. It has a waiting period and an exclusion period. It is pool underwritten. Any benefits which are payable under a LifeChoices policy are paid on a monthly basis. As with stand-alone PPI, if customers wish to buy insurance to protect their credit repayments, they do not have to hold the credit product with HSBC to be eligible to purchase LifeChoices from it.

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<sup>2</sup>M&S and First Direct. HFC did not withdraw PPI from sale.

### ***HSBC Income Protection Plan***

10. HSBC also offers an income protection plan which provides cover in the event that a customer is unable to work due to accident or sickness. The customer is able to choose their level of income protection up to a maximum of 50 per cent of their taxable earnings, or 50 per cent of net profit if they are self-employed.

### ***Post Office Lifestyle Protection***

11. The Post Office offers a product called Lifestyle Protection which offers insurance for accident, sickness, unemployment or death. The customer nominates the amount of cover and type of cover. In the event that the customer is unable to work due to accident, sickness or involuntary unemployment, the insurance pays directly to the customer the nominated amount per month for a maximum of 12 months. In the event of death, a lump sum of up to 12 times the nominated monthly amount is paid directly to the customer's nominated beneficiary.
12. The Post Office referred to the product as 'flexible all-in-one cover', and customers are encouraged to select a level of cover which would be sufficient to meet their monthly outgoings plus an additional amount for day-to-day living expenses in the event of a claim. Customers are able to choose a minimum of £100 per month of cover, and a maximum of £2,500 of cover per month.

### ***HBOS Bill Protector***

13. HBOS offers a protection insurance product called Bill Protector. It offers accident, sickness, unemployment and carer cover. Customers receive a fixed amount of £200 per month in the event of a claim. The insurance pays benefits for up to 12 months. The benefit payments are deposited into the customer's bank account.

14. Bill Protector is advertised by HBOS as being designed to assist customers with their household bills or other financial commitments, but in fact customers are able to use the benefits in whichever way they choose.

### ***RBSG Churchill Income Protection***

15. RBSG offers a short-term IP through its Churchill brand. It offers cover in the event of accident, sickness or unemployment, and pays benefits for a maximum of 12 months. The customer is able to choose the amount of benefit they are insured for, with a minimum monthly benefit of £100 and a maximum monthly benefit of £2,500 or no more than 60 per cent of gross monthly salary, whichever is less. Any benefit paid is deposited into the customers' bank account.

### **The views of parties**

16. The parties to the inquiry had mixed views as to whether short-term IP was the same as PPI. The views of HSBC, in relation to their own short-term IP policy, are set out in paragraph 8.
17. AXA told us that there was no real difference between short-term IP policies and PPI.
18. However, Lloyds TSB said that short-term IP and PPI were separate types of policies and it questioned the extent to which they could be viewed as substitutes. Millennium Insurance said that substitutable products for PPI did not exist yet. Legal and General said that there were a number of alternative products available that went some way towards providing the cover offered by PPI, but none were direct substitutes for PPI. Genworth said that alternatives which were cited in our Emerging Thinking should be viewed as complementary products to PPI, but not potential substitutes, because, among other things, the alternatives did not protect the same risks as PPI, and because PPI was sold at the same time as the credit (see Appendix

3.6). Northern Rock said that there was very little demand-side substitutability between PPI and alternative financial products.

19. The FLA told us that stand-alone PPI products were not strictly payment protection products but, in practice, income insurance. It was of the view that stand-alone PPI could affect the state benefits available to consumers, which was not the case with linked PPI products. The FLA cited CCPPI as an example—it was paid directly to the credit card account and therefore did not affect eligibility for state benefits.
20. Further, MBNA considered that stand-alone PPI products should properly be regarded as IP products, rather than PPI products, since:
  - they were not tied to the underlying credit product;
  - any claim was paid to the customer rather than to the credit provider; and
  - in the case of credit cards, the insurance did not track the varying monthly credit balance.

## **Comparison of PPI and short-term IP**

### ***Summary of the characteristics of the policies***

21. TABLE 1 provides a summary of the policy characteristics of PPI and short-term IP.

TABLE 1 Characteristics of PPI and short-term IP

	<i>PPI</i>	<i>Short-term IP</i>
<b>Cash flow insured</b>	<p>Repayments of:</p> <ul style="list-style-type: none"> <li>• Personal loan debt.</li> <li>• Mortgage debt (first and second charge).</li> <li>• Credit card debt.</li> <li>• Overdraft debt.</li> <li>• Retail credit debt.</li> </ul>	<p>Gross income (normally a selected amount subject to a maximum percentage of gross income (eg 50 per cent)) or monthly outgoings (up to a percentage of gross income), for a year.*</p>
<b>Risks insured</b>	<ul style="list-style-type: none"> <li>• Accident, sickness and unemployment;</li> <li>• accident and sickness; or</li> <li>• unemployment.</li> </ul> <p>Most loan, credit cards and overdraft PPI policies also include life insurance and some policies include critical illness insurance.</p> <p>Some policies also include hospitalization, permanent disability cover and carer cover.†</p>	<ul style="list-style-type: none"> <li>• Accident, sickness and unemployment;</li> <li>• accident and sickness; or</li> <li>• unemployment.</li> </ul> <p>Some policies also offer the option of additional benefits, such as life cover, critical illness cover or carer cover.</p>
<b>Type of underwriting</b>	<p>Community rated pricing (ie all customers are charged the same premium).</p> <p>Some underwriters and lenders (for example, [X]) told us that they offered or were considering offering risk-based products, the price of which varied according to a set of variables such as age or type of employment.</p>	<p>Community rated pricing; although pricing can be risk-based (ie price varies according to a set of variables such as age or type of employment).</p>
<b>Payment of premium</b>	<p>PPI for personal loans and second-charge mortgages:</p> <ul style="list-style-type: none"> <li>• Monthly or single premium with premium rate linked to term of the loan.</li> </ul> <p>PPI for credit cards:</p> <ul style="list-style-type: none"> <li>• Fixed amount per £100 of monthly outstanding balance (eg 79p per £100 of outstanding balance); premium is not paid if there is no outstanding balance on the card.</li> </ul> <p>PPI for mortgages:</p> <ul style="list-style-type: none"> <li>• Monthly premium (normally as a fixed amount per £100 benefit).</li> </ul>	<p>Customers typically pay monthly premiums.</p>
<b>Benefits paid to customers or to dependants‡</b>	<p>Amount of monthly debt repayment (or in the case of credit cards and overdraft a specified percentage of the outstanding balance, eg 10 per cent) or repayment of the whole debt in the case of life insurance or critical illness insurance.§</p>	<ul style="list-style-type: none"> <li>• Fixed monthly amount up to the limit insured.</li> <li>• Benefits can be used for any purpose.</li> </ul>
<b>Typical exclusions</b>	<p>Deliberate self-injury, or any injury or pre-existing medical condition of which the applicant had knowledge prior to the application for cover,¶</p> <p>AIDS-related conditions and conditions due to drug and alcohol abuse or criminal activities.</p> <p>Many policies apply restrictions to payment of claims for conditions related to pregnancy, stress, and backache. These restrictions might include limits to the length of period benefits are paid for and/or a requirement for the applicants to be referred to and under the care of an appropriate specialist.</p> <p>If unemployment cover was selected, customers would not be covered if: at the time of their application, they knew or had reason to believe that they might become unemployed; their work is seasonal or temporary; they accept voluntary unemployment.</p>	<p>Deliberate self-injury, or any injury or condition of which the applicant had knowledge prior to the application for cover, AIDS-related conditions and conditions due to drug and alcohol abuse or criminal activities.</p> <p>Depending on the policy, restrictions might apply to the payment of claims for conditions related to pregnancy, stress, and backache. These restrictions include limits to the length of period benefits are paid for and/or a requirement for the applicants to be referred to and be under the care of an appropriate specialist.</p> <p>If unemployment cover was selected, customers would not be covered if: at the time of their application, they knew or had reason to believe they might become unemployed; their work is seasonal or temporary; they accept voluntary unemployment.</p>

PPI

Short-term IP

**Eligibility**

Applicants:

- must be over 18 and under 60 (depending on the cover the maximum age can be higher (eg 65 or 70));
- must be employed (typically for at least 16 hours per week);# and
- must be resident in the UK.

Most policies are available to applicants who are self-employed and have been so continuously for a period prior to the application, although the benefits for the self-employed may differ to those with an employed status.

Applicants:

- must be over 18 and under 60 (depending on the cover the maximum age can be higher (65 or 70)).

Must be employed or self-employed and have been so continuously for at least the previous six months.

**Benefits period~**

It depends on the policy.  
 Unemployment benefits: typically 12 months.  
 Accident and sickness: 12–24 months or, with some policies, until the customer returns to work, or in the case of PPI for loans, for the term of the loan.  
 Death and permanent invalidity benefits: some policies would repay the whole of the outstanding debt in case of death or permanent invalidity. Other policies would repay up to a maximum amount or length of time for permanent invalidity benefits (for example, Lloyds TSB PaymentCare Gold).

Typically 12 months.

Source: CC.

\*Bill protector policies, a variation of short-term IP, are offered by some providers. Bill protector policies are designed to cover outgoings for household bills up to a certain amount (eg £300) in case of accident, sickness or unemployment.

†The cover applies when the policyholder leaves work to look after a member of their immediate family.

‡Payments can also be made directly to the provider of the credit product sold alongside PPI.

§Capital One told us in its response to the issues statements that benefits of PPI include the following:

- PPI protects a customer credit history (negative information on credit record is reverted once a claim has been accepted).
- PPI refunds any fees incurred by customers during the claim process (eg default fees).
- PPI ensures that the customer is never over- or under-insured.

¶Exclusions for pre-existing conditions will be waived if the insured is able to demonstrate a period in which they have not suffered the condition or any of its symptoms.

#Employment is not an eligibility criterion for some products or in cases where restricted cover such as hospitalization, disability or life is provided for. For example, Barclays offers life and disability cover to customers who are not in employment.

~Length of time benefits will be paid for.

**What is covered**

22. Both short-term IP and PPI generally provide cover in the event of accident, sickness and unemployment. Some offer the option of additional types of cover (for example, for life and critical illness). In the event of a claim they both make monthly payments for the benefit of the customer, rather than a lump sum (except in the case of a life claim, which is paid by way of a lump sum).

23. PPI is normally part of a combination with the underlying credit product, so, for example, the level of cover is tailored to the payments on a loan or the outstanding

balance on a credit card. Short-term IP is not usually linked to payments for a specific credit product, although for certain types of credit where repayments are stable or predictable (for example, mortgages, second-charges mortgages, personal loans) this feature could be replicated by taking out short-term IP cover for the same amount as the repayment. Short-term IP is similar to stand-alone PPI in this respect.

### ***Payment of benefits***

24. When a claim is made on a short-term IP policy, the benefits are paid to the policyholder. This means that the insured person can use the payments received for whatever purposes they choose at that time.
  
25. In contrast, most PPI policies pay the benefit to the creditor directly. However, we are aware of the following exceptions: Abbey, HSBC (before it withdrew its PPI offer) and HBOS which said that benefits paid under their MPPI policies were credited to customers' current accounts (from which the loan repayments are debited). This means that customers are able to utilize the benefit as they see fit, in the same way as they can with a short-term IP policy.
  
26. We are aware of three MPPI policies which, while linked to a mortgage product (thought not necessarily the PPI provider's mortgage product), pay a benefit in excess of 100 per cent of the mortgage repayment in the event of a claim. Abbey's Paymentcare MPPI allows the customer to nominate the level of cover,<sup>3</sup> such that they receive an amount which covers their mortgage repayment and other essential bills in the event they are unable to work due to accident, sickness and/or unemployment. The MPPI offered by HBOS, allows the customer to adjust the level

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<sup>3</sup>The minimum benefit a customer can choose is £100 per month; and the maximum benefit is £2,000 per month or 50% of the customer's monthly gross salary, whichever is lower.

of cover<sup>4</sup> such that payments meet their mortgage repayments and related bills. Lloyds TSB offers MPPI which covers the mortgage payment and the property insurance payment each month, and, if the total cost of the mortgage payment and the property insurance payment each month is less than £1,300, Lloyds TSB pays the customer an additional cash benefit.<sup>5</sup>

### **Comparison of price and quality of short-term IP and stand-alone PPI**

27. We also compared the cost to the customer of a selection of short-term IP and stand-alone PPI policies. We compared two stand-alone PPI policies with two short-term IP policies. As Table 2 shows, there was no clear difference in terms of pricing or quality between the short-term IP and standalone PPI products we looked at.

TABLE 2 **Illustrative Comparison of the price of short-term IP and stand-alone PPI**

<i>PPI provider</i>	<i>Product name</i>	<i>Type of product</i>	<i>Default score</i>	<i>Cost per £100 cover for a 35-year-old male non-smoker £</i>
Churchill	Income protection	Short-term IP	60	4.00
British Insurance	LASU	Stand-alone PPI	56	3.50
Paymentcare	LASU—30	Stand-alone PPI	56	5.50
Post Office	Lifestyle protection	Short-term IP	49	4.50

Source: CC.

### **The difference between PPI and short-term IP**

28. Prior to the launch of the Lifestyle Protection product by the Post Office, the underwriter of the product, AXA, conducted research into consumer perceptions of the PPI market and consumer thoughts about Lifestyle Protection as a credible alternative to PPI. That research indicated that the consumers who participated in the

<sup>4</sup>To a level not exceeding 133 per cent (for new business since November 2006) or 125 per cent (for existing business before November 2006) of the mortgage.

<sup>5</sup>The additional cash benefit is worked out at £3 for every £1,000 of the original mortgage balance. If a customer qualifies for the additional cash benefit, the most they can receive is £1,300 per month. If the total cost of the mortgage payment and the property insurance payment each month is greater than £1,300, then the policy will cover this (eg if the total cost of the mortgage payment and the property insurance payment each month is £1,800, then the policy will pay £1,800), but no additional cash benefit will be available.

research had difficulty understanding the product differentiation between PPI and its Lifestyle Protection product.

29. We found that the primary difference between PPI and short-term IP is the customer focus—with PPI the consumer uses the policy to insure a specific credit repayment, whilst short-term IP is advertised as being cover for either credit repayments and/or more general outgoings. In every other material respect the policies are the same.
30. Therefore we concluded that, while PPI and short-term IP are sold with a different customer focus, they are effectively the same type of insurance, covering the same events in the same way for about the same price. Therefore, short-term IP can be a form of PPI and as such we are satisfied that it falls within our terms of reference.<sup>6</sup>
31. We considered whether, if a short-term IP policy was sold after a customer was referred to a salesperson during the sale of a credit product, this amounted to sale at the point of sale of the credit product (see paragraph 2.61).
32. Whilst there is often a time lag between the referral to the salesperson being made and the discussion about short-term IP with that salesperson, the contact is triggered by the sale of credit, and the discussion with the salesperson is focused on protection needs which have been brought to the customer's attention by the sale of the credit. Whilst sales of LifeChoices have not risen to levels of sales of PLPPI and CCPPI prior to December 2007 (see FIGURE 2), sales of LifeChoices have clearly risen significantly since a referral to discuss protection needs was factored into the credit sales process.

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<sup>6</sup>Our terms of reference include 'payment protection insurance services'.

33. On the basis that the sale of the product is triggered by the credit sale, and the sales of a short-term IP product designed to increase penetration of mortgage insurance have matched those of the product it replaced even with the referral system in place, we concluded that short-term IP policies sold as a result of a referral during a credit sale are effectively sales of short-term IP at the point of sale. As a result, we regard such cross-sales of short-term IP as enjoying the same advantages and giving rise to the same concerns as PPI sold at the point of sale.

***Whether LifeChoices is a PPI product***

34. We looked in detail at the development of one short-term IP product, HSBC's LifeChoices product, in order to understand the drivers behind its development and how the business viewed it.
35. We chose the LifeChoices product as a focus for two primary reasons. First, during the inquiry HSBC stopped selling MPPI and introduced LifeChoices; it then also stopped selling PLPPI and CCPPI and instead began to offer its personal loan and credit card customers the chance to discuss their protection needs (not just those relating to the credit product acquired), with LifeChoices as one of the possible solutions. Secondly, as we explained in paragraph 8, HSBC told us that LifeChoices was not PPI because, inter alia, it is not linked to a credit product and the customers can select the level of cover they require. The LifeChoices product is described in paragraphs 3 to 9.
36. We received information and data from HSBC with regard to its decision to begin offering its LifeChoices products to customers, some of whom would previously have been offered its PPI products. As stated above, we found that LifeChoices was designed to be sold to HSBC's mortgage customers with the aim of increasing the

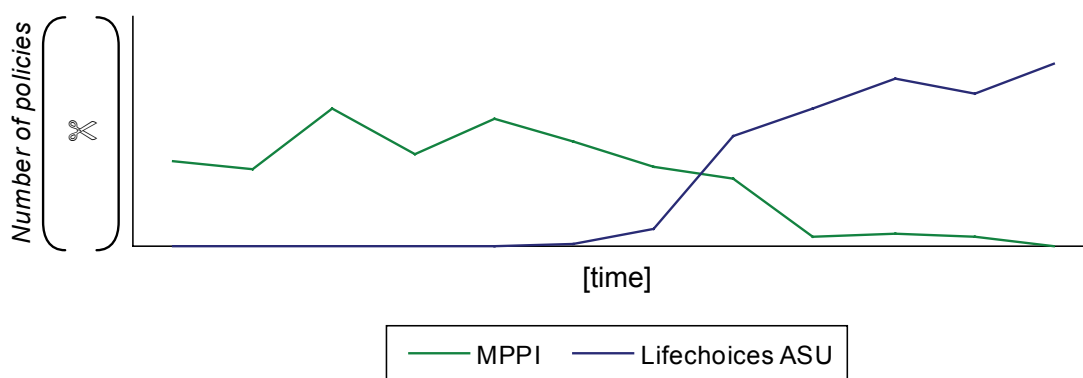
penetration rate of mortgage insurance. When introduced it replaced two products: HSBC's existing MPPI product and a life insurance product.

37. LifeChoices offers life and terminal illness cover, accident and sickness cover, serious illness cover and unemployment cover, some of which were previously offered by HSBC's PPI products.

38. We looked at sales of its LifeChoices products and its PPI products. FIGURE 1 shows HSBC's sales<sup>7</sup> of MPPI and sales of any LifeChoices policy which contains an element of accident, sickness and/or unemployment.

FIGURE 1

**HSBC sales of MPPI and LifeChoices  
(policies containing A, S or U cover only), [~~€~~]**



Source: CC based on data provided by HSBC.

39. The data indicates that MPPI sales were effectively 'replaced' by LifeChoices sales when it was launched in June 2007.

40. FIGURE 2 shows a comparison of HSBC's sales of protection products.

<sup>7</sup>HSBC branded policies only.

FIGURE 2

**HSBC sales of protection products**



*Source:* CC based on data provided by HSBC.

41. There was a large spike in LifeChoices sales when PLPPI and CCPPI were discontinued (sales of LifeChoices increased by [✂] [more than 200] per cent). HSBC said that it thought this was mainly due to HSBC's 'January Sale' promotion. Our view is that this is evidence that LifeChoices is a form of PPI. However, there appears to have been a decline in PLPPI sales for which the increased sales of LifeChoices did not fully compensate; we consider that this can be explained by the delay in the time from when the customer buys the credit product to the time they speak to the Financial Planning Manager to discuss their protection needs.
42. The evidence supplied to us on why LifeChoices was developed clearly indicated that it was specifically designed to be cross-sold as protection insurance alongside mortgages in the first instance. We therefore concluded that it was originally developed to be an MPPI policy (we also noted that it could be, and is, sold to meet other protection needs) and continues to be treated as such when cross-sold with HSBC mortgages. Data on LifeChoices sales confirmed our conclusion.
43. The evidence we saw on sales of LifeChoices since PLPPI and CCPPI were withdrawn and replaced with the offer of a referral to discuss protection needs likewise led us to conclude that LifeChoices can also be a PLPPI or CCPPI product when cross-sold.