

## Donating Your Money to a Warranty Company

Why the motor vehicle warranty you bought might be worthless

A report prepared by the Consumer Action Law Centre  
August 2015



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# Executive Summary

## What are Motor Vehicle Discretionary Risk Products?

The Motor Vehicle Discretionary Risk Products (**MVDRP**) discussed by this report are quasi-insurance products sold with motor vehicles or motor vehicle finance. We discuss products issued by three companies: National Warranty Company (**NWC**), Australian Warranty Network (**AWN**)<sup>1</sup> and Integrity Car Care (**Integrity**).

These products operate like an extended warranty with one exception: the provider has complete discretion over whether to pay a claim or not. Providers say that they are required to consider the merits of claims and exercise their discretion fairly. But we think this can mean little in practice, as the contract terms allow warranty providers to exclude almost any claim.

As well as this general discretion to decline claims, MVDRP providers can rely on a number of exclusions in their contracts, such as that:

- anything other than mechanical breakdown (like accident, fire or theft) is not covered;
- breakdowns caused by a fault that existed when you bought the car, or the car not being in good mechanical condition at the time of purchase are not covered;
- breakdowns caused by wear and tear or overheating are not covered;
- the policy will only pay to repair or replace certain components—many are excluded;
- even the included components are only covered up to certain monetary limits;
- MVDRP providers may refuse cover if the consumer fails to service their car (at their own cost) to a strict schedule, and provide proof of servicing.

## **Key problem: Motor Vehicle Discretionary Risk Products are almost completely worthless**

As far as we can tell, warranty providers can avoid paying many if not most claims, either by relying on their discretion or on one of the exclusions. We think that makes these products almost completely worthless.

We do not think that many people would buy one of these products if they understood their limitations. In our view, many people buy these products because of tricky sales techniques, and in particular by selling them as an 'add-on' when the customer is buying another product. Those involved in the selling of these products also receive hefty commissions—up to 80 per cent of the premium—which may encourage and exacerbate poor selling practices.

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<sup>1</sup> Note that AWN appears to have recently changed their contracts to remove the discretionary element. This is discussed further below.

## What can be done?

- Change the law to ban MVDRPs being sold in consumer-trader transactions  
Banning MVDRPs in consumer transactions might be achieved by defining DRPs in the law as being something which can be used by business or community groups as a genuine alternative to insurance, but cannot be sold in consumer-trader transactions.
- Prevent on the spot sales of add-on financial products  
Salespeople could be free to promote a financial product add-ons, but should be prevented from completing the sale for two to seven days after the sale of the headline product, and only if the consumer opts in without further sales pressure.
- Encourage consumers to seek refunds:  
We believe that a very large number of Australian consumers may have been mis-sold MVDRPs and could claim refunds. We plan to make consumers who have purchased MVDRPs aware of their rights and encourage them to seek refunds.

# Introduction

If you buy a car from a second hand car dealer or apply for motor vehicle finance it is likely that you will also be asked if you want to buy a 'warranty' which will provide some cover if the car breaks down. These products (which might cost anything from a few hundred to a few thousand dollars depending on which one you buy) might sound like a good idea to reduce the cost of unexpected repairs later on. And when they are offered at the point you are about to sign up for your new car, many people are happy to agree to pay a little extra for some additional protection without asking to examine the fine print.

What nobody seems to know when they are sold these products—known as Motor Vehicle Discretionary Risk Products—is the warranty provider doesn't have to offer you any protection at all. These products aren't really warranties in the sense that most people understand that word, because most include terms that give the warranty provider complete discretion over whether they pay a claim or not. Even when you make a claim that is covered under the terms of the contract, the warranty provider could use this discretion and choose to pay the claim, pay it in part, or not pay it at all.

When you also consider that these contracts only cover some components (and only up to a certain amount), require you to service your car (at your cost) enough to prevent almost any breakdown occurring, and won't pay for any breakdowns caused by a fault that existed before you bought the car, normal wear and tear, overheating, or a list of other things—these warranties look less like 'peace of mind' and more like a very bad deal.

We think these products are almost completely worthless, and the companies that sell them—National Warranty Company, Australian Warranty Network and Integrity Car Care—should be brought to account. In the coming months, we intend to encourage people who have been mis-sold these products to seek refunds. We hope that, if enough customers of these companies are willing to challenge the tricky practices used to sell these products, it will encourage NWC, AWN and Integrity to change the way they do business.

This report argues that the loophole in financial services law that allowed discretionary risk products to be sold to consumers as motor vehicle warranties needs to be closed. While there may be a legitimate role for discretionary risk products as an alternative insurance option for businesspeople and community groups, they create the risk for significant detriment for consumers.

We also think that the stories about how discretionary risk products are sold gives more evidence of why the 'add-on' sales technique should not be permitted to sell financial products. We recommend that, if a salesperson suggests a consumer buy an add-on financial product, they should not be able to close the deal unless the consumer makes contact within a specified period of time to opt in to the sale.

# What is this report about?

This report is about products that are sold to consumers when they are buying motor vehicles or motor vehicle finance. There is a broader category of discretionary products (also known as 'mutual risk products' or 'discretionary mutual funds') where members of particular professions, small business associations, franchise owners and community groups come together to cover risk. This report is not about those kinds of arrangements.

We know of three companies that provide, or have provided, MVDRPs to be sold with motor vehicles: National Warranty Company (**NWC**), Australian Warranty Network (**AWN**) and Integrity Car Care (**Integrity**).

These companies have described their MVDRPs as 'warranties' and say:

are specially designed to help reduce the financial impact of unexpected and potentially expensive mechanical repairs when you can least afford it.<sup>2</sup>

are designed to help reduce the financial impact of unexpected costs of mechanical or electrical failure by providing cover for both parts and labour of covered components.<sup>3</sup>

offer a level of protection from "Surprise" mechanical problems<sup>4</sup>

However, the 'protection' they offer is subject to the MVDRP provider having complete discretion over whether or not to pay a claim. Examples of the terms allowing this discretion are provided below:

## **Integrity Extended Warranties**

Integrity has absolute discretion as to whether it will or will not pay even if the claim comes within the Warranty terms in this booklet. Although the discretion is absolute, Integrity will not exercise that discretion in a way that is unfair or unconscionable and will always consider the merits of your claim.

The Warranty is not the same as an insurance policy because you do not [sic] have a right to be indemnified for your loss, you have a right to have your claim for discretionary assistance considered by Integrity and you are entitled to know the outcome of that decision.<sup>5</sup>

## **National Warranty Company**

The Warranty is a discretionary risk product. This means that you are entitled to have your claim for assistance heard, but that NWC is not obliged to pay all claims that come within the

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<sup>2</sup> Australian Warranty Network, *Motor Vehicle: VP Warranty* (product brochure), page 2. This brochure refers to AWN's older policy and was downloaded from AWN's website in December 2014.

<sup>3</sup> National Warranty Company, 'NWC Motor Vehicle Warranties', accessed from <https://www.nwc.com.au/personal/our-products/vehicle-warranties>, 2 April 2015.

<sup>4</sup> Integrity Extended Warranties 'Why Buy a Warranty', accessed from <http://www.iwarranty.com.au/why-buy-a-warranty>, 2 April 2015.

<sup>5</sup> Integrity Extended Warranties, *Affinity Warranty, Combined Financial Services Guide and Product Disclosure Statement*, page 4. Accessed from [iwarranty.com.au](http://www.iwarranty.com.au) on 7 July 2015.



terms and conditions of the Warranty. You are entitled to have NWC decide whether or not to pay the entire claim or to make a contribution to your claim.

We will always consider the merits of your claim when making this decision to ensure that we exercise our discretion in a fair or just way. If we decide not to pay your claim, you will be responsible for the repair costs yourself. Because NWC retains the discretion regarding the payment of claims, NWC may also decide to contribute to or pay entirely for repairs that do not come within the terms and conditions of the Warranty.<sup>6</sup>

#### **Australian Warranty Network**

AWN has an absolute discretion as to whether it will or will not pay a claim that falls within the Warranty Terms and Conditions and Limitations. Although the discretion is absolute, AWN will not exercise that discretion in a way that is unfair and unconscionable, within the Terms and Conditions and Limitations of the Warranty, and will always consider the merit of the claim.<sup>7</sup>

What these terms mean is that whenever a consumer makes a claim under the warranty, the warranty provider may choose to pay the claim, pay it in part, or not pay it at all. AWN has recently changed its contracts and removed the term quoted above giving them 'absolute discretion' to accept or deny a claim.<sup>8</sup> However, this term was still in warranties sold in late 2014 which will still be held by many consumers.

The problem is that, as far as we can tell, consumers buying these MVDRPs do not know they are buying a discretionary product. They are offered a 'warranty', which they reasonably expect will require the warranty provider to give a payout for at least some problems.

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<sup>6</sup> National Warranty Company, *Product Disclosure Statement and Warranty Contract* for 'Sentinel Warranty' and 'Extension to Manufacturer's Warranty', clause 11.1. Both documents dated 1 July 2013, accessed December 2014 from NWC's website. We used a version downloaded in 2014 as NWC does not seem to publish PDS' on their website anymore.

<sup>7</sup> Australian Warranty Network, *Product Disclosure Statement, Proposal and Warranty*, page 1. This document is a version provided by a client of Consumer Action Law Centre for a warranty which commenced in 2014.

<sup>8</sup> The new PDS we reviewed is the *LVP Warranty Policy: Product Disclosure Statement and Policy Document*, downloaded 29 May 2015 from <http://www.australianwarranty.com.au/OnLine/pdf/Samples/LVP%20Warranty%20Policy%20%5BLVP-AWN-WP-02%5D%20sample.pdf>

**Post on Whirlpool forum, 17 February 2014**

*If you ever go to the trouble of reading the applicable NWC Product Disclosure Statement, you will see the comment:*

*"This Warranty is a discretionary risk product. This means that you are entitled to have your claim for assistance heard, but that NWC is not obliged to pay all claims that come within the terms and conditions of the Warranty. You are entitled to have NWC decide whether or not to pay the entire claim or to make a contribution to your claim."*

*This means that an NWC "warranty", is not a "warranty" as you and I understand the word. It's basically just paying NWC to give them the right to refuse your claim, even if you do everything right.<sup>9</sup>*

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<sup>9</sup> Posted 17 February 2014. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=3> on 17 April 2015.

# Main finding: Motor Vehicle Discretionary Risk Products are almost completely worthless

“In the final analysis virtually all claims... are excluded for some reason or another”

We do not agree with the claims of MVDRP providers that these products offer real protection against the cost of unexpected mechanical repairs. As far as we can tell, warranty providers can avoid paying out almost any claim, either by relying on their discretion or on one of the many exclusions to cover in their terms and conditions. The new AWN contract (which does not contain the 'absolute discretion' clause) still has the same exclusions as the older AWN contract: we believe it is still almost worthless.

This finding is supported by the report of an expert consultant, Mr Erich Kannen, who we commissioned to provide technical advice on elements of warranties from NWC, AWN and Integrity and to answer general questions about (for example) the causes of mechanical breakdowns in motor vehicles, how often vehicles need to be serviced and how much servicing costs.<sup>10</sup> Mr Kannen's view was that 'virtually all claims' could fall under one of the exclusions in the warranties, even without using the 'absolute discretion' clause.

In the final analysis virtually all claims are either pre-existing, caused by wear and tear or are excluded for some other reason or another. Warranties have conditions that no purchaser of a used vehicle could possibly know, some even a dealer would not know, but they can be used to decline a claim.<sup>11</sup>

We have listed some significant exclusions below:

- **The warranties only cover mechanical breakdown:** The NWC 'Sentinel' warranty PDS states that it is designed to only cover costs due to 'mechanical failure'.<sup>12</sup> AWN and Integrity warranties state that they only provide cover in respect to 'mechanical breakdown'.<sup>13</sup> NWC and Integrity define failures or breakdowns as being 'sudden' events meaning the component can no longer fulfil its function.<sup>14</sup> AWN does not

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<sup>10</sup> Erich Kannen (9 June 2015) *Re: Request for technical advice on certain motor vehicle warranties*, Car Solutions Motor Vehicle Consultants. The list of questions we initially asked Mr Kannen to answer are at Attachment A. Mr Kannen referred to NWC's Sentinel warranty, Integrity's Affinity warranty and AWN's (2015) LVP Warranty Policy.

<sup>11</sup> Erich Kannen (2015) p 17.

<sup>12</sup> National Warranty Company, *Product Disclosure Statement and Warranty Contract* for 'Sentinel Warranty', dated 1 July 2013, accessed December 2014 from NWC's website, p 2.

<sup>13</sup> Integrity Affinity Warranty, p 4; AWN (2014), PDS p 10; AWN LVP Warranty Policy (2015), p5.

<sup>14</sup> NWC Sentinel Warranty, p 2; Integrity Affinity Warranty, p 9.

define 'breakdown' but it is safe to assume they use a similar definition, a sudden<sup>15</sup> failure which means the component or the vehicle can no longer be used. None of the three warranties cover damage caused by things like accident, impact, fire, submersion, or theft;<sup>16</sup>

- **Pre-existing problems:** AWN warranties offer no cover unless the vehicle is in 'good mechanical condition, with no pre-existing faults' at the time the consumer purchases it.<sup>17</sup> NWC will not cover pre-existing defects,<sup>18</sup> and requires vehicles to be 'in a roadworthy condition and mechanically sound'.<sup>19</sup> Integrity will not pay claims 'where the fault causing the Mechanical Breakdown was evident prior to the expiry of the Manufacturer's or Dealer Warranty or prior to the purchase of the Vehicle'.<sup>20</sup>
- **Normal wear and tear:** We do not believe AWN, NWC or Integrity will cover damage which has been caused by normal wear and tear, that is, the reduction in performance of components caused by normal use. NWC state that they won't pay for 'any component failure attributed to Normal Wear & Tear' or 'components replaced during a repair which have not failed'.<sup>21</sup> AWN says it does not cover 'normal wear and tear'.<sup>22</sup> Integrity's warranty has no explicit exclusion for wear and tear in their warranty, but on our reading, Integrity's definition of 'mechanical breakdown' excludes damage caused by wear and tear.<sup>23</sup> Normal wear and tear is also excluded in most cases by the requirement that drivers service their car regularly (which will identify worn parts before they fail) and that drivers stop using the car when they suspect a problem. We discuss this more below.

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<sup>15</sup> It is safe to assume AWN requires a 'sudden' event, as they do not pay to repair normal wear and tear, nor do they pay a claim if the driver continued to drive the car after becoming aware of a problem. We discuss this later in the report.

<sup>16</sup> NWC Sentinel Warranty, page 2 (overview) and clause 9; AWN (2014), PDS page 1 ('benefits of the warranty') and clause 6(b); AWN LVP Warranty Policy (2015) clause 7(b).

<sup>17</sup> AWN (2014), PDS 1(b), 6(k); AWN LVP Warranty Policy (2015) clauses 2(b) and 7(k).

<sup>18</sup> NWC Sentinel Warranty clause 9.

<sup>19</sup> NWC, Sentinel Warranty, p 3.

<sup>20</sup> Integrity, Affinity Warranty, p 15.

<sup>21</sup> NWC Sentinel Warranty, clause 9.

<sup>22</sup> AWN (2014), PDS 6(h); AWN LVP Warranty Policy (2015) clause 7(h).

<sup>23</sup> Affinity Warranty Booklet, Page 9. The definition seems to require any failure of a component or part leading to breakdown to be a 'sudden stoppage' in function (not a gradual reduction) and to have arisen 'from defects in material and/or workmanship of the Components and Parts' (not worn down from normal use). However, this definition is worded ambiguously and other interpretations are possible.

## Post on Whirlpool forum, 23 May 2012

*After having my used car for around one year and doing 10,000 km, the diff needed replacement (according to me and my mechanic). I called NWC about this and after numerous phone calls and abuse from them they claimed that, despite the specifically being covered by the warranty, diff that this was not covered due to the it being a item that fails under “wear and tear”. I had to replace it at my cost. The main problem with NWC is that they will only cover things that do not fail under “wear and tear” and any failure in a car can be attributed to “wear and tear”.<sup>24</sup>*

- **Time the warranty is bought by the customer or application received by the warranty provider (AWN):** The older version of AWN's product requires the warranty to be 'acquired at the time the Motor Vehicle is purchased'.<sup>25</sup> Both the older and new AWN products require the warranty premium and 'signed warranty application page' to be 'received and approved' by AWN within 21 days of the purchase of the motor vehicle;<sup>26</sup>
- **Overheating:** Warranties do not cover damage caused by overheating or lack of oil;<sup>27</sup>
- **Excluded components:** Only particular components of the motor vehicle are covered, and even then, some parts of those covered components are not covered.<sup>28</sup> For example AWN's older warranty is said to cover the 'Braking System', but it does not cover 'brake pads or linings, service items and disk rotors'. Coverage in the same warranty of 'Fuel Pump and Fuel Injection Systems' does not cover 'fuel injectors and injection service items'.<sup>29</sup>

Many other parts are expressly excluded. For example, Integrity's Affinity Warranty Booklet reads:

### **Certain components and parts of the Vehicle are always excluded**

Claims for repairs and replacement of the following components and parts:

- oil leaks , oil spills or oil burning;
- timing belts (where the Vehicle's manufacturer requires routine replacement at intervals specified by them);
- damage caused by overheating, nor any resultant damage;
- blown head gaskets;
- paintwork, bodywork;
- water ingress and corrosion;

<sup>24</sup> Posted 23 May 2012 on a Whirlpool forum about National Warranty Company. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057> on 17 April 2015.

<sup>25</sup> AWN (2014), PDS 1(e).

<sup>26</sup> AWN (2014), PDS 1(f); AWN LVP Warranty Policy (2015) clause 2(e).

<sup>27</sup> AWN (2014), PDS p 6 and clause 6(c); AWN LVP Warranty Policy (2015) clause 7(c); NWC Sentinel Warranty Clause 9; Integrity, Affinity Warranty, p 16.

<sup>28</sup> NWC Sentinel Warranty, p 4-5; AWN (2015) LVP Warranty Policy pages 2-4; AWN (2014), PDS 'covered components' table; Integrity, Affinity Warranty, pages 12-13, 16.

<sup>29</sup> AWN (2014), PDS pages 4-5.

- glass;
- trim and bright work;
- locks;
- wheels, wheel balancing and alignment, tyres;
- exhaust system;
- engine tuning;
- cleaning of fuel lines;
- upholstery;
- impact or external damage to radiators;
- cleaning of radiators;
- windscreen wiper blades and rubbers;
- clamps, mountings;
- tappings, studs, screws and nuts;
- in-vehicle entertainment equipment and aerials;
- satellite navigation systems;
- car phones;
- wires, terminals;
- lamps, bulbs and fuses;
- adjustments, alignments and items associated with manufacturer's recommended routine servicing;
- fuel chemicals, fluids, grease or oils unless required in direct connection with the repairs or replacement of a part covered by this Agreement;
- seals or gaskets except where they necessitate removal of engine, gearbox/drive unit and drive shafts or differential unit to carry out repairs;
- clutch linings, clutch bearings, brake linings and pads;
- worn or glazed cylinder bores;
- ignition coil/module;
- computers and associated sensors;
- components in relation to LPG fitment (other than manufacturer fitment);
- switches and non-standard items;
- batteries of any kind.<sup>30</sup>

Kannen advised that the impact of excluding certain parts of covered components greatly limited the actual cover:

Virtually all after-market warranties offer cover for the components that are most likely to be the source of a breakdown. However, virtually all after-market warranties then EXCLUDE most of the parts that are fitted to, or are part of these components and are the source of the component failing / breakdown.

The net effect is that few if any components are covered by warranty. The warranty is mostly illusory.<sup>31</sup>

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<sup>30</sup> Integrity, Affinity Warranty, p 16.

<sup>31</sup> Erich Kannen (2015) p 19.

### Case study 1

Christian (not his real name) bought a second hand car in late 2014. He had had gearbox trouble with a previous car which cost him a lot of money, so when he noticed advertising for NWC warranties at the dealership he asked for more information about what it covered. The salesperson didn't give much information, but referred him to NWC's brochure for their Extension of Manufacturer's warranty. Christian decided to buy the most expensive option, 'Plan C' (\$1400), because he thought it was worthwhile going with a more comprehensive option.

Christian said that he thought he understood the extent of cover provided after reading the booklet. For example, he understood that the product only covered breakdowns, and required him to service the car to a certain schedule. The salesperson mentioned that wear and tear was not covered, which Christian understood meant things like tyres, oil changes and filters, but nothing broader than that. However, Christian said he did not realise that the warranty gave NWC discretion over whether or not to pay claims.

Some time later, the car's turbocharger began leaking oil. Christian contacted NWC, had his mechanic look at the vehicle and sent a repair quote to the warranty company. NWC said that Christian would have to have the turbocharger removed from the car and dismantled to diagnose the problem, and only then would NWC be able to decide if the warranty would cover the repairs. Christian asked if he would be covered for that work, and the staff member at NWC indicated that there shouldn't be a problem as Christian had the highest level of cover.

After doing further work, Christian's mechanic emailed NWC to explain that they weren't entirely sure why the turbo was leaking, but it was possibly because of a seal. NWC responded that they wouldn't cover the repair as they don't cover seals. Christian said that he couldn't understand this response—if that component is covered, then it should be covered regardless of what went wrong inside of it.

- **Payout caps on individual components:** AWN, NWC and Integrity all state that they will only pay a certain amount on repairs for covered components.<sup>32</sup> The amount covered varies depending on the component and the type of warranty. However, the payout cap may be much lower than the ordinary cost of a repair (see case study 2, below). The advice of our expert consultant suggests that it is rare for the cheapest level of cover from each warranty provider to be enough to pay for common problems with each component.<sup>33</sup> In addition, AWN's older warranty says that, if more than one component is repaired, the most they will pay is the cap for the component with the highest cap.<sup>34</sup> AWN's current warranty limits the amount payable on any one claim to \$1000 for their 'Elect' level of cover and \$5000 for their 'Complete' level cover. The

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<sup>32</sup> NWC Sentinel Warranty, p 4; Integrity Affinity Warranty, p 10; AWN (2014), PDS, p 4; AWN LVP Warranty Policy (2015), p5.

<sup>33</sup> For example, our consultant considered that a problem with the Engine causing breakdown would cost approximately \$4,960 in labour and parts to fix. The limit on NWC Sentinel Warranty's cheapest cover for Engine is \$1,250 per claim (NWC Sentinel Warranty, p 4).

<sup>34</sup> AWN (2014), PDS 5(b)

most AWN will pay in total for the life of the warranty is the market value of the motor vehicle as determined by AWN.<sup>35</sup>

- **Continuing to drive the vehicle after becoming aware of a problem:** All three providers say limit cover where a driver continues to drive the vehicle. AWN's current warranty requires customers to 'take all reasonable precautions to minimise damages' and cease operating the vehicle 'if damage to a Covered Component is reasonably suspected'<sup>36</sup>. NWC's Sentinel Warranty says that the customer may be ineligible to claim, or NWC may decline a claim if the customer fails to 'minimise damage... by continuing to drive the Vehicle when damage to any of the Vehicles components is suspected.'<sup>37</sup> Integrity's Affinity Warranty says that Integrity 'will not pay any contribution or claim... required as a result of continued operation of the Vehicle once a defect or fault has occurred (including loss of lubricants and coolant).'<sup>38</sup> These requirements might seem reasonable on their own (requiring drivers to mitigate their loss), but the practical impact is that they may be used to exclude almost every claim. The warranties only cover sudden 'breakdown' or 'failure', but it is rare for any breakdown to occur without a vehicle first giving some sign of a problem while being driven.<sup>39</sup>
- **Servicing schedule:** consumers are required to meet strict servicing requirements. NWC and AWN's older policy require older cars to be serviced every three months or 5,000 kilometres, whichever occurs first.<sup>40</sup> Integrity requires servicing every six months or 10,000 kilometres, whichever occurs first.<sup>41</sup> The cost of this regular servicing must be paid by the consumer which adds a hidden cost to the warranty holder—we are advised that even the cheapest service will cost between \$150-\$300 depending on the car, with major services costing between \$600-\$1350.<sup>42</sup> But regular servicing will also prevent most breakdowns occurring, meaning there is little need for the warranty if a driver is already willing to have their vehicle serviced as often as the warranty requires.<sup>43</sup> The exception to this rule is electrical components like engine control modules and solenoids, which may fail suddenly without warning.<sup>44</sup>

Some consumers have commented online that their warranties require cars to be serviced more often than required by vehicle manufacturers.

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<sup>35</sup> AWN LVP Warranty Policy (2015), clauses 5(a) and 5(b).

<sup>36</sup> AWN LVP Warranty Policy (2015), clause 4 (c). AWN's (2014) PDS has a similar requirement at clause 3 (c).

<sup>37</sup> Clause 8.1.

<sup>38</sup> Pages 14, 16.

<sup>39</sup> Erich Kannen (2015) p 7.

<sup>40</sup> AWN (2014), PDS 3(a); NWC Sentinel Warranty, clause 5.1.

<sup>41</sup> Integrity, Affinity Warranty, p 14.

<sup>42</sup> Erich Kannen (2015) p 4.

<sup>43</sup> Erich Kannen (2015) pp 5-6.

<sup>44</sup> Erich Kannen (2015) p 7.



### Whirlpool forum post, 20 February 2013

*Apparently one of the riders is that you must get your car serviced the sooner of 10,000klms or 6 months, although the later rider was not pointed out to me and this was hidden in the binding of the booklet. I bought a BMW 335 and bought the extended warranty from NWC. Unfortunately I had not seen this forum before hand (so feeling a bit dumb!)*

*Anyway you think you are doing the right thing, these cars can be expensive if they need major repairs. I followed all the prescribed servicing by BMW, its on board mgt system etc and with in the 10,000klms, but as I do not do a lot of klms the servicing did not comply with the 6 month rider. BTW if you take your BMW into be serviced before the mgt system indicates it the dealer asks you why you are there!!*

*Just before my 'warranty' expired I have had some significant repairs done to the hydraulics etc..... failed parts and nothing to do with servicing at all. My claim was rejected. Have nothing to do with them they are a scam!!!!<sup>45</sup>*

### Whirlpool forum post, 26 March 2014

*We have a 5 year deluxe warranty for \$2975 with [Australian Warranty Network] and had all services done on time for the first 2 years (every 6 months is a must according to their terms and conditions). You end up paying more for services because of that. Even when our manufacturer recommends services every 12 months or 20,000km you have to do them every 6 months or 10,000km or whatever comes first. Read the fine print. Then after 2 years we missed a service by 1 ½ months (actually 15 days after the 30 days grace period) and Australian Warranty Network (AWN) declared our warranty contract void!<sup>46</sup>*

- **Only certain mechanics may service:** Integrity and AWN's current warranties requires that the regular servicing must be done by the vehicle's selling dealer or another outlet approved by the warranty company;<sup>47</sup>
- **Proof of servicing:** When each service is performed, AWN and Integrity require a service coupon to be filled out by the mechanic and posted, along with the mechanic's tax invoice, to the warranty provider within seven days of the warranty being performed.<sup>48</sup> NWC requires a record of service invoices but they may be posted, uploaded or emailed;<sup>49</sup>

<sup>45</sup> Posted 20 February 2013 on Whirlpool Forum about National Warranty Company. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=2> on 17 April 2015.

<sup>46</sup> Post on Whirlpool forum from 26 March 2014 regarding Australian Warranty Network. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=2240111> on 17 April 2015.

<sup>47</sup> Integrity, Affinity Warranty, p 14; AWN LVP Warranty Policy (2015) clause 4(a)

<sup>48</sup> AWN (2014), PDS 3(b); AWN LVP Warranty Policy (2015) clause 4(b); Integrity, Affinity Warranty, p 14.

<sup>49</sup> NWC Sentinel Warranty, clause 5.3.

## Post on Whirlpool forum, 8 July 2014

*Oh no! I got a tow home tonight as my clutch on my Prado seems to have had it. I have 3 years (plan C) cover. I have had it serviced every 10k km's but not submitted the service papers to them and didn't realise this until just now. After reading your posts, I am not hopeful for tomorrow. But thanks for the great advise. I think I'm going to need it :-<sup>50</sup>*

- **Only authorised repairs:** The warranty company will only pay for repairs it has authorised,<sup>51</sup> and only those made by its authorised repairer.<sup>52</sup> Integrity states that consumers must bear the cost of any expenses incurred in claiming, including getting the car to the authorised mechanic.<sup>53</sup> NWC requires consumers to pay a mechanic to diagnose a problem before it will authorise any work under the warranty.<sup>54</sup>

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<sup>50</sup> Post on Whirlpool from 8 July 2014. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=4>

<sup>51</sup> AWN (2014), PDS 4(c); AWN LVP Warranty Policy (2015) clause 5(c); NWC Sentinel clause 8.1; Integrity, Affinity Warranty, p 14.

<sup>52</sup> AWN (2014), PDS 4(e); AWN LVP Warranty Policy (2015) clause 5(c); Integrity, Affinity Warranty, p 14.

<sup>53</sup> Integrity, Affinity Warranty, p 14.

<sup>54</sup> NWC Sentinel Warranty, clause 5.3.

## Case study 2

Phil (not his real name) bought a used car as a gift for his granddaughter in October 2014. He also bought a motor vehicle warranty from National Warranty Company. Phil paid \$4500 for the car and \$295 for the warranty.

The car broke down in January 2015 and had to be towed. Phil paid for the car to be towed to a mechanic he knew and trusted, and that had dealt with NWC before. The mechanic advised that the transmission needed to be replaced at a cost of \$4350. Phil confirmed this quote with a second mechanic, a transmission expert. Phil advises that under the NWC product he bought, the maximum that would be paid for a transmission repair was \$1200.

When Phil got in touch with NWC they said he would be required to take the car to their nominated mechanic, which was around an hour's drive away. Phil was willing to send the car to NWC's mechanic until he was told that NWC wouldn't pay for the tow—which Phil understood would cost around \$400 as a round trip. The \$1200 cap meant Phil would already be out of pocket so he wasn't willing to spend another \$400 on a tow, but NWC wouldn't budge.

When we spoke to Phil, he emphasised that he was given the impression that the salesman was offering him a manufacturer's extended warranty, not something provided by a third party. Phil was extraordinarily dissatisfied about the limitations of the NWC even before he knew about the clause that gave NWC complete discretion over whether to accept claims. He was clear that, had he known what this product was, he would have advised his grand-daughter against buying it.

Ultimately Phil bought a second hand gearbox 'taking a punt' and had it installed for \$2600 total. His granddaughter's car is back on the road and Phil is 'trying to forget about it'.

Phil's assessment of National Warranty Company: 'They take money and provide no service, no backup. End of story'

Even if you get through all those limitations, remember that the NWC, Integrity and AWN (if you bought their older contract) retain discretion over whether to pay a claim or not. Providers say that they are bound to consider the merits of claims and promise to exercise their discretion fairly.<sup>55</sup> But we think this means very little in practice when the warranty provider seems to be able to exclude almost any loss based on the exclusions in the contract.

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<sup>55</sup> NWC says that they 'will always consider the merits of your claim when making this decision to ensure that we exercise our discretion in a fair or just way' (Sentinel Warranty, clause 11.1). Integrity says that they 'will not exercise [their] discretion in a way that is unfair or unconscionable and will always consider the merits of your claim' (Affinity Warranty, p 4). AWN's older warranty says that AWN 'will not exercise [their] discretion in a way that is unfair and unconscionable, within the Terms and Conditions and Limitations of the Warranty, and will always consider the merit of the claim (AWN (2014), PDS, p 1.)

All in all, these contracts read like a list of reasons why the warranty will not pay out. The terms of the warranties and the expert advice received from Mr Kannen suggest that there are very few situations where they would need to pay. The only circumstances that come to mind are when electrical components fail without warning and suddenly render the car unable to be driven. All other problems could be excluded on the basis that they are a pre-existing problem, wear and tear, a failure to service the vehicle as required or the driver continuing to use the car after suspecting there was a problem.

### **Comment on Whirlpool forum, 22 January 2013**

*I bought a used Landrover Discovery 2002 model V8 in 2007... Always serviced reguarly when was due. Not 1 problem with it until the Thermostat crapped itself and the motor went in it, As the Thermostat was Wear and Tear (as they Put it) the engine rebuild wasnt covered by the Warranty, and as 1 service had been done outside the Schedule, was rendered Void<sup>56</sup>*

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<sup>56</sup> Posted 22 January 2013 on a Whirlpool forum about National Warranty Company. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057> on 17 April 2015.

# Why do people buy Motor Vehicle Discretionary Risk Products?

We do not think that many people would buy one of these products if they knew what they really were.

So why do people buy them if they are almost useless? The short answer is: clever sales techniques, deception, or both.

A big part of the reason people buy these products is the “add-on” sales tactic—that is, adding the warranty on when someone is buying a car or a loan, rather than just trying to sell the warranty on its own. It’s the same technique used other “add-on” products like consumer credit insurance or gap insurance (also added to car loans), extended warranties on consumer electronics and whitegoods, cartridges for printers, blades with shavers, even upsizing in fast food. When selling MVDRPs, it is the car salespeople or the finance provider that uses this technique, but warranty providers are aware that their products are sold in this way.

The Financial Conduct Authority in the UK has studied add-ons in the insurance market and found that the add-on technique ends with consumers getting a bad deal for a number of reasons, including that:

- Consumers’ attention is on the purchase of the primary product rather than the add-on, leading many to buy add-on products they do not need or understand;
- Add-on buyers are less likely to shop around and are less price sensitive. They also have poor awareness of what products they have bought—19 per cent of people in the FCA’s research were unaware that they owned the add-on product at all; and
- Consumers lacked the ability to assess their options and make choices because they are given insufficient information about the quality and price of add-ons, and because the information is often presented very late in the buying process.

Overall, the FCA found that ineffective competition in markets they studied for add-on insurance products led to consumers overpaying by between £108-£200 million each year<sup>57</sup> (around AU\$200-\$400 million).

In our experience, people do not usually ask for a warranty, they buy them because they are promoted by the salesperson. All consumers we have spoken to indicated that the salesperson didn’t explain the nature of the product, simply saying that it was a warranty and that it would provide some protection. Some consumers are actually misled, like our client in case study 3, who was told that she had to buy the warranty, and that the warranty gave her free services.

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<sup>57</sup> Financial Conduct Authority, *General Insurance Add-Ons: Provisional findings of market study and proposed remedies*, March 2014, page 8.

### Case study 3

Our client signed up for car finance to buy a car in 2014. The finance, provided through a broker, covered the car for approximately \$18000, over \$1000 of fees, over \$2000 of Consumer Credit Insurance (CCI) and a discretionary risk product which also cost around \$2000. We cannot name the businesses involved.

At the time of signing up for the finance, our client was in 'fairly dire straits' and needed a car urgently. Our client made an online application to the finance broker after seeing an advertisement that said they could help people with poor credit histories. Our client got a phone call the same day from a finance broker saying a car could be arranged before the weekend.

Our client states that they were told that they had to buy the warranty and the CCI to get their car loan. The representative produced the warranty and said that it was the only warranty the representative carried. Our client says they were confused by that, as they thought there would be other choices.

Our client thinks the adviser probably 'had the feeling I had no idea' as the process of buying a car was new to them. However, the adviser was very friendly, which helped reassure our client that he cared about their interests. It was only later when our client's mother looked over the documents and questioned the add-ons that our client began to doubt what had happened.

When our client signed up for the finance and add-on products, they did not know the cost of the warranty, nor did they know that the warranty:

- only covered mechanical breakdown, and not things like accident, fire or theft;
- gave warranty provider the discretion to refuse claims
- required our client to service the car regularly and forward evidence of each service to the warranty provider.

In fact our client tells us that the broker's representative said that the service dockets in the warranty contract entitled them to free services.

The contract documents do not disclose exactly what commission the broker received for selling the CCI and warranty, but state that it can be up to 20 per cent of the CCI premium and 80 per cent of the warranty premium. In other words, the adviser may have received over \$2000 for selling our client add-on products which our client did not ask for, and which they only bought because of a deception.

Whirlpool posts suggest that the client in this case study wasn't the only one told that there was some kind of requirement to buy the warranty:

**Comment on Whirlpool forum, 10 November 2014**

*My son didn't want a warranty when buying a car but was told the warranty came with the finance. He paid \$3,495 for a 5 yr warranty and now that he can't make the payments he has to sell the car... How can the finance company get away with implying that without a warranty they couldn't approve the finance?<sup>58</sup>*

**Comment on Whirlpool forum, 13 January 2014**

*Bought a 12 month old car (Mitsu) from a Holden dealer. It still has manufacturer warranty. 4 years. Dealer explained their warranty is conditional on them doing the servicing. Then he tried to sell me more warranty. Good thing I read this thread long before. No deal. But I'm sure some people get sucked in.<sup>59</sup>*

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<sup>58</sup> Posted 10 November 2014. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=4>

<sup>59</sup> Posted 13 January 2014. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=3> on 17 April 2015.

#### Case study 4

Our client Zachary (not his real name), who is reliant on Centrelink benefits bought a used car in 2014 for around \$8,500. Zachary paid a \$2000 deposit and obtained finance through the dealership for the remainder. An AWN warranty was added on for \$1250 financed under the credit contract.

Our client says that the salesperson brought up the warranty while going through the finance saying it was 'just part of the deal'. However, the finance documents itemise the warranty as a separate cost. There was no option to choose a different warranty provider.

Zachary said that the salesperson opened up the AWN brochure and pointed out a few things, such as that there were different kinds of warranty and the mid-range one that Zachary was buying. The salesperson briefly explained a few points, such as that the car would need to be serviced every six months, and that the warranty would only cover components up to a monetary limit. However, the salesperson did not explain AWN has a discretion over whether to accept or decline a claim and this was not clear to Zachary until he spoke to Consumer Action. Zachary said he 'wasn't really aware of the finer details', and he 'just assumed if something went wrong, they would fix it if it is listed in the warranty. That's what a warranty is'.

On top of the warranty, Zachary ended up paying much more for the vehicle than he expected, and said he felt under pressure to buy on the day. He told us that 'the car was advertised at a certain price (\$8500), but it doesn't tell you about the extra charges'. Zachary loved the vehicle and was happy to keep it even though making the repayments was 'very tight', but felt that his financial position wasn't taken into account during the finance process.

Shortly after purchase, serious defects became apparent and an independent mechanic advised that Zachary should not continue to drive the vehicle and that it may cost \$1200 to repair.

Zachary approached Consumer Action Law Centre for assistance after negotiating with the car dealer without success. Ultimately a settlement was reached with the car dealer that was satisfactory for our client. AWN was not involved in the settlement. Overall Zachary finished this episode disillusioned: 'I just like businesses to be fair, and I think I was treated unfairly. Australia's supposed to be a fair place'

We don't know of anyone who was explicitly told that the warranty provider has discretion to accept or refuse claims, or about any of the other restrictions described above, before they bought the warranty. All of the customers we spoke to during the preparation of this report said that if they knew what they know now about the warranty, they wouldn't have bought it. All expressed some level of anger or injustice that they were sold a product like this.<sup>60</sup>

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<sup>60</sup> We spoke to 11 people during the preparation of this report. Some of those were people who had contacted us for legal advice and the rest were people who responded to requests we put on our website and elsewhere inviting people with experience of MVDPRs to tell us their story.



Many comments on online forums for NWC and AWN make the same point:

#### **Comment on Whirlpool Forum, 24 April 2013**

*When I purchased my [car] 6 months ago I was offered an extended 5 year warranty for approximately \$2,000. I was told by the dealer that it was an excellent product and the best aftermarket warranty that you can buy. Well as it turns out, I have now found this thread which I wish I had have stumbled across 6 months ago!! Today my car has gone into 'limp mode' due to an 'Exhaust Pressure Sensor', which I have now been told by NWC that as this specific sensor is not one of the 50 or so listed items that they cover then they won't be covering my \$450 sensor (parts/labour). Apparently they will only cover the very specific listed items and nothing more, so as the 'Exhaust Pressure Sensor' is not listed, it is not covered! So I guess unless you are 'lucky' enough that the part that fails on your car just happens to be one of the few listed items covered, and then you have sent your service paperwork to NWC every 6 months or 10,000km's within 7 days of servicing at an authorised mechanic, then you will probably be donating your money to NWC as I have! I hope someone else reads this thread before they get sucked in to NWC!<sup>61</sup>*

“unless you are lucky... you will probably be donating your money to NWC as I have!”

#### **Comment on Whirlpool Forum, 24 July 2013**

*Thumbs down from me too...had a transmission issue that they refused to pay saying it's wear and tear...had to shell out 400 bucks from my pocket...wish I had researched this before buying the warrantaty..Avoid like the plague! these guys just take money from you....I would like to start a company like this myself and make money!<sup>62</sup>*

The consumer experience described in our case studies and online forum extracts is backed up by the promotional material of warranty companies themselves. The websites and promotional brochures from these companies talk at length about the 'benefits' offered by these products but fail to mention the discretion that the provider has to reject claims. None of the websites or promotional brochures of NWC or Integrity balance comments about the 'benefits' of their warranties by explaining that the only right a customer has is to make a claim and have it considered. The discretionary nature of these products is only explained in the Product Disclosure Statements.

<sup>61</sup> Posted 24 April 2013. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=2> on 17 April 2015.

<sup>62</sup> Posted 24 July 2013 on a Whirlpool forum about National Warranty Company. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=2> on 17 April 2015.

### Comment on Whirlpool forum, 23 January 2013

*Used car dealers make them sound like an awesome thing. I only escaped because I have an excellent mechanic who told me to stay far, far, away.*<sup>63</sup>

Car dealers and finance providers receive a financial incentive for selling MVDRPs. Contracts don't say exactly what commissions are paid to salespeople (the law doesn't require this to be disclosed if the commission is 'unascertainable'), but AWN's current Financial Services Guide indicates that salespeople receive up to 66.67 per cent of gross written premium and the AWN warranty from 2014 we have sighted indicates that the commission paid to the salesperson can be up to 80 per cent of the premium. This may not be unusual—ASIC is reported as saying that commissions on insurance products sold by car dealers can be 75 per cent of the premium or more.<sup>64</sup> Contracts also say that if a warranty is included in the price of the car, the warranty provider does not pay a direct commission to the salesperson.<sup>65</sup> However we expect there will be a financial arrangement between the warranty provider and the car yard which encourages the sale of warranties.<sup>66</sup> There may also be informal arrangements as in Nick's case (below) where the car dealer gets a cash payment directly from a customer.

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<sup>63</sup> Posted 23 January 2013 on a Whirlpool forum about National Warranty Company. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057> on 17 April 2015.

<sup>64</sup> 'Industry culture must change: ASIC', [insurancenews.com.au](http://insurancenews.com.au), 27 July 2015.  
<http://insurancenews.com.au/regulatory-government/industry-culture-must-change-asic>

<sup>65</sup> AWN Financial Services Guide; Integrity Affinity warranty, p 2-3.

<sup>66</sup> For example, Integrity's Affinity Warranty indicates that car salespeople may receive a bonus for selling warranties, p 3.

### Case study 5

Nick (not his real name) bought a used BMW early in 2015. At the time of the purchase, the dealer said that a three year warranty was included in the price. This warranty turned out to be a National Warranty Company 'Sentinel' warranty, but Nick says that he assumed he was being offered a manufacturer's warranty.

The salesperson gave no details on what the warranty covered, or Nick's obligations under the contract, such as the service requirements. Nick also said he was told he could cancel the warranty at any time. The salesperson promoted the warranty by emphasising that the car was an expensive car with expensive parts and the warranty offered protection from that cost.

The salesman said that he would cover the cost of the warranty at that time but that Nick would have to pay the salesman \$1000 for the warranty later. It isn't clear to us why the salesman asked Nick to pay for the warranty in this way.

Shortly after buying the car, it had mechanical issues and Nick took it to a mechanic. Around this time, Nick took a closer look at the warranty documents and tried to cancel the warranty after deciding that it offered him no real benefit. Clause 10.1 of the warranty document signed by Nick states that 'You may cancel your Warranty Contract at any time by writing to NWC'. However, when Nick asked to cancel the warranty, he was told that he is entitled to cancel but will not receive any refund if he does.

Nick said he would 'definitely not' have agreed to buy the warranty if he knew NWC had discretion over whether to accept claims and about the other limitations. It is telling that Nick was also offered add-on insurance at the car yard, which he refused to buy because he has existing insurance cover. Nick, an educated, small business owner says he only bought the NWC product because he was under the impression that the warranty was a manufacturer's warranty and because of the anxiety the salesman created by talking about how expensive repairs and parts would be. Nick says that, since this episode with NWC he has been to other car yards and seen other dealers selling similar products in the same way.

Nick says that, as a recent migrant he had an impression of Australia as being a place where people were 'legitimate and upfront' and is justifiably disappointed at the conduct of NWC. 'No other company in Greece would do this and be in business the next day.'

US academics Tom Baker and Peter Siegelman agree that second stage or supplemental products, whether for print cartridges or insurance, allow providers to charge prices higher than competitive markets would usually allow. This ability to charge high prices, along with the fact that a decision to buy add-on insurance is 'irrational',

implies that all kinds of hard-sell tactics are virtually compulsory because the marginal return to a dollar spent on inducing a customer to purchase add-on insurance is high.<sup>67</sup>

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<sup>67</sup> Tom Baker and Peter Siegelman (2013) *Protecting Consumers from Add-On Insurance Products: New Lessons for Insurance Regulation from Behavioural Economics*. University of Pennsylvania Law School Institute for Law and Economics, Research Paper No. 13-1, pages 6-7.

# Conclusions and Recommendations

## Law reform - closing the loophole

The Motor Vehicle Discretionary Risk Products provided by NWC, AWN and Integrity are regulated alongside a broader category of discretionary products (known as 'mutual risk products' or 'discretionary mutual funds') which are considered to provide a legitimate alternative to insurance in certain circumstances. ASIC has described mutual risk products as

...risk products that provide an alternative to conventional general insurance products. Generally, MRPs involve participation in a 'mutual' scheme based around particular professions, small business associations, franchise operations or community groups (MRP scheme). MRP schemes may cover a range of risks, such as professional indemnity and public liability risks.<sup>68</sup>

The appropriate level of regulation for these discretionary products was considered as part of the reforms following the 2003 Royal Commission into the collapse of HIH Insurance. Given that context, the main concern for the Government seemed to be on prudential rather than consumer protection settings. The Government ultimately came to a view that these products do not warrant heavy handed regulation as they do not present a significant risk to the financial system. However, it was decided that discretionary product providers should report data to the prudential regulator, and disclose to their clients that they have a discretion as to whether or not they pay out a claim.<sup>69</sup>

This decision, and the operation of the broader financial law, means that discretionary risk product providers are currently required to:

- hold an Australian Financial Services License, as they are providing a financial product;
- provide disclosure documents required by the *Corporations Act 2001 (Cth)*, such as Product Disclosure Statements and Financial Services Guides; and
- meet the requirements of the general consumer law set out in either the *Australian Securities and Investments Commission Act 2001 (Cth)* and the Australian Consumer Law.

As indicated above, we do not have any view on the sale or use of discretionary risk by businesses as an alternative to insurance. But we do not think the products that are sold by NWC, AWN or Integrity are useful or necessary, and we also believe that there is ample evidence that the sale of these products is causing consumers harm. It is our view that the sale of discretionary risk products through consumer transactions should not be permitted.

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<sup>68</sup> ASIC, *IR 03-17 ASIC's interim approach for regulation of mutual risk products*, 15 July 2003. Accessed from <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2003-releases/ir-03-17-asic-s-interim-approach-for-regulation-of-mutual-risk-products/>

<sup>69</sup> See the second reading speech to the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007, Hansard, House of Representatives, Thursday, 21 June 2007, p 15. <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22chamber%2Fhansard%2F2007-06-21%2F0039%22>.

One way the Government could prohibit these kind of sales may be to permit discretionary risk products (perhaps in the Corporations Act or the ASIC Act) in contracts entered into by businesses, franchise owners, community groups, but not in transactions between a consumer and a trader.

**Recommendation:**

We recommend that the Commonwealth Government change the law to ban discretionary risk products from being sold in consumer-trader transactions.

We expect that the MVDRP providers will argue that MVDRPs should be able to be sold to consumers because the fact that many consumers buy these products means that people see value in them, including that they offer 'peace of mind'. We disagree. We believe the only reason consumers buy these products is because they are sold in a way which:

- is designed to prompt consumers to buy without shopping around or considering the product in depth, as they would if they were buying a product off the shelf;<sup>70</sup>
- leads people to think that MVDRPs are something which they are not—they are called 'warranties' and salespeople effectively recommend them on the basis that they provide some cover against breakdown; and
- hides important facts about the product, such as its discretionary nature, the extent of the exclusions, caps on cover and servicing requirements.

We think that many consumers buy AWN, NWC and Integrity products due to the tricky sales processes. We are doubtful that consumers who really understand the product and its limitations would buy it.

Providers will also argue that they do pay some claims, and this is true. We know of some clients who have received partial payments on claims, and posts on online forums also mention part payments.

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<sup>70</sup> Financial Conduct Authority (March 2014) *How does selling insurance as an add-on affect consumer decisions? A practical application of behavioural experiments in financial regulation*, pages 7-8.

**Whirlpool forum post, 17 December 2013**

*I too purchased this product for a car that was 18 months old with the intent of keeping it for many years. The car broke down outside of the manufacturers warranty period. Went to claim and it was denied because they didn't receive the service record each time it was serviced. They stated they would re-instate the warranty after the current, expensive, problem was rectified and service conducted. I had the car fixed, serviced and back on the road. The following day, the car broke down again (different part failed) and as we were dealing with the same person from NWC, they honored their portion of the repair. It was another shock to find they only covered about 40% of the cost of the repair. In the end I took it and never corresponded with them again. The 40% repair cost was almost enough to cover the price I paid for the product in the first place so as far as I am concerned I only lost a few sleepless nights and not a great deal of money to them. Karma.<sup>71</sup>*

**Facebook post regarding National Warranty Company, 28 October 2014**

*I have been rejected twice by these \*\*\* !!! The car is well maintained and I was told no less than 3 times the part is covered by them on the phone!!! And the. Get told today they don't cover it ... All I got with my warranty was a booklet nothing else ... And the part they will cover out of the \$2800 bill was \$175 yeah \*\*\* right!! They will cover one hour labour and a second hand power steering pump!?!???<sup>72</sup>*

**Comment on Whirlpool forum about NWC, 5 April 2015**

*Some dealers give you the basic cover, and then upsell to the best cover. My son bought an Alfa a few years ago, and as it was a piece of rubbish (i couldn't convince him not to buy it) I thought it was a good idea so we upgraded for about \$1,500.*

*Fast forward 6 months (10,000kms), water pump and timing belt failed requiring rebuilt of motor and replacement of water pump and timing belt. Total Cost \$6,000. After arguments they paid \$500 for the "initial cause" as resultant damage wasn't covered. As resultant damage isn't covered, they will cover the initial issue, hence they get away with it all.*

*...*

*I vowed then that I would never buy any aftermarket warranty, especially NWC, again.*

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<sup>71</sup> Posted December 17 2013. Accessed from <http://forums.whirlpool.net.au/forum-replies.cfm?t=1785057&p=2> on 17 April 2015.

<sup>72</sup> Accessed from <https://www.facebook.com/pages/National-Warranty-Company-Is-A-Scam/771481869539441?fref=ts> on 17 April 2015.

### **Comment on Whirlpool forum, 23 and 29 April 2014**

*I am about to make a claim with NWC for a faulty power window motor. The car is going to the mechanic tonight with a view to have the quote to NWC by tomorrow. After reading through the comments here, I am not too confident that the repair will get the authorisation and completed. I'm on plan C which the booklet says should cover \$550 for power window motors. I'll add an update once I hear from them.*

...

*Well, I think I may have the only positive story here. Power window motor went in my benz, took it to my mechanic who I've been going to for years now and they sent the quote yesterday, got the approval back yesterday and its being repair today.. I was not expecting that at all, but glad that it was all approved. Probably because the repairs were under \$550. That may have had something to do with it.*

However, we would be surprised if these providers are paying a respectable amount on claims relative to the premiums they receive, given the terms of their contracts do not seem to require them to pay out anything at all. Insurance companies are required to report to the Australian Prudential Regulation Authority (APRA) on how much they earn in premiums and pay out in claims. APRA data from the last 4 years shows that, on average, domestic motor vehicle insurers pay out 71 cents in claims for every dollar they earn in premiums. Homeowners insurance pays 57 cents in the dollar, travel insurance pays 50 cents and Consumer Credit insurance pays only 23 cents in the dollar.<sup>73</sup> If MVDRP providers want to claim that their product is value for money, then they should prove it by publicly reporting how much they pay in claims for each dollar they earn in premiums.

MVDRP providers should also publicly report how many claims they receive, and how many of those claims are accepted, declined or withdrawn. Insurers who are signatories to the General Insurance Code of Practice already report this data to the Financial Ombudsman Service, who publish it each year.

MVDRP providers may also respond that they receive very few disputes about their products, which shows that their customers are happy. However, complaint figures are not always a good indicator of customer satisfaction. It is very common for people who have consumer disputes to either not report them or at least, not report them to regulators—research by Consumer Affairs Victoria has found that as little as 4 per cent of people with consumer disputes end up bringing them to the regulator, smaller numbers go to other bodies like an ombudsman.<sup>74</sup>

Many people who have bought products from AWN, NWC and Integrity will not realise they have a problem with the product as they never have to claim. Our experience suggests that others don't even know they have been sold the cover. People who do make a claim or raise a dispute with a provider may be brushed off and feel like there is nothing they can do but

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<sup>73</sup> Analysis by Consumer Action Law Centre using data from APRA, Quarterly General Insurance Performance Statistics, December 2014 (reissued 17 March 2015).

<sup>74</sup> Consumer Affairs Victoria (October 2006) *Consumer Detriment in Victoria: a survey of its nature, costs and implications*, research Paper No. 10, page 9.

accept the decision of the warranty provider. Again, MVDRP providers could give a better indication of the number of complaints by releasing data about the number of claims and disputes they receive, and how they are handled.

The number of posts on the Whirlpool forum about NWC (most from the last two years), and over 200 disputes heard at FOS in the last four years against extended warranty companies (and trending up)<sup>75</sup> suggest to us that there is a significant number of consumers dissatisfied with these products.

#### Law reform - preventing on the spot sales of add-on financial products

While the biggest problem with MVDRPs is the lack of value for consumers, the experience with MVDRPs also shows broader problems caused by the add-on sales technique, in particular in financial services.

#### **Recommendation**

We recommend that if businesses want to sell financial products as an add-on:

- there should be a mandatory delay of two to seven days between the sale of the headline product and the sale of the add-on; the salesperson can promote the product, but the transaction cannot be completed until the consumer takes a step to opt in. That is, they would have to call the salesperson themselves (after the mandatory delay) and say that they want to buy the product; and
- to avoid doubt, no add-on should be sold through an 'opt out' mechanism, such as where the contracts have a pre-ticked box saying that the consumer agrees to buy the add-on unless they say otherwise.

Similar reforms are currently being considered by the Financial Conduct Authority (FCA) in the UK. The FCA has recently recommended that GAP insurance<sup>76</sup> may not be introduced and sold on the same day. Instead, there would be a four day deferral period in which the customer could consider the purchase and shop around. After the four day period, the business could contact the customer to try to complete the sale. Consumers would be able to make the purchase sooner, at their own initiative, if they wished to do so.<sup>77</sup>

The FCA has also recommended a ban on 'opt-out selling' across all financial services. An opt-out sale is

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<sup>75</sup> FOS 2013-14 Annual review, page 60. Accessed from <http://www.fos.org.au/publications/annual-review/>

<sup>76</sup> An insurance product, often sold as an add-on, which covers a car owner if their vehicle is written off and their comprehensive car insurance policy does not pay out the whole amount due under the car loan.

<sup>77</sup> Financial Conduct Authority (December 2014) *Guaranteed Asset Protection insurance: a competition remedy*, paragraph 1.22.



any sale where the customer has to override a default setting that pre-selects a purchase for them. Opt-outs commonly take the form of pre-ticked boxes, although they are not limited to this.<sup>78</sup>

To be clear, we do not support the part of the FCA's proposal that allows the business to contact the consumer to complete the sale after the deferral period. We believe that this will still lead to many consumers signing up to the add-on cover after being subjected to pressure sales techniques after the deferral period. If the add-on product is useful for the consumer, they will be motivated to get back in touch with the business and complete the transaction themselves.

### **Collecting consumer stories and helping consumers get refunds**

The case studies above only tell the stories of a small number of people. However the fundamental problems with the design of these products and the way they are sold means that there may be a very large number of Australian consumers who have been mis-sold this product.

Over the next few months we want to hear from more consumers who have bought MVDRPs to learn more about sales practices and claims experience. We will use this information to build momentum for changes that will fix the problems we've described. If you have an experience you want to share, please get in contact by emailing us at [campaigns@consumeraction.org.au](mailto:campaigns@consumeraction.org.au).

We also want to ensure that people who have been sold MVDRPs in a way that breaches the law can enforce their rights under the law. In many cases consumers may be entitled to a refund of what they have paid for an MVDRP. We intend to launch a campaign in the near future that will help consumers who have been mis-sold MVDRPs to complain about how they were treated and seek refunds.

For more information, please visit our website – <http://www.consumeraction.org.au>

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<sup>78</sup> Financial Conduct Authority, *General Insurance Add-Ons Market Study - Proposed Remedies: Banning opt-out selling across financial services and supporting informed decision-making for add-on buyers*, Consultation Paper CP15/13, 25 March 2015, page 8. <https://www.fca.org.uk/your-fca/documents/consultation-papers/cp15-13>

# Attachment A: Questions initially put to expert consultant

## Servicing requirements

1. One warranty provider requires consumers to service their vehicle:

- every six months or 10,000 km, whichever occurs earlier (for cars under twelve years old that have travelled less than 225,000km)
- every three months or 5,000km, whichever occurs earlier (for cars twelve years or older and/or that have travelled 225,000km or more)

Another warranty provider requires:

- all motor vehicles to be serviced every six months or 10,000 km, whichever occurs earlier; and
  - if the vehicle is over 10 years old or has travelled in excess of 200,000km, the consumer must also ensure the vehicle has a 'motor mechanic safety check and oil change' every three months or 5,000km, whichever occurs earlier.
- a. How do these servicing requirements compare with what manufacturers recommend? For example, do these warranties require consumers to service their vehicle more often, less often or about as often as is recommended by manufacturers?
  - b. If the warranties require more frequent servicing than is recommended by manufacturers: would servicing a vehicle as often as required by the warranty provide greater protection against mechanical breakdown than if a person only serviced their vehicle as often as recommended by the manufacturer?
  - c. If a consumer serviced their vehicle as often as required by the warranties, would it prevent any mechanical breakdown occurring, or could a breakdown still occur?
  - d. Do motor vehicles require more frequent servicing as they get older?
  - e. Do motor vehicles require more frequent servicing once they have done around 200,000 kilometres?
  - f. What would a person typically pay for a standard service for a motor vehicle? We understand that prices vary depending on the vehicle, so please provide a reasonable range of prices for small, medium and large vehicles.
  - g. What would a person typically pay for a 'motor mechanic safety check and oil change'? As above, please provide a reasonable range of prices for small, medium and large vehicles.

### **Reasons a motor vehicle might break down**

2. The motor vehicle warranties we are interested in only cover repairs needed because the vehicle suffers a mechanical breakdown. They do not cover repairs needed because of an accident / impact, fire, theft, submersion or corrosion.

What could cause a mechanical breakdown if we exclude things on the following list?

- a) a pre-existing fault in a second hand vehicle;
  - b) misuse, neglect or abuse of the vehicle; or use of the vehicle outside of the manufacturer's specifications, such as for racing and stunts;
  - c) damage caused by overheating;
  - d) damage caused by a person continuing to drive the vehicle when they know or suspect that it has a fault.
3. What could cause a mechanical breakdown if we exclude things on the list in question 2 and we also exclude **normal wear and tear**?
4. What could cause a mechanical breakdown if we exclude things on the list in question 2 and we also exclude **damage caused by lack of oil, lubricant, water or coolant**?
5. What could cause a mechanical breakdown if we exclude things on the list in question 2 and we also exclude **damage caused by rust or corrosion**?
6. Is it true that any motor vehicle breakdown in a second hand car could be attributed to either:
- a problem that existed when the consumer bought the car; or
  - normal wear and tear?

### **Extent of coverage**

7. Each warranty provides cover for certain components up to a monetary limit. [At this point we attached tables from the PDS' from each warranty provider detailing those limits] Please refer to those tables and advise:
- a) are common problems with the listed components likely to be covered by each warranty provider, noting that only certain parts of each component are covered;
  - b) would common problems with each component be able to be repaired within the monetary limits imposed by the warranties?

### **Other matters**

8. In your experience as a car dealer and mechanic, are there any other obvious benefits or weaknesses to these warranties not discussed above.