Consumer Credit Law Centre SA
Legal Advice and Services
Credit • Debt • Financial Counselling

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Australian Securities and Investments Commission

By email: add-on.consultation@asic.gov.au

Joint submission: Options to reform the sale of add-on insurance and warranties in car yards

Thank you for the opportunity to comment on Consultation Paper 294: The sale of add-on insurance and warranties through caryard intermediaries (**CP 294**).

Our organisations strongly support the Australian Securities and Investment Commission's (ASIC's) proposal to mandate a delayed sales model for add-on insurance and warranties sold through car yards, and to improve supervision of these sales.

We have held long-standing concerns about the sale of add-on insurance and warranties in car yards evidenced through multiple ASIC reports as well as our own casework and Consumer Action's DemandARefund.com website. We strongly believe reform is long overdue and that many of the proposals outlined in CP294 have a real potential to address the most prevalent problems if implemented.

In our view, any reforms to car yard add-on sales should improve demand-side competition and protect people who are vulnerable.

We believe there are several principles that should inform the design of a final deferred sales model. We believe that the decision to purchase and finance a vehicle must be distinct from the decision to purchase and/or finance an add-on insurance product. This means that the sale of add-on insurance should take place only after the vehicle has been purchased, finance is approved, and the vehicle delivered. Customers should have useful product information regarding an add-on insurance product and have engaged with it before the deferral period starts. The customer should also know the total cost of add-on insurance before a deferral period starts.

These principles have led our organisations to propose an alternative sales sequence which would see the deferral period commence when the car has been delivered.

A key consideration in designing and implementing a final model will be the need to eliminate risks of circumvention or regulatory gaming by car dealers. We strongly believe that gaming will occur if a consumer opt-out mechanism is included in the final model. An opt-out mechanism will simply still lead to many consumers to be subjected to further pressure sales techniques to opt-out, thereby defeating the purpose of the reform.

The industries engaged in the car yard add-on insurance market have had many years and prompts to improve their own practices and implement effective self-regulation.[1] Their efforts to date have been insufficient. It is clearly now the role of ASIC to protect these businesses' customers.

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[1] Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470) http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-470-buying-add-on-insurance-in-car-yards-why-it-can-be-hard-to-say-no/; Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471) http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-471-the-sale-of-life-insurance-through-car-dealers-taking-consumers-for-a-ride/; and Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492) http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-492-a-market-that-is-failing-consumers-the-sale-of-add-on-insurance-through-car-dealers/. ACCC, ACCC denies authorisation for insurance companies to jointly set a cap on sales commission, 9 March 2017, https://www.accc.gov.au/media-release/accc-denies-authorisation-for-insurance-companies-to-jointly-set-a-cap-on-sales-commissions

Recommendations

- A mandated deferral period for the sale of add-on products by caryard intermediaries for both new and used vehicles should be introduced.
- A consumer opt-out period should not be included in a final deferred sales model.
- The deferral period commencing once the vehicle has been purchased, financed *and* delivered to the consumer and the consumer communication has been provided.
- The objectives of the deferred sales period would be better met by starting the deferred period on delivery of the car. An alternative sales sequence where the deferral period commences once the car has been purchased, financed and delivered should be implemented.
- The principles that should be met in the final design of the deferral period are:
  - a. the vehicle should be purchased before the add-on insurance sale;
  - b. finance should be approved before the add-on insurance sale;
  - c. the vehicle should be delivered before the add-on insurance sale;
  - d. the decision to purchase and finance a vehicle must be distinct from the decision to purchase and/or finance an add-on insurance product;
  - e. the customer should have useful product information regarding an add-on insurance product and engage with it before the deferral period starts;
  - f. the customer should know the total, discrete cost of add-on insurance before the deferral period starts.
- Insurers should not offer 'bridging' cover during the deferral period, as it would not address the small risk involved in the lack of coverage during the deferral period, could perpetuate high-pressure selling and could distort consumer decision-making. Insurers should reduce or remove waiting periods altogether in add-on products to reduce the period in which consumer are uninsured.
- A deferral period of at least four days is required. The longer the period however, the greater the impact of the expected benefits. We believe there is considerable merit in introducing a 30 day deferral period to allow a consumer to fully assess their financial situation before purchasing add-on insurance. Consideration of a deferral period though should be secondary to the needed to begin commencement of the deferral period following purchase, financing and delivery.
- As a principle, the consumer approach should be tested before it is rolled out. The structure and form of this testing, however, should not be used to delay the introduction of the deferred sales model. The consumer communication should then be routinely reviewed and refined over time.
- Innovative, interactive consumer communication techniques should be mandated and supervised to ensure greater consumer understanding and purchase of suitable add-on insurance products. To ensure this we support a standardised model that is

a. active/interactive and not passive (that is simply providing a piece of paper); and

b. includes a series of ‘filter’ or ‘knock out’ questions, before the purchase of the product.

- Any consumer communication developed must include information relating to:

  a. the key features of the product including premiums, exclusions, conditions and benefits (including maximum benefits).

  b. claims data including claims ratios;

  c. sufficient information for the consumer to identify whether the product is suitable to the consumer’s needs.

- Consumer communication should make it clear in an interactive manner that the add-on products they are offering, or products offering similar cover, could be available at competitive prices from other providers including directly from the same insurer/warranty company.

- Insurers must ensure that the consumer understands the total cost of the add-on products, including interest and fees.

- The sale and distribution of mechanical breakdown insurance and warranties should be regulated under a model that prohibits the sale of these products more than one month before the expiry of the manufacturers warranty.

- Enhanced supervision obligations with specific requirements must be introduced as a part of the deferred sales model.

- We support ASIC’s proposal of risk indicators to allow early intervention where a particular dealership is selling add on products in a way that is non-compliant or unfair. Other measures should include:

  a. Analysis of the data collected through filter and knock our questions

  b. Benchmarking and analysis of claims experience data, and

  c. Benchmarking and analysis of penetration rates.

  d. Oversight and analysis of sales representative data including:
     - size of commissions and amounts earned – analysis to identify where particular representatives earn high amounts of commissions;
     - sales volumes – where a representative sells a high volume of add-on insurance;
     - disciplinary history of sales representatives – where a representative has a history of misconduct; and
     - experience of sales representatives and training – to identify potential problems where a representative is inexperienced in sales.

  e. Adequate education to representatives about their responsibilities when engaging in the sale of add-on insurance. This may include requiring providers to undertake strict accreditation checks before and after they appoint authorised representatives.

  f. ASIC should conduct post-sale interviews with consumers to test the effectiveness of supervision/disclosure.

- Remediation schemes should be designed at the same time as monitoring and compliance systems.
- Claims ratio targets should be mandated.

Proposal 1: Deferred sales model for add-on products

We support ASIC's proposal to mandate a deferred sales model for add-on insurance and warranties for new and used cars by caryard intermediaries via a legislative instrument.

The evidence is in ASIC Reports 470, 471 and 492, along with the almost countless case studies provided by our organisations over the years via our casework and the stories told via Consumer Action's DemandARefund.com website, have made it abundantly clear that the add-on insurance market via caryard sales is failing consumers, producing significant harm and in dire need for oversight and reform. We have also long advocated for a deferred sales model as a solution given known behavioural biases, and the nature of the sales tactics employed.

A key consideration in designing and implementing a final model will be the need to eliminate risks of circumvention or regulatory gaming by car dealers. Circumvention may be, for example, through the proposed bridging insurance (see further below) or different commercial arrangements which side step the restrictions placed on insurers. It may also arise through the types of information provided in consumer communications and in any "innovative" untested forms of mandated disclosure.

We strongly believe that gaming will occur if a consumer opt-out mechanism is included in the final model with dealers potentially building misplaced confidence in consumers with regard to these products. An opt-out mechanism will simply still lead to many consumers to be subjected to further pressure sales techniques to opt-out, thereby defeating the purpose of the reform. We do not believe there are any consumer cohorts where the need to be able to opt-out it can be justified. People who have bought the product before need to consider the different product features within a new context – that of purchasing a new or used car. They too need to make this decision separately. People who want a same day sale – can have this but consider and purchase an add-on product separately. Indeed given the nature of this group to focus on speed, these are the people who need to consider the purchase of an add-on product separately as they will be more vulnerable to confused decision-making.

Reliance on a consumer stating that they understand falls into the same trap that currently exists in terms of confused decision-making.

Recommendations

We fully support the introduction of a mandated deferral period to the sale of add-on products by caryard intermediaries for both new and used vehicles.

A consumer opt-out period should not be included in a final deferred sales model.

Commencement of the deferral period

CP294 proposes three options for when the deferral period should commence:

a. When the consumer communication is provided
b. When the agreement to purchase the vehicle and/or arrange financing is finalised and the consumer communication has been provided and
c. When the vehicle has been delivered to the consumer and the consumer communication has been provided.

We support the deferral period beginning once the vehicle has been purchased, financed *and* delivered to the consumer and the consumer communication has been provided.

We believe that there are several principles which should inform the commencement of the deferral period under the model. These are as follows:

The vehicle should be purchased before the add-on insurance sale: As CP 294 notes, if add-on products are offered before the car purchase, a consumer cannot make an informed decision about the add-ons, and is more likely to experience decision fatigue.[2]

Finance should be approved before the add-on insurance sale: Similarly, the finance process must be clearly separated from the add-on sales process. Consumers must not be led to believe that purchasing add-on insurance such as Consumer Credit Insurance (**CCI**) and GAP insurance will improve their chances of finance approval or the terms on which finance is offered. While this may lead to an additional financing approval process being required if the add-on insurance is ultimately financed, this is an important financial decision for both the financier and the purchaser to consider separately and provides a significant opportunity to inform and engage the mind of the consumer as to the consequences of the decision to purchase an add-on insurance product on finance. Our services have seen car finance contracts where the add on products are equal or greater in value to the cost of the car –this is a substantial purchase with significant financial implications, particularly when attracting interest, sometimes very high interest (e.g.48% per annum).

The vehicle should be delivered before the add-on insurance sale: Consumers need to be in possession of the vehicle before true consideration of the distinct add-on products can be undertaken. This model wholly removes the add on insurance sales process from the context of the caryard and the high pressure techniques that being on the sales person territory can entail. A consumer would no longer have to worry about having to please a sales person in order to ensure a smooth transition to final possession of the car. A deferred sales model that continues to allow pressure sales techniques before a consumer can take possession of the car simply perpetuates the central problems that the deferred sales model is seeking to solve.

The decision to purchase and finance a vehicle must be distinct from the decision to purchase and/or finance an add-on insurance product: The central aim of the model should be to ensure that the decision to purchase a vehicle and the decision to purchase an insurance product are clear and distinct. The deferral period and its commencement must be designed to promote this as much as possible. This model separates the purchase decisions completely and removes any inference (express or implied) that the purchase of the add-on products can influence final approval of the finance or any other aspect of the sale.

The customer should have useful product information regarding an add-on insurance product and have engaged with it before the deferral period starts: The car dealer should provide the customer with the required communications before or at the time the deferral period starts, to enable to consumer to make a genuinely informed assessment.

[2] CP 294, Figure 1, Sales sequence C, page 52.

The customer should know the total cost of add-on insurance before the deferral period starts: The deferral period should not commence until the car dealer gives the consumer the complete cost of add-on products for their specific vehicle and finance arrangements.

The principles outlined here are not met under the proposed option (a), however they are met in a combination of (b) and (c).

Option (a) allows the caryard to decide when the consumer communication is to be provided and therefore does not ensure that vehicle is purchased and financed before the sale of add-on insurance begins.

Option (b) is close but the commencement could still be before the delivery of the vehicle and depending upon the length of the deferment could be completed before the delivery of the vehicle. We believe it is important that the vehicle is delivered to truly delineate the two decisions.

Option (c) is closest but does not refer to finance being completed – although this may have been implied.

As will be clear with our preferred alternative sales sequence model below, we believe that for a range of reasons including simplicity, certainty for distributors and for supervisors, improved clarity of decision-making as well as allowing consumers the space to consider their needs once they own a vehicle, a deferral period beginning at vehicle delivery is the most appropriate.

We acknowledge that this will, as CP 294 states “be more disruptive to the distribution of add-on products through car dealerships” but this is what is necessary to solve the consumer harm currently occurring.

Recommendations

We support the deferral period commencing once the vehicle has been purchased, financed *and* delivered to the consumer and the consumer communication has been provided.

Proposed sales sequences

CP294 proposes three potential sales sequences:

(a) Sales sequence A—The consumer is asked to select the add-on products they want to buy after they have chosen the vehicle but before financed is approved.
(b) Sales sequence B—The consumer is asked to select the add-on products they want to buy after they have chosen the vehicle and finance is approved.
(c) Sales sequence C—The consumer is asked to select the add-on products they want to buy before they have chosen the vehicle and before financed is approved.

We do not support sales sequence A or C.

Sales sequence A is business as usual. From our observations, new car dealers in particular will lock in the car purchase with their customer, then sell the add-ons when the customer returns to pick up the car. Option A would therefore perpetuate the problems of impaired consumer decision-making and pressure selling. This is in addition to the add-on costs being unknown when the consumer makes the decision, as identified in CP 294.

It will be argued that the sales discussion of an add-on insurance product needs to take place before financing in order to know the full price for financing and not duplicate the process. We fundamentally disagree. We strongly believe that the discussions regarding financing need to be distinct and separated out. It is not duplication. They are two very different financing conversations.

'Sales sequence C' could also distort the sales process, albeit it in a different way, by increasing the importance of add-on insurance in the customer's eyes. It will exacerbate the bias towards agreeing to a product in order to obtain the vehicle. There will be a real chance that – whether implicitly or explicitly in the add-on discussion –a consumer will feel they need to purchase the add-on product in order to obtain the finance and the car.

Of the options proposed by ASIC, 'sales sequence B'[3] aligns closest to our view albeit not quite. This model still allows a car dealer to sell add-on products before the consumer has taken the car, and the problems inherent in mixing the two sales processes including confusion and other behavioural biases, are still at play.

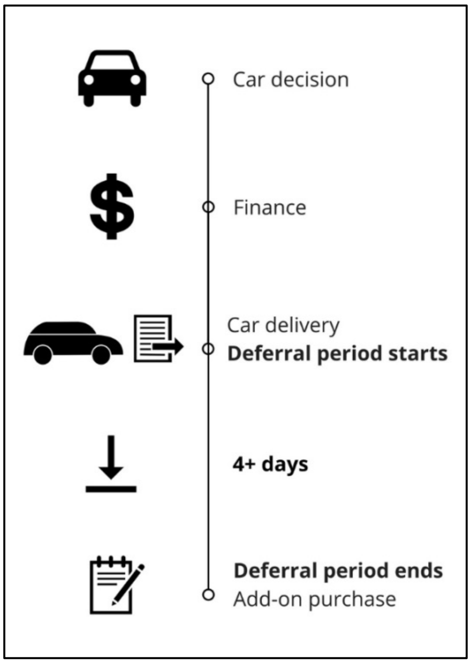
For the most part, Sales Sequence B means consumers can make a decision with complete information about the vehicle, add-on products and associated costs. More importantly, this sales sequence means a consumer can largely make a separate and distinct decision about add-on products. However, until full delivery of the vehicle is made, the relationship between the consumer and salesperson, and the known biases that impact upon this interplay, remain. While the car is still at the car yard, the opportunity is wide open for dealers to pressure sell add-on products – a situation that and new deferred sales model is meant to avoid.

We therefore propose an alternative sales sequence.

[3] CP 294, Figure 1, page 52.

Alternative sales sequence

The objectives of the deferred sales period would be better met by starting the deferred period on delivery of the car. An alternative sales sequence would see the deferral period commence when the car has been delivered. The model below shows the sequence and key advantages and disadvantages of this model for customers.



Advantages

- Consumer can consider add-on products in light of own vehicle and finance arrangements
- Consumer knows the exact cost of add-on products
- Consumer has time to assess add-on products
- Consumer less likely to experience decision fatigue and make a decision under pressure
- Start of deferral period easily documented
- Allows for telephone and online sales, which are more easily monitored
- Add-on product payment would be considered and arranged separately to car sales and financing
- Appropriately disrupts current sales process leading to mis-selling and consumer harm

Sequencing add-on product sales in this way would have significant benefits for consumers and meet the principles we have outlined above.

The key advantages of this model are:

1. The consumer will be able to consider the add-on products in light of their own vehicle financing arrangements, risk profile, budget and needs, rather than the less specific, vague, potentially high pressured sales context.
2. The consumer would be able to assess the value of the add-on products knowing the exact cost of the products for their own vehicle and finance arrangements. Otherwise, as currently occurs, the costs of the product are lost in the figures and unclear.
3. The consumer will have more time to assess the features and benefits of the add-on products, although the content and format of the product information will be critical in enabling people to do this.
4. The consumer makes the purchasing decision outside the caryard, therefore is less likely to experience decision fatigue or to make a decision under pressure from a dealer.

5. The start of deferral period will be easily documented and verified, addressing the issues outlined in CP 294[4] and question E1.1Q3.
6. Significantly, this model would more easily fit telephone and online/email sales processes. These types of sales are more readily monitored (that is, through call recordings and online correspondence and transactions) than caryard sales. This model could therefore contribute to achieving the objectives of CP 294 proposal 2 on enhancing supervision obligations for product providers.

It will be argued by many that under our proposed alternative sequence that financing for the add-on product or products will need to be arranged separately to the vehicle financing, and that will add an extra step in the process. We believe that this in fact the key advantage to the alternative sequence being proposed. Only by separating out these two very different products, with vastly different sets of considerations (for example, considerations of transport requirements, safety etc versus risk profiles) will consumers be better prepared to make more informed decisions about the distinct costs and benefits for both decisions. Further, a relatively minor administrative change should not be a barrier to the design of a sales process that ensures genuine informed consent in a market that is currently failing consumers.

We understand that earlier in 2017, insurers proposed to offer non-financed premium payment options for all add-on insurance. They stated that this 'may include cash payment and payment by instalments; customers will be given clear information about payment options and their implications.'[5] This could provide a more transparent and convenient payment method than financed single premiums and could operate similarly to comprehensive car insurance instalment payments. But again we feel strongly that this still needs to be a distinct conversation held after the delivery of the vehicle.

Our proposed alternative sales sequence will be also disruptive to the status quo by removing add-on sales from the car yard sales process. Car yard sales people will have to have a different conversation in a different context. This will take some getting used to but we believe they will be up to the challenge.

Coverage and bridging insurance

As with other Sales Sequences, there is a risk that under our Alternative Sales Sequence, consumers may be uninsured during the deferral period. We strongly agree with ASIC this risk is very small and the fact that consumers will be uninsured during the deferral period does not create a need for 'bridging' cover.[6] This does not seem practical or desirable. We note that comprehensive car insurance (which covers a very real and present risk) is not included in this model and will still be available before the consumer takes the delivery of the vehicle or drives it.

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[4] CP 294, paras 207 to 212.

[5] Gilbert+Tobin (for Aioi Nissay Dowa and others), Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors – applications for authorisation A91556 – A91557, page 3.

[6] CP 294 para 212.

Many add-on insurance policies and warranties currently include waiting periods, during which the customer is not covered.[7] It is difficult to understand any industry concern that consumers will not be covered from the moment they drive away from the car yard when this has been the status quo for a significant time.

Case study one

Sumeet took out Loan Protection Insurance with her mortgage. She was made redundant five weeks after she took out the policy. The insurer declined the claim on the basis that she did not meet the two month waiting period.*

Source: Consumer Action Law Centre

If insurers were genuine in their concern and wish to reduce the time in which people are not covered by an add-on product, they should remove the waiting periods from existing add-on and other insurance products.

'Bridging' insurance would establish a new opportunity for high-pressure selling in car yards. It would also have the 'endowment effect' or exploit the consumers' 'status quo bias',[8] by making them feel invested in the bridging product, and that, because they have something akin to the add-on product, that the add-on product has some intrinsic value. This would distort people's decision-making and make them more inclined to buy add-on products after the deferral period. If car dealers used incentives or discounts to buy add-on insurance, the risk of poor decision-making would significantly increase.

Recommendations

The objectives of the deferred sales period would be better met by starting the deferred period on delivery of the car. An alternative sales sequence where the deferral period commences once the car has been purchased, financed and delivered should be implemented.

Insurers should not offer 'bridging' cover during the deferral period, as it would not address the small risk involved in the lack of coverage during the deferral period, could perpetuate high-pressure selling and could distort consumer decision-making. Insurers should reduce or remove waiting periods altogether in add-on products to reduce the period in which consumer are uninsured.

Duration of the deferral period

[7] For example: Eric Loan Protection Insurance includes a 21-day waiting period for disability and unemployment cover (PDS dated 1 October 2016, p 6), Eric Warranty Platinum cover commences 90 days after the policy is issued, or when the vehicle has travelled 5,000 kilometres from the date of purchase (PDS dated 1 October 2016, p 7).

[8] See further Daniel Kahneman, Jack L. Knetsch, Richard H. Thaler, Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias, The Journal of Economic Perspectives 5(1), pp 193-206, Winter 1991.

A deferral period of at least four days is required and would reduce the risks of pressure selling and give consumers an opportunity to understand the add-ons offered by dealers. We note that the Australian Bankers' Association is implementing a minimum four-day deferral period for CCI sold with credit cards in bank branches and over the telephone,[9] so aligning both sales models on this detail could be appropriate. We note however that the longer the period, the more distinct and disruptive the processes will be and therefore the greater the potential benefit to consumer decision-making. We believe there is considerable merit in a introducing a 30 day deferral period. A 30 day period would enable a consumer to have made at least one payment towards any financing, allowing the consumer to better assess their financial situation and their ability to finance extra insurance.

The length of the deferral period should, however, not be the primary mechanism for separating the sale of the car and uptake of finance from the sale of add-on products. The deferred sales model would likely fail if it relied on the number of days in a transaction having this effect. For example, if a four-day deferral period meant that a car dealer could simply ask the customer to pick up the car on Thursday rather than Tuesday, and could sell add-on products before the car purchase and finance are finalised, the deferral period may have no benefit to the consumer and may not meet ASIC's objectives.

The central mechanism to ensure distinct sales processes and purchasing decisions is in our view, the commencement of the deferral period being upon delivery following purchase and financing.

We also do not believe there is any justification to differentiate between new and used cars.

Recommendations

A deferral period of at least four days is required. The longer the period however, the greater the impact of the expected benefits. We believe there is considerable merit in introducing a 30 day deferral period to allow a consumer to fully assess their financial situation before purchasing add-on insurance. Consideration of a deferral period though should be secondary to the needed to begin commencement of the deferral period following purchase, financing and delivery.

Consumer communication

It is important that people understand the add-on products that they are offered through car dealers. Consumers in the car yard have for too long been passively sold add-on products, rather than actively seeking them out and purchasing them. However, in our view, this is the most challenging and imperfect aspect of designing the deferred sales model.

Our casework has shown overwhelmingly that the vast majority of people do not understand the add-on products they have bought. One in four DemandARefund.com users did not even know they had bought the products.

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[9] ASIC, 17-255MR Banks to overhaul consumer credit insurance sales processes, 1 August 2017 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-255mr-banks-to-overhaul-consumer-credit-insurance-sales-processes/

Because of the low-value and high cost of add-on products, we believe that a significant number of people who buy add-on products would not have done so if they understood what they were buying.

While a certain segment of consumers will engage with the delayed sales process and seek to understand the add-on products on offer, many people will not or cannot undertake this exercise at the time. As CP 294 states, people must make multiple complex considerations when deciding whether to buy add-on products[10] The primary aim of ASIC's intervention should therefore be removing the consumer from the high-pressure environment which distorts decision-making.

Because there are complex personal considerations in assessing the suitability of add-on products, there is a question of whether it is appropriate for car dealers to sell add-on insurance under a no advice model. While this issue is beyond the scope of this consultation, it is part of the difficulty in effectively arming consumers to make choices about these products.

The communication approach should be consumer tested before it is rolled out. However the structure and form of this testing should not be used to delay the introduction of the deferred sales model. The consumer communication should then be routinely reviewed and refined over time.

Recommendation

As a principle, the consumer approach should be tested before it is rolled out. The structure and form of this testing, however, should not be used to delay the introduction of the deferred sales model. The consumer communication should then be routinely reviewed and refined over time.

Form of communication

We support ASIC's expectation that innovative techniques be used by insurers to give consumers information about add-on insurance. We understand that industry will need to develop these communication techniques in line with ASIC's expectations.

As CP 294 states, the current disclosure requirements for add-ons sales have not ensured that people understand what they are buying.[11] It is now widely accepted that traditional disclosure models, chiefly the Product Disclosure Statement (**PDS**), are similarly ineffective.[12] Even when a person is buying insurance as a primary purchase, they are highly

[10] CP paras 179-180.

[11] CP 294 paras 11-116.

[12] p193, Financial System Inquiry, Final Report, November 2014 http://fsi.gov.au/publications/final-report/

unlikely to read the PDS. Research commissioned by the Insurance Council found that 81 per cent of people did not read the PDS before buying their comprehensive car insurance.[13]

The FSI Final Report found that while “product disclosure plays an important part in establishing the contract between issuers and consumers … in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions.” The FSI recommended that innovate product disclosure and communication with consumers could improve the way risk and fees are communicated to consumers.[14]

The current Treasury proposal for Design and Distribution Obligations on issuers and distributors of financial products[15] signals a shift in the onus for suitable insurance sales towards insurers and their distributors, including car dealers. It is clear that a PDS will no longer be the primary requirement for insurers when it comes to suitable selling.

The communication requirements under the deferred sales model should therefore not simply require a car dealer to provide detailed information about add-on products to a customer who then takes that information away to consider for several days. Providing information in hard copy or soft copy form is simply too passive a way to effectively inform and will lead to a failure to meet the policy objectives. Insurers must start developing and implementing ways to help people evaluate whether insurance is suitable for them.

One effective way to achieve this in the car yard add-on channel could be a series of ‘filter’ or ‘knock out’ questions, before the purchase of the product. These would go to a person’s eligibility to claim—for example, for CCI there should be questions about a person’s age, employment status, dependents, residency status and any pre-existing conditions. These questions would also more broadly turn their mind to whether add-on products are covering a risk they want to cover.

Where a person answers the filter questions and *is not eligible* to claim under the product, they should not be sold the add-on product. This would be the case when, for example:

- they do not meet the age, residency or employment requirements under a CCI policy, or
- there is little or no GAP between their car loan amount and the sum insured under their comprehensive car insurance policy (for GAP insurance)
- they have a manufacturer’s warranty covering the same period for Mechanical Breakdown Insurance.

Where a person answers these questions and *may not be eligible* to claim under the policy, they should be clearly informed of this and told how they could get more advice or

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[13] Insurance Council of Australia, Consumer Research on General Insurance Product Disclosures: Research findings report, February 2017, p 18. http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf

[14] Recommendation 23, p 213, Financial System Inquiry, Final Report, November 2014, http://fsi.gov.au/publications/final-report/

[15] Treasury, Design and Distribution Obligations and Product Intervention Power: Proposals Paper, December 2016 https://treasury.gov.au/consultation/design-and-distribution-obligations-and-product-intervention-power/

information. For example, where a consumer has flagged a pre-existing medical condition, they may call the insurer to ask whether that type of condition will exclude them from making a claim under the policy.

Where a consumer flags that the policy *may not be of value*, for example, because they have indicated they have insurance in their superannuation which duplicates much of the add-on CCI offered through the car yard, consumers should also be told this clearly.

This model would operate effectively within the bounds of the no advice model (see further below on the appropriateness of add-on insurance being sold under a no advice model).

This filter question model could operate online, using text and/or audio-visual elements in multiple languages. It could also work using a combination of over the phone and/or in a car yard.

Online apps have the potential to effectively assist the significant segment of consumers who have access to technology and have basic skills in using it. We agree with ASIC that this could operate as another distribution channel.[16] It would be critical that the content and format of online customer communication is useful, and the deferral period is effective. If this is achieved, we agree with ASIC's assessment that an online app could improve competition in a market where competition is currently lacking.[17]

We note also that just because a consumer may be eligible to claim under the policy, it does not follow that the policy is suitable to their needs. It is important that this message is made clear to the consumer.

Recommendations

Innovative, interactive consumer communication techniques should be mandated and supervised to ensure greater consumer understanding and purchase of suitable add-on insurance products. To ensure this we support a standardised model that is

- active/interactive and not passive (that is simply providing a piece of paper); and
- includes a series of 'filter' or 'knock out' questions, before the purchase of the product.

Content of communication

Consumers need to understand each add-on insurance product, including the components of each product to make a genuinely informed decision about add-on insurance. To decide whether or not to buy add-on products they are offered, consumers need to understand:

- *the key features of the product* including premiums, exclusions, conditions and benefits and benefit periods,
- *the claims experiences* that other consumer have had with the product, and

[16] CP 294, para 221.

[17] As described in ASIC, Report 492.

- *whether the product is suitable* for them personally, considering add-on products are sold under a no advice model.

Key features

Insurance is a complex financial product. Where insurance is sold under a no advice model, it can be difficult for consumers to know what the maximum benefits are. In the add-on space, there is significant variation in product features across insurers.

Premiums: ASIC has reported on the high cost of add-on products in car yards compared with the same products bought directly from the insurer—pointing to a factor of up to ten times.[18] Consumer communication must make it clear that the add-on products they are offering may be included in other insurance the consumer already has or available at competitive prices elsewhere, including directly from the insurer/warranty company. Insurers must also ensure that the consumer understands the total cost of the add-on products, including interest and fees (and the total cost including interest if the premium is to be financed).

Benefits: Many add-on products are poor value because the maximum claims people can make are much lower than expected, and sometimes even less than the cost of the product. It is particularly important that consumers understand the maximum value of the product and when the maximum benefit may be paid. It is also important that they understand if and when the maximum benefit will not be paid—for example, the benefit period for the unemployment component of a CCI policy may be significantly less than that for the disability component.

Exclusions: CCI policies exclude cover for pre-existing medical conditions and some for mental health conditions. Warranties exclude a broad range of parts and problems from cover. Insurers and warranty providers must satisfy themselves that the people who buy their products know the exclusions which commonly cause claims to be denied and which are not ‘intuitive’ to their customers.

Conditions: Warranties can have onerous requirements in order to make a valid claim (for example, servicing the vehicle once every three months). Again, insurers must ensure their customers understand the key conditions which are not ‘intuitive’ to customers and which are commonly invoked when claims are denied.

Claims experiences

Information about claims outcomes is a significant tool for assessing whether or not a product has been suitable *and* good value for people who have made claims. It is also indicative of how well designed a product is and how well the insurer treats its customers. This data includes:

- claims acceptance rates,
- the number and nature of claims disputes, and
- claims ratios, which capture the cost, claims acceptance and benefits paid out.

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[18] ASIC, Report 471.

Accurate claims data enables consumers to compare insurers and products, and provides a useful picture of whether like-products are actually like-products. Claims ratios can identify a problem product and be a significant indicator of any changes to a problem product.

If the car dealer offers a discount on the car loan interest rate if the consumer takes out CCI and/or GAP, the dealer must make the total discount value and total premium value over the life of the loan (including interest and other costs) clear to the consumer.

Suitability

As discussed in the section above, a set of filter or knock out questions would address some of the key eligibility and suitability issues for consumers. This would not only better inform consumers but enable insurers to target sales and avoid mis-selling.

The questions would do this by flagging the key eligibility criteria of the policies and broader suitability issues, for example:

CCI

- *Age:*
  - o younger people are unlikely to have debts or dependents which would mean this type of cover is of value. We note that QBE is refunding all the life component of CCI sold to people under the age of 25,[19]
  - o older people, usually 65 or over, are often ineligible under a policy.
- *Employment status:* Coverage of people who are on fixed term contracts, self-employed or work part-time or casual varies significantly between policies.
- *Residency status:* Some policies require a consumer to be a permanent resident for a specific period, for example two years, to be eligible for coverage.
- *Dependents:* People without dependents may not need or want death cover.
- *Duplication:* People may already have life/TPD/trauma/IP in their superannuation (the only 'unique' CCI cover we know of is unemployment cover for involuntary redundancy)
- *Pre-existing medical conditions.*

GAP insurance

- *Sum insured:* the comprehensive car insurance sum insured is adequate to cover the amount under the loan.

Warranties

- *Mileage:* the car has done more than the maximum number of kilometres allowed for coverage.
- *Existing warranty:* The car is new and covered by a manufacturer's warranty for the next three to seven years.

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[19] ASIC, 17-258MR *QBE refunds $15.9 million in add-on insurance premiums* http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-258mr-qbe-refunds-159-million-in-add-on-insurance-premiums/

Recommendations

Any consumer communication developed must include information relating to:

- the key features of the product including premiums, exclusions, conditions and benefits (including maximum benefits).
- claims data including claims ratios;
- whether the product is suitable to the consumer's needs.

Consumer communication should make it clear that the add-on products they are offering may be included in other insurance the consumer already has or available at competitive prices elsewhere, including directly from the insurer/warranty company.

Insurers must ensure that the consumer understands the total cost of the add-on products, including interest and fees.

Mechanical breakdown insurance and warranties

We share ASIC's view that mechanical breakdown insurance and warranties sold with new cars should not fall under the same deferred sales model. Although a separate sales model for this sales scenario would be more onerous,[20] the extent of consumer harm in this area, including payment of premiums and interest for a useless product, requires a strong response.

We agree with the consumer communication inclusions outlined in CP 294, including the variable maximum benefit payable over time and exclusion for faults during the manufacturer's warranty period.[21] However, these highlight the complexities for consumers who are offered these products at the time of the sale of a car still covered under the manufacturer's warranty.

We agree that cooling off is not a sufficient mechanism to deal with this issue.[22] Dealing with product design problems and not selling these products with new cars would be an effective way to address this problem.

We support a model in which dealers can sell these products more than one month before the expiry of the manufacturer's warranty.

Case study two

Luke bought a car from a dealer which still had a manufacturer's warranty. The dealer also sold him an extended warranty for almost $1,500, which expired before the manufacturer's warranty ended, so the extended warranty was of no use at all.*

Source: Consumer Action Law Centre

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[20] As noted in CP 294, para 239.

[21] CP 294 para 242.

[22] CP 294 para 243.

We are also concerned about warranty providers selling dealer warranties (as identified at pages 21 and 22 of CP 294) in an attempt to avoid the licensing and conduct obligations under the *Corporations* Act, the deferred sales process and external dispute resolution. Our position is that these products cause the same harm as warranty insurance and third party warranties.

We would support any steps to clarify whether or not these products fall within the *Corporations Act* exemptions. We consider that there are some 'dealer warranties' on the market that should not fall within the exemptions. We also consider that it is vital that this space is monitored closely to ensure avoidance does not ensue.

Recommendations

The sale and distribution of mechanical breakdown insurance and warranties should be regulated under a model that prohibits the sale of these products more than one month before the expiry of the manufacturer's warranty.

ASIC should seek clarity in relation to whether or not dealer warranties fall within the *Corporations Act* exemptions.

ASIC should monitor and supervise the dealer warranty space with a view to identify any potential existing or future avoidance.

Proposal 2: Enhanced supervision obligations for product providers

There is overwhelming evidence that insurers' current supervision of the car dealer channel for add-on insurance sales is 'manifestly inadequate'.[23] While insurers have acknowledged that commissions they pay to car dealers lead to unfair and misleading sales, we agree that addressing commissions will not necessarily see benefits flow to consumers.[24]

Case study three

Rose sought a refund for mis-sold add-on insurance. The insurer asked her to provide documents so they could assess whether or not their authorised representative complied with the law. It seems that the insurer had no system in place to ensure compliance*

Source: Consumer Action Law Centre

The problems with add-on insurance and warranties often materialise when people make a claim. While insurers profit from add-on insurance mis-selling, they also bear the burden of it

[23] CP 294 para 247.

[24] CP 294 paras 250, 253.

through claims disputes and regulatory intervention. Improved supervision appears to be in the interests of both consumers and industry.

We support ASIC's proposal of the use of risk indicators to allow early intervention where a particular dealership is selling add on products in a way that is non-compliant or unfair.[25]

Other measures which would improve supervision and compliance include:

- Analysis of the data collected through filter and knock our questions (discussed above) to check whether dealers are selling policies to people for whom they are unsuitable.
- Benchmarking and analysis of claims experience data (discussed above), including denied claims, which may indicate a higher level of unsuitable sales in some dealerships. We would expect this data to improve over time.
- Benchmarking and analysis of penetration rates. We would also expect penetration rates to improve over time.
- Oversight and analysis of sales representative data including:
    - size of commissions and amounts earned – analysis to identify where particular representatives earn high amounts of commissions;
    - sales volumes – where a representative sells a high volume of add-on insurance;
    - disciplinary history of sales representatives – where a representative has a history of misconduct; and
    - experience of sales representatives and training – to identify potential problems where a representative is inexperienced in sales.
- Adequate education to representatives about their responsibilities when engaging in the sale of add-on insurance. This may include requiring providers to undertake strict accreditation checks before and after they appoint authorised representatives.
- ASIC should conduct post-sale interviews with consumers to test the effectiveness of supervision/disclosure.

Recommendations

Enhanced supervision obligations with specific requirements must be introduced as a part of the deferred sales model.

We support ASIC's proposal of the use of risk indicators to allow early intervention where a particular dealership is selling add on products in a way that is non-compliant or unfair. Other measures should include:

- Analysis of the data collected through filter and knock our questions
- Benchmarking and analysis of claims experience data, and
- Benchmarking and analysis of penetration rates.
- Oversight and analysis of sales representative data including:
    - size of commissions and amounts earned – analysis to identify where particular representatives earn high amounts of commissions;
    - sales volumes – where a representative sells a high volume of add-on

[25] CP para 256.

insurance;
  - disciplinary history of sales representatives – where a representative has a history of misconduct; and
  - experience of sales representatives and training – to identify potential problems where a representative is inexperienced in sales.

- Adequate education to representatives about their responsibilities when engaging in the sale of add-on insurance. This may include requiring providers to undertake strict accreditation checks before and after they appoint authorised representatives.

- ASIC should conduct post-sale interviews with consumers to test the effectiveness of supervision/disclosure.

Other effective measures

While we understand that ASIC's consultation is confined in scope to the deferred sales model and supervision improvements, there are other measure which would be genuine improvements for consumers.

Remediation schemes

Several insurers have agreed to remediate customers to whom they mis-sold add-on insurance.[26] We understand that more announcements are coming. This is a good first step towards compensating people who were clearly ripped off by add-on products.

We need a future-proof solution to stop the business model which has dented customer trust in insurers and car dealers. While a delayed sales model is a significant step towards this, insurers should establish systems which will not only prevent and detect mis-selling, but provide quick and complete remediation to victims of mis-selling. Remediation schemes should be designed at the same time as monitoring and compliance systems.

Claim ratio targets

Claims or loss ratios are one of the most effective measures of product value. ASIC has identified the extraordinarily low claims ratios in the car yard add-on market of 9% overall, with loan termination insurance as low as 4.4%.[27]

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[26] Virginia Surety: ASIC 17-189MR Virginia Surety to refund over $330,000 to add-on insurance customers, 20 June 2017 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-189mr-virginia-surety-to-refund-over-330-000-to-add-on-insurance-customers/, QBE: ASIC, 17-258MR QBE refunds $15.9 million in add-on insurance premiums, 2 August 2017 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-258mr-qbe-refunds-159-million-in-add-on-insurance-premiums/ Commonwealth Bank: ASIC, 17-268MR Commonwealth Bank to refund over $10 million for mis-sold consumer credit insurance, 14 August, 2017 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-268mr-commonwealth-bank-to-refund-over-10-million-for-mis-sold-consumer-credit-insurance/

[27] Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492) http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-492-a-market-that-is-failing-consumers-the-sale-of-add-on-insurance-through-car-dealers/.

We note that CP 294 points to the US insurers setting their own target of a 60% claims ratio, and this subsequently being legislated in three states. Target claims ratios are critical if the industry is genuine about measuring the results of any market reforms.