Junk Merchants

How Australians are being sold rubbish insurance, and what we can do about it

A report prepared by the Consumer Action Law Centre

December 2015

consumer action law centre

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The Consumer Action Law Centre is an independent, not-for-profit consumer casework and policy organisation based in Melbourne, Australia.

www.consumeraction.org.au

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Executive Summary

What is add-on insurance?

'Add-on insurance' is insurance which is added on at the point of sale when a consumer is buying another product like a credit contract or a car.

In particular, this report looks at two products commonly sold as an add-on:

- <u>Consumer Credit Insurance:</u> a product designed to protect a consumer's ability to meet their credit repayments in the event of death and/or involuntary unemployment and/or permanent disablement; and
- <u>Gap insurance:</u> if a motor vehicle is written off, Gap insurance is designed to cover the amount left to pay on the consumer's car loan once a comprehensive car insurance policy has paid out.

Selling CCI and Gap as an add-on leads to mis-selling and poor value products

Our casework, together with the work done by regulators in Australia and the UK, show that the add-on sales technique leads to consumers buying insurance that they don't understand and is unsuitable for their needs. The add-on sales process, together with commission-based remuneration for sales staff, also encourages mis-selling. Our solicitors have provided advice in many cases where consumers have been sold insurance without their knowledge or consent and where insurance sold is clearly inappropriate for the consumer.

These products are also very poor value. Statistics published by the Financial Ombudsman Service (**FOS**) and the Australian Prudential Regulation Authority (**APRA**) show that CCI is consistently poor value for consumers, because:

- CCI policies consistently receive fewer claims than other classes of insurance;
- CCI insurers decline more claims than anyone else; and
- CCI insurers pay out less in claims other insurers.

Neither FOS nor APRA publish statistics that allow us to compare the value of Gap insurance to other products, but our casework and research undertaken by the UK Financial Conduct Authority suggests that Gap is at least as bad value as CCI.

Next steps

- Encouraging insurers to stop allowing their products to be sold as add-ons
  Problems with add-on insurance, and particularly CCI, have been raised by consumer advocates for decades. Reports by ASIC from 2011 and 2013 demonstrated serious problems with CCI sales practices by Australian banks, and high profile Australian insurers collectively paid $2.4 million in refunds for CCI mis-sold through payday lender The Cash Store.

  More recently, Westpac has been required to repay consumers who have been mis-sold CCI associated with its home lending,[1] and Esanda has agreed to compensate consumers for sales conduct of a broker which included selling add-on products without the knowledge or consent of the consumer.[2] In the UK, an estimated £22 billion in compensation has been refunded to consumers after widespread mis-selling of add-on financial products.

  That's why we think that Australian insurers should be on notice that allowing their product to be sold as an add-on leads to mis-selling and poor value for consumers. We want insurers to stop allowing their products to be sold as an add-on.

- Encouraging consumers to seek refunds
  If insurers do not want to stop using the add-on sales model voluntarily, the UK experience suggests that the best way to respond to this is to ensure consumers can complain about mis-selling and seek compensation. This report estimates that Australian insurers and warranty providers might be due to pay over $70 million in refunds to consumers for add-on financial products mis-sold each year. We plan

[1] ASIC Media Release 15-318MR, 29 October 2015, Westpac to refund premiums for unwanted insurance cover. http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-318mr-westpac-to-refund-premiums-for-unwanted-insurance-cover/
[2] ASIC Media Release 15-312MR (27 October 2015) Esanda compensates consumers for conduct by finance broker. http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-312mr-esanda-compensates-consumers-for-conduct-by-finance-broker/

to make more consumers aware of the problems with add-on products and help them seek refunds for insurance they didn't want, didn't need or couldn't use.

- Law reform to prevent on the spot sales of add-on financial products
  Salespeople could be free to promote 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.

Introduction

In 2014, Consumer Action Law Centre received funding via the Office of the Fire Services Levy Monitor (OFSLM) which was to be used in a way that benefited Victorian insurance consumers. This report is part of a project investigating 'add-on' insurance, that is, insurance that is added on at point of sale when a consumer buys something else, like a credit contract or a motor vehicle. We decided to dedicate part of the OFSLM funding to add-on insurance products because this is the most prevalent insurance-related issue handled by our legal practice.

Add-on products we have seen in our casework include:

- Consumer Credit Insurance (CCI): a product designed to protect a consumer's ability to meet their credit repayments in the event of death and/or involuntary unemployment and/or permanent disablement. The benefits are generally paid directly to the finance provider.
- Gap Insurance: if a motor vehicle is written off, Gap insurance is designed to cover any amount left to pay on the consumer's car loan once a comprehensive car insurance policy has paid out.
- Tyre and Rim Insurance: which covers damage to a motor vehicle's tyres and rims (which are often not covered by comprehensive car insurance); and
- Motor Vehicle Discretionary Risk Products: products usually sold as motor vehicle 'warranties' that allow the warranty provider a complete discretion over whether they pay out claims (whether the claim meets the conditions of the warranty or not).

This report focuses on CCI and Gap sold as add-ons. We understand that Tyre and Rim cover is also sold as an add-on, but we have limited casework experience with this product. We have discussed Motor Vehicle Discretionary Risk Products in a different report, *Donating Your Money to a Warranty Company: Why the motor vehicle warranty you bought might be worthless*.[3]

[3] This report is available here: http://consumeraction.org.au/wp-content/uploads/2015/08/DonatingYourMoneyToAWarrantyCompany.pdf

What is wrong with add-on insurance?

Our casework, and the work done by regulators here and in the UK shows that the add-on sales technique—in combination with commissions paid to intermediaries to sell insurance—lead to consumers buying insurance that they don't understand, is unsuitable for their needs, and is poor value.

Problems with add-on insurance, and particularly CCI, have been raised by consumer advocates for decades,[4] and ASIC considered problems in two reports exposing poor CCI sales practices in 2011[5] and 2013.[6] Meanwhile, statistics have consistently shown that CCI is extremely poor value for consumers. None of this has so far prompted insurers to substantially change the way they sell CCI and similar products like Gap.

Until recently, a similar situation also existed in the UK.[7] But by 2011, a large number of complaints were being made to the UK's Financial Ombudsman Service about mis-selling of PPI (payment protection insurance, the British equivalent of CCI), and by January 2015, it was estimated that around 1.25 million ombudsman complaints had been made, with banks alone paying around £22 billion in compensation. At that date, the Ombudsman was still receiving 4.000 complaints per week and considered that it may still be years before the PPI mis-selling episode is over.[8]

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[4] The Australian Financial Counselling and Credit Reform Association (now known as Financial Counselling Australia) released reports as early as 1987 regarding CCI. C Clothier and G Renouf's report *Need or greed: a report on consumer credit insurance*. This was followed in 1991 by G Renouf (1991) *Thirty-one cents in the dollar: a report on consumer credit insurance from the consumer's perspective*.

[5] ASIC (October 2011) *Report 256: Consumer Credit Insurance: A review of sales practices by authorised deposit-taking institutions*

[66] Susan Bell Research for ASIC (July 2013) *Report 361: Consumer credit insurance policies: Consumers' claims experiences*.

[7] Emily Saint-Smith at Risk Info Magazine, a financial services industry publication, reports that PPI first emerged in the UK in the 1990s and a 'scandal was brewing' from the early 2000s. 'UK insurance scandal: Could it happen here?' Risk Info Magazine edition 16, http://magazine.riskinfo.com.au/16/uk-insurance-scandal-could-it-happen-here/#.VVSSSZO2pGY.

[8] 'Years before PPI scandal is over, says Financial Ombudsman', BBC News, 6 January 2015. Accessed 15 May 2015 from http://www.bbc.com/news/business-30695720

In parallel, the UK's financial services regulator, the Financial Conduct Authority (FCA) conducted a market study on the sale of add-on insurance in general, finding that:

> ...the add-on mechanism has a clear impact on consumer behaviour and affects the way they make decisions. Add-on buyers are less likely to shop around, less effective when they do shop around, and less sensitive to price. In the consumer survey, 58% of add-on buyers said they did not consider any other policy when purchasing their insurance compared to only 22% per cent of stand-alone buyers. One in four consumers who bought insurance as an add-on were not aware they could buy the product separately elsewhere. Consumers who bought insurance as an add-on were much less likely to be able to correctly recall how much they paid for their insurance – in fact, 69% of add-on buyers could not give an accurate estimate of the price they paid.
>
> Our research also shows that when buying add-ons, consumers are often not engaging with the purchase and are buying products without clear intent, and as a result they are more likely to end up with products they do not need or use. In our survey, 38% of add-on buyers said they had not thought about buying insurance before the day of their purchase, compared with just 15% of stand-alone buyers. This rose to 59% for those buying GAP as an add-on. When surveyed approximately three to four months after the purchase, 19% of add-on buyers – almost 1 in every 5 – were not aware that they owned the product (compared to 9% for stand-alone buyers).[9]

The FCA concluded that

> ...in many cases competition is not currently delivering value for money add-on products. We
> estimate that consumers overpay for the add-on products in our study by around £108m to £200m per annum.[10]

The FCA has recently made rules to prevent financial service providers from using 'opt out' selling (such as pre-ticked boxes)[11] and to introduce a mandatory period of delay when selling Gap insurance.[12]

Selling Payment Protection Insurance (PPI) at the same time as selling credit had already been banned in the UK since April 2012. This ban prevents PPI from being sold from the start of a sale of credit for a period of seven days,

[9] Financial Conduct Authority (March 2014), Market Study 14/1, *General insurance add-ons: Provisional findings of market study and proposed* remedies, Page 7.
[10] FCA (March 2014), page 8.
[11] FCA (September 2015) *PS15/22: General Insurance Add-Ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision-making for add-on buyers*
[12] FCA (June 2015) *PS15/13: Guaranteed Asset Protection Insurance: competition remedy*.

though a consumer may choose to make contact from the day after the credit sale and complete the transaction.[13]

Add-on products are poor value

Data from the Financial Ombudsman Service (FOS) and the Australian Prudential Regulation Authority (APRA) shows that CCI is consistently the worst value insurance consumers can buy - at least the worst value insurance for which data is available. We do not have access to similar data on Gap insurance,[14] but we have good reasons to consider that Gap insurance is also very poor value, which we discuss below.

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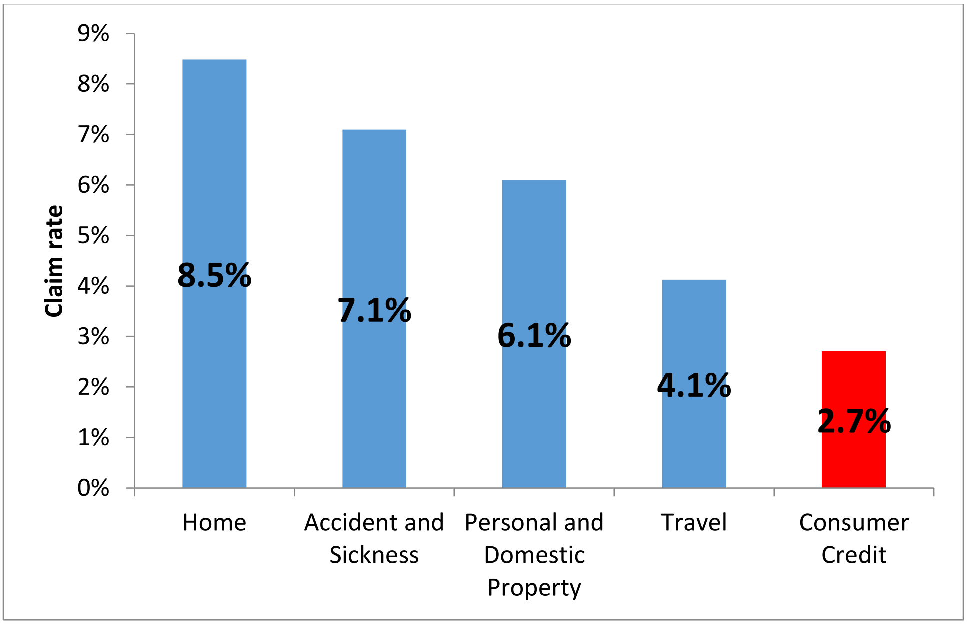
[13] Competition and Markets Authority, 24 March 2011, PPI Markets Investigation Order 2011, *Explanatory Note to accompany the Payment Protection Insurance Market Investigation Order 2011* para 102-117. Accessed from https://www.gov.uk/government/publications/ppi-market-investigation-order-2011. See also Which? (6 April 2012) *PPI law changes aid consumers from today,* http://www.which.co.uk/news/2012/04/ppi-law-changes-aid-consumers-from-today-282944/

[14] Neither FOS nor APRA report data for Gap Insurance as an individual class of insurance. FOS advises that they bundle Gap insurance in the 'Personal and Domestic Property' category along with many other types of cover including caravans, pleasure craft, trailers, pet insurance and portables/valuables such as laptops, tablets and mobile telephones. It is not clear to us where APRA reports statistics on Gap insurance.

CCI policies consistently receive fewer claims than other classes of insurance

Over the last five years, CCI has received fewer claims per policy than any other type of personal direct insurance product noted in FOS reports.[15] This is unsurprising given so many people do not understand what these products cover, and as many as one in five people who are sold financial products as an add-on do not know they have bought them at all.[16]

Chart 1: Claim rate, personal direct insurance, average for last five years



Source: Financial Ombudsman Service[17]

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[15] The only exception is that Accident and Sickness cover had a slightly lower claim rate in 2013-14 than CCI (1.91% compared to 2.52%). This is the only time in the last five years that CCI has had less claims than another class of insurance.

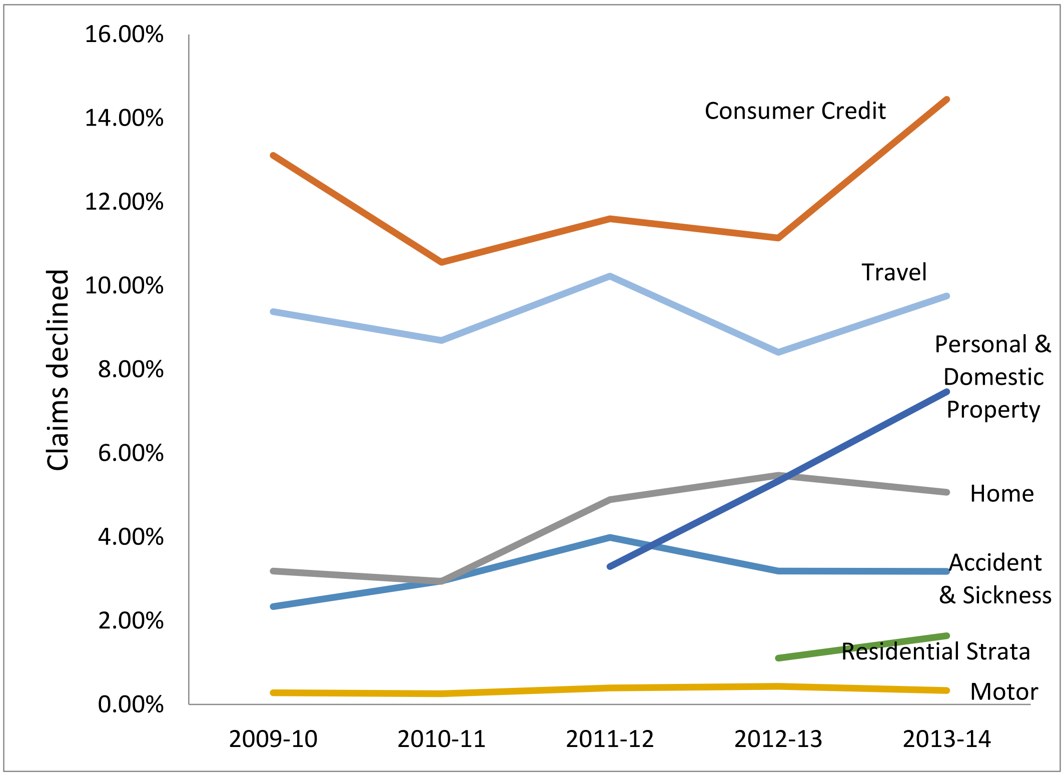
[16] In research conducted by the UK's Financial Conduct Authority, 19 per cent of respondents who bought an add-on product were unaware they had bought it. *General Insurance Add-Ons Market Study - Proposed Remedies: Banning opt-out selling across financial services and supporting informed decision-making for add-on buyers*, Consultation Paper CP15/13, 25 March 2015, para 1.11. Our casework also contains many examples of consumers who are unaware that add-ons have been sold to them, and this problem was also reported by ASIC: Report 256, paragraph 8.

[17] FOS, GI Code of Practice Aggregated Industry Data Report Overview of the year 2013-14, 31 March 2015, Tables B, E, F, G, H, I; FOS, General Insurance Code of Practice: Overview of the Year 2011-2012, May 2013, Appendix I; FOS, General Insurance Code of Practice: Overview of the Year 2010-2011, 29 February 2012, Appendix B; FOS, General Insurance Code of Practice: Overview of the Year 2009/2010, Appendix D.

CCI insurers decline more claims than anyone else

Every year since 2009-10, CCI insurers declined more claims than any other consumer insurance product according to FOS statistics.[18] During this period, CCI claims were rejected three times more than home insurance claims, four times more than Accident and Sickness claims and 36 times more often than motor vehicle insurance claims. Not only are these figures bad, they are getting worse: CCI insurers declined more claims in 2013-14 than any time in the last five years.

Chart 2: Claim decline rate, last five years



Source: Financial Ombudsman Service.[19]

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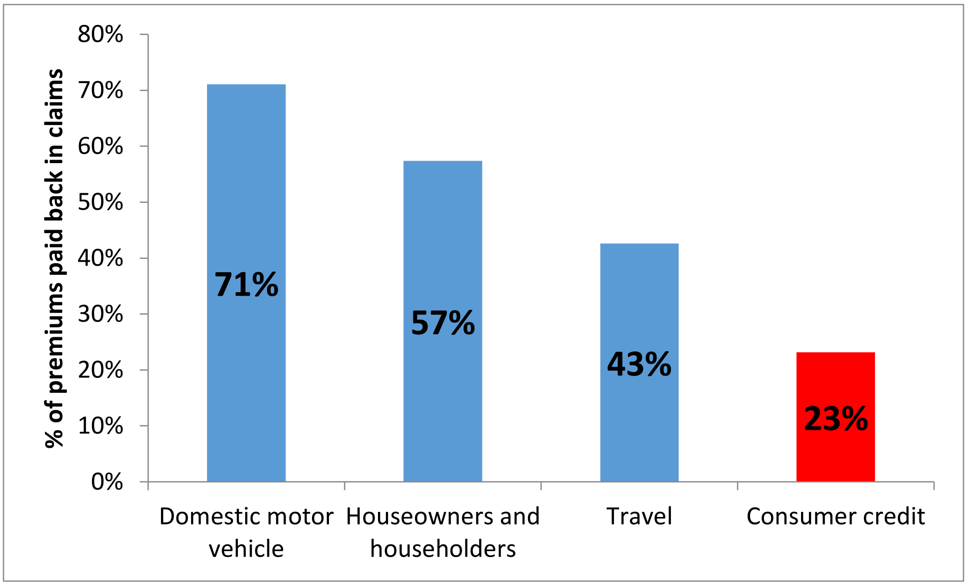
[18] By 'decline rate' we mean the number of declined claims in a financial year divided by the number of claims made in that same year. It is not possible to state exact decline rates from FOS data as a claim may be made in one year and then decided in another. However, we think that these figures still show a clear pattern of CCI being declined more often than all other classes.
[19] FOS, GI Code of Practice Overviews 2009-2014. See note 17.

CCI insurers keep more of your premiums than other insurers

APRA data from the last 4 years shows that, on average, CCI pays about 23 per cent of the money it earns in premiums back to consumers in claims. This much less than other comparable products. Payouts by CCI are less than half of what home insurers pay and less than one third of those paid by car insurance policies.

Chart 3: CCI: Percentage of premiums paid out in claims



Source: APRA[20]

[20] APRA, Quarterly General Insurance Performance Statistics, December 2014 (reissued 17 March 2015). 'Home' refers to APRA's 'Homeowners / Householders' category. 'Motor vehicle' is APRA's 'domestic motor vehicle' category. Percentage 'paid out in claims' refers to the average gross loss ratio for that class of insurance for the 18 quarters between September 2010 and December 2014. Gross loss ratio is defined by APRA as the Gross incurred claims (current and prior years) (net of non-reinsurance recoveries revenue) divided by Gross earned premium.

APRA and FOS do not report data regarding Gap insurance, so we cannot say conclusively that it is also poor value. However, we expect that Gap insurance is likely to be bad value for consumers because it is sold with the same products and in the same way that CCI is often sold - that is, as an add-on with credit contracts and motor vehicles.

In addition, the FCA's research on the UK add-on insurance market singled out Gap insurance as a poor performer requiring focused intervention.

> *GAP insurance stands out relative to the other products in our sample.* ***The impact of the add-on mechanism on consumer behaviour and decision-making appears to be particularly severe in respect of GAP.*** *Of the products in our sample, GAP add-on customers were the least likely to shop around (19% said they did). GAP add-on buyers had worse understanding of the product than those who had bought GAP on a stand-alone basis. GAP was generally not a planned purchase and almost two-thirds of add-on GAP buyers (59%) reported not having thought about buying the insurance until the day they bought it. Almost half of customers reported being unaware that they could have bought the GAP insurance elsewhere. This suggests that the point of sale advantage enjoyed by the person selling the car or car finance is particularly strong.*
>
> *...*
>
> ***This is reinforced by the extent of poor value products and consumer overpayment in GAP insurance.*** *Our evidence shows that GAP sold as an add-on is poor value for consumers with around 10% of retail prices paid being paid out in claims – a very low claims ratio. GAP add-on sales made up a significant proportion of our estimate of the yearly overpayment by consumers – £76m out of at least £108m under our most conservative estimate.*
>
> ***The extent of the market distortion strengthens the case for action focused on this product at this stage, rather than relying on our more general remedies proposed.*** *[FCA's emphasis]*[21]

The FCA's work also showed that Gap insurance was much more likely to be sold through an add-on process than other types of insurance—99 per cent of all Gap insurance sales were made in through an add-on process.[22] Fifty-nine per cent of add-on buyers in the FCA study who bought Gap insurance

[21] FCA (March 2014), page 56.
[22] FCA (March 2014), page 22.

said that they had not considered buying insurance before the day of their purchase (compared to 38 per cent of people buying add-on products generally),[23] and it was 'particularly common' for Gap buyers to report that they were not aware they could not buy the product outside of the car purchase.[24]

We do not have similar data for the Australian market, but we expect that (as in the UK) Gap is very rarely sold outside of an add-on process. Our scan of the market suggests that most companies advertising Gap insurance are primarily credit providers rather than insurers[25], suggesting that Gap will more often than not be sold bundled with a credit contract. We believe this reluctance to sell Gap insurance directly suggests that insurers know consumers are unlikely to buy this product when they have time to calmly consider what value it offers them.

Mis-selling

The most consistent problem reported to us about add-on insurance is that salespeople misrepresent or fail to explain the nature of the product, or important terms and exclusions.

This is not only a problem noticed by Consumer Action. ASIC's 2011 report on the sale of CCI by authorised deposit-taking institutions (that is, banks and credit unions) noted that:

> *Problems with the process of selling CCI have been identified by regulators and consumer representative groups over a number of years. More recent complaints made to and investigated by ASIC indicated that there were persistent issues with the sale and distribution of some CCI products in relation to the distributors investigated. These issues included:*
>
> - *consumers being sold CCI products without their knowledge or consent;*
> - *pressure tactics and harassment being used to induce consumers to purchase CCI products;*
> - *misleading representations being made during the sale of CCI products; and*
> - *serious deficiencies in the scripts used for the sale of CCI products.*[26]

[23] FCA (March 2014), page 7.
[24] FCA (March 2014), page 25.
[25] Notable exceptions being Swann Insurance and Avea.
[26] ASIC (October 2011) *Report 256: Consumer Credit Insurance: A review of sales practices by authorised deposit-taking institutions*, paragraph 8.

ASIC's recommendations in this report included that bank staff should:

- *make a clear statement that they intend to try to sell CCI, rather than just beginning the sales pitch;*
- *be clear that the purchase of CCI is optional;*
- *use words like 'purchase' and 'buy' to describe the purchase of CCI, rather than potentially misleading words such as 'activate', 'enrol' and 'process';*
- *include a clear question asking the consumer if they consent to purchase CCI;*
- *obtain evidence that a consumer has consented to purchase CCI, such as through a signature or a voice recording (for phone sales); and*
- *end an attempted telephone sale if the consumer indicates once (or at most, twice) that they don't want to buy CCI.*[27]

It is telling that banks selling CCI need to be told by a regulator to do things as self-evident as saying that CCI is optional, asking consumers if they consent to buy it before finalising a sale, and to not continue a sales process where a customer has indicated they are not interested. We think this indicates a culture in CCI sales (at least at the time of ASIC's investigation) that staff are trained to sell the product whether a customer wants it or not. The practice of using evasive language like 'activate' and 'process' rather than 'buy', and a failure to obtain evidence that a consumer consents to buy CCI also helps explain why so many consumers end up 'buying' this product without realising it.

[27] ASIC report 256, recommendation 1.

I bought what?

We have spoken to many people who did not realise they had bought insurance at all until they sought legal advice.

Case study 1

Mick and Caroline (not their real names) applied for car finance in 2015 through a smaller finance provider. After initially spending over 10 hours with the finance provider, Mick and Caroline met a representative of the financier in a restaurant on a later day to sign the paperwork. It was late in the evening and Mick and Caroline had their toddler with them in the restaurant and other children at home who were unwell. There were a large number of papers to look through and Caroline said she felt under pressure to sign. The salesperson pointed out one add-on product and said that this meant someone would come and get them if they broke down. Only many weeks later, when Caroline was speaking to Consumer Action did she realise she had signed up for three add-on products (CCI, Gap and a discretionary risk product) that she did not know about.

Mick and Caroline have been released from the credit contract.

Case study 2

A solicitor from a community legal centre sought advice from Consumer Action in mid 2014 about his client who had bought a car with finance arranged by the car dealer and a finance broker. The solicitor said that his client was now paying off three add-on products (CCI, Gap, and a Discretionary Risk Product) that he did not know he had bought. The discretionary risk product alone had cost over $2,500. The client also paid originating fees, an establishment fee and a cash payment charge that he was not aware of. The client could not afford to keep up payments on the finance.

Case study 3

Patrick bought a used car in 2014 for about $16,000 while he was employed as an apprentice. He later lost his job and called Consumer Action for advice when the lender threatened to repossess the car.

Patrick's documents showed that a Gap policy (for around $1,300) and a Discretionary Risk Product (for around $1,600) were also financed under the contract at 19% interest per annum. Patrick says that neither these add-ons, nor around $1,000 in fees, were mentioned when he entered the contract. Once the add-on products, fees and interest were included, Patrick was required to pay over $30,000 for the car.

Case study 4

Lionel bought a used motor vehicle in 2012 with finance arranged by a broker. Lionel had informed the broker that his English skills were limited, and he would not be able to fully understand the contract. Basic information concerning interest and repayments was given but Lionel was not notified of the total amount payable, or that he had bought a Gap insurance policy for around $1,000 and a Discretionary Risk Product for $1,700.

With assistance from Consumer Action, Lionel argued that the broker had engaged in unconscionable conduct and misleading or deceptive conduct. Lionel reached a settlement with the finance broker.

Case study 5

Andrea took out a credit card with a major bank in 2002. After several years, Andrea noticed that the bank had been charging her between $30 and $50 per month for insurance. Andrea called the bank to query these deductions, and the bank representative she spoke to said that the insurance was to cover her if she loses money in the future due to fraud.

Andrea accepted this explanation until a friend told her in 2014 that the bank should protect her against fraud on her account and this was not covered by the insurance. When Andrea called the bank again the bank representative told her that the insurance was there to cover payments if she lost her job. The bank told her that the deductions had occurred since 2004, and that about $3,500 had been deducted over that time.

Andrea says that she never consented to the insurance, never received any notification explaining the full terms of the insurance and she was misinformed by bank staff when she first called to inquire. When Andrea later complained to the bank they offered to deduct $1,000 off her credit card balance and ended the insurance on her request.

Buy it or else

We also see cases where clients advise that they queried the insurance in their contract but the customer is left with the impression that they have to buy the add-on to get the finance. A salesperson who tells a customer that they must buy CCI, Gap Insurance or a motor vehicle warranty would be in breach of section 143 of the National Credit Code, and would also be engaging in misleading or deceptive conduct. This issue was recognised in a 2013 report by Susan Bell Research (commissioned by ASIC), which found that a few participants in the research:

> *...have no recollection [of being offered CCI] believing that the policy was provided automatically. A few believed that it was mandatory to take it out.*[28]

[28] ASIC report 361, pages 14-15.

This was a feature of Mick and Caroline's case above, and also of other clients assisted by Consumer Action.

Case study 6

Jessica signed up for car finance to buy a car in 2014. The finance, provided through a broker, covered the car for approximately $18,000, over $1,000 of fees, over $2,000 of Consumer Credit Insurance (CCI) and a discretionary risk product which also cost around $2,000.

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

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

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

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 $2,000 for selling Jessica add-on products which she did not ask for, and which they only bought because she felt the add-ons were compulsory.

We think insurers should be extremely concerned that their intermediaries are signing customers up for add-on insurance without the customer's consent, or by misrepresenting that the insurance is compulsory. The fact that we still see cases of such serious misconduct in contracts entered after ASIC pointed out this problem in reports in 2011,[29] and 2013[30] suggests that insurers are not taking this problem seriously enough.

[29] ASIC report 256, paragraph 8.
[30] ASIC report 361, pages 14-15.

It's useless

Another common category of insurance mis-selling is where a salesperson sells add-on insurance to a consumer despite being aware that the insurance will be useless for them. CCI will be useless or of limited use to consumers who:

- are of advanced age: most CCI policies stop providing cover at either age 65 or 70;
- have a pre-existing medical condition, and expect to have that condition recur in the future: CCI will not cover someone who has lost income due to a condition they had before entering the insurance contract;
- are in contract or casual work, or are unemployed: the involuntary unemployment element of CCI does not usually cover those groups; or
- have adequate life and income protection insurance already, such as in their superannuation: CCI often contains involuntary unemployment, life and income protection elements, which might be duplicating cover already in place.

Gap insurance will be useless to consumers who:

- are not buying a motor vehicle on finance (see Case Study 8 below); or
- where the car loan is small, with a large deposit, because it is less likely there will be a 'Gap' between a motor vehicle insurance payout and the amount financed in the case of total loss; or
- where comprehensive motor vehicle insurance will cover the whole financed amount.

Sales of useless CCI were examined by the Federal Court in 2014 in its *ASIC v The Cash Store* decision.[31] In this case, The Cash Store was found to have engaged in unconscionable conduct and fined $1.1 million for selling CCI while on notice that it would be useless for its customers when (for example) the salesperson knew the customer was unemployed. Consumer Action raised this problem with ASIC as early as April 2012 and we also encouraged ASIC to seek refunds from the insurers involved following the Federal Court decision.

[31] *ASIC v The Cash Store Pty Ltd (in liquidation)* FCA 926, 26 August 2014 before Justice Davies.

ASIC v The Cash Store

The Cash Store (TCS) added CCI to over 180,000 payday loans entered between 14 August 2010 and March 16 2011. This represented 68% of the credit contracts entered into during that period. TCS retained $1,301,332 in commission for the sales of the CCI. The policies sold gave rise to only 110 claims, 43 resulting in settlement of a combined total of $25,118.

TCS encouraged its employees to overcome customers' objections in their efforts to sell the CCI and had a policy of simply advising the customer that a "payment protection plan" had been arranged for their benefit, rather than explaining what the policy actually covered.

ASIC took enforcement action against the Cash Store and the matter was heard by Justice Davies of the Federal Court. Justice Davies found that the coverage provided by the CCI (which included cover for death, disablement, catastrophic illness and involuntary unemployment) was 'almost invariably inappropriate to offer to payday lending customers because it was very unlikely to be of any use to them'. Justice Davies found in particular that the insurance was 'certainly useless for those [borrowers] who were unemployed, a fact that must have been known to [The Cash Store].

For the above reasons, as well as in consideration of the high cost and low claims rates of the policies, the court found that TCS engaged in unconscionable conduct and ordered it to pay a $1.1 million penalty (the maximum penalty available) for that breach.

In March 2015, Allianz agreed to refund $400,016 in premiums to consumers who bought its CCI through the Cash Store. CGU Insurance Limited, together with Accident and Health International Underwriting Pty Ltd agreed to refund an additional $2,000,000 in CCI premiums and fees in July 2015.

There are a number of examples in our casework where our clients have been sold insurance which is clearly unsuitable for them.

Case study 7

Steve (not his real name) took out a home loan with a major bank in 2013. The loan was for a relatively small amount—Steve had received an inheritance which paid for most of the house and the loan was for the remainder. A few months after taking out the loan, he approached the same bank again and applied for a credit card to pay for some renovations on the home. Steve is a full time carer for his wife, who has a disability. Both are solely reliant on Centrelink income.

During the application process, the bank staff added CCI (including an unemployment benefit) to the credit card. Steve did not ask to buy insurance and the CCI he ended up with was not explained to him. He doesn't recall what was said about insurance when he applied for the credit card—he said that 'they just start talking and don't stop, then say: "you understand all that", and you just say "yeah"'.

However, it should have been clear to the bank staff that both Steve and his wife—who did all their banking with this bank—were solely reliant on social security and neither could have claimed the unemployment benefit.

Steve paid around $90 per month on CCI premiums for two years. By the time the two years had passed, his wife's medical condition worsened and Steve needed to spend more money on renovations to make the home suitable to a person with limited mobility. This extra expense caused financial strain and Steve rang the bank to ask if the insurance policy we had would cover the period of financial difficulty.

The bank staff told Steve that his policy would only cover him if he became unemployed. Steve responded that he wasn't working when he was sold the policy. According to Steve, the bank staff 'didn't have any real answers' about why he had been sold the policy.

Steve called back later and cancelled the policy. Consumer Action gave assistance to help Steve apply for a refund on the premiums he paid.

Case study 8

Gerry took out a personal loan for over $12,000 with a small lender in 2013 for a loan which was not used to buy a car. The loan, which included a $1,000 Gap insurance policy, a large amount of fees and an interest rate of 28% per annum would have cost Gerry nearly $20,000 to pay off over 3 years. Gerry was not told about the Gap insurance, and it was certainly not explained to him.

Gap insurance is generally only sold when a consumer purchases a car on finance. The insurance provides protection if the car is written off and an insurance payout is not enough to pay the full amount left to be repaid on the car loan. In this case, the loan was not used to buy a car meaning it was useless for Gerry.

With assistance from Consumer Action, Gerry reached a satisfactory settlement with the lender.

Case study 9

Danny applied for a $20,000 loan with a major bank in late 2013 to consolidate two existing debts with the same bank. He was issued with $2,274 of income protection insurance for the $20,000 loan, even though he told the bank that he was not working at the time. Danny had been off work for some time and receiving an income from WorkCover. The client instructs that the bank's response was 'if you're on Workcover, you're still employed, so we'll put that on the application'.

Case study 10

John was a customer of a major bank and had a personal credit card with a limit of $10,000 which was almost at the limit. When John visited a branch of the bank in 2011 he got into a conversation with a staff member about the small business he was starting. The staff member encouraged him to buy CCI for his credit card, saying that if he lost his income the insurance would make the payments.

John made CCI payments for 4 months before his small business failed and he was left without an income. He made a claim on the CCI but was rejected on the basis that the involuntary unemployment cover did not protect people who are self-employed.

John kept the CCI policy as it also provided cover for disablement, death and terminal illness. At a later date he made a claim for an injury to his hand which prevented him from earning income in his new job. This claim was also rejected on the basis that he had a pre-existing injury.

Claim Rejected!

Susan Bell Research's report for ASIC in 2013 found that consumers were not asked questions about their potential eligibility when purchasing a CCI policy (such as employment status or pre-existing conditions). Some consumers participating in the research pointed out that they would not have known what questions to ask to find out about eligibility criteria, and others had the impression that sales staff did not themselves know about the policy's eligibility criteria.[32]

This resulted in claims being denied for consumers who were ineligible to claim from the time they took out the cover because they were employed on a contract[33] and others with pre-existing conditions said they would never have taken out the policy if they knew of the exclusion for such conditions.[34] Another participant was six months off her 65th birthday when she entered the CCI contract, which made her ineligible to claim after age 65.[35]

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[32] ASIC (July 2013) *Report 361*, pages 16-18.
[33] ASIC (July 2013) *Report 361*, page 32.
[34] ASIC (July 2013) *Report 361*, page 33.
[35] ASIC (July 2013) *Report 361*, page 34.

Case study 11

Matthew, who had suffered a mental illness in the past, purchased a car in late 2011 with finance from the car dealer, along with a CCI policy. When Matthew bought the CCI he expected that it would cover him in a number of circumstances, including if he suffered another episode of the same mental illness.

Matthew disclosed that he had suffered the mental illness at the time of applying for the insurance and the finance company representative said that, considering he had not suffered an episode of the mental illness for a number of years, he was 'fine' to take up a policy. Matthew bought the cover in relying on what the finance company representative said.

Matthew's illness did recur, which required him to spend time in hospital without income. His claim on the CCI was rejected on the basis that his mental illness was a pre-existing condition. Matthew could not continue payments on the loan, the vehicle was repossessed and sold and he was pursued for a residual amount by his lender.

High Commissions

Commissions paid by insurers to intermediaries for the sale of CCI to consumers cannot exceed 20 per cent of the premium.[36] However, there is no cap on the size of commissions payable on Gap Insurance and motor vehicle warranties. There is also no limit on the commission that can be applied on sales of CCI that are not regulated by the *National Consumer Credit Protection Act*, such as sales to businesses. These commissions can be very high—ASIC has found that car dealers can receive commissions as high as 75 per cent on insurance.[37] We have seen a motor vehicle warranty which say that intermediaries can be paid commissions up to 80 per cent of the premium.[38]

High commissions can be expected to drive, at least in part, the problems of mis-selling and low value discussed above. When an insurer pays high commissions to an intermediary for selling their product, they have less

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[36] National Credit Code, section 145.
[37] 'Industry culture must change: ASIC', insuranceNEWS.com.au, 27 July 2015. http://insurancenews.com.au/regulatory-government/industry-culture-must-change-asic
[38] The warranty was an Australian Warranty Network contract entered in 2014.

money to pay out claims, meaning cover has to be very limited. High commissions also encourage intermediaries to aggressively sell products regardless of whether they are suitable for consumers. While CCI commissions are limited by the law, this does not appear to be reducing the incidence of poor selling practices.

Responsible lending

Add-on insurance may also be mis-sold because the credit provider or broker breaches the responsible lending requirements under the *National Consumer Credit Protection Act 2009* (**the NCCP Act)**.

The NCCP Act requires credit assistance providers and credit providers to:

- make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract;
- take reasonable steps to verify consumer's financial situation;
- make a preliminary assessment (for credit assistance) or final assessment (for credit) about whether the credit contract is 'not unsuitable' for the consumer.[39]

Under section 131 of the NCCP Act, a credit provider must assess that a *credit contract* will be unsuitable for a consumer if it is likely that:

- the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship; or
- the contract will not meet the consumer's requirements or objectives.

Add-on insurance paid for with consumer credit may lead to a breach of responsible lending obligations where:

- a consumer was not aware they had been sold the add-on;
- a consumer did not want the add-on insurance, or it was not a purpose for which they were seeking credit;
- a consumer was not aware that the add-on was being financed and of the additional costs associated;
- the addition of the insurance or warranty premiums makes the credit contract unaffordable or otherwise renders the loan unsuitable, for example if it makes the loan term longer than was suitable;[40] or

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[39] Chapter 3 of the *National Consumer Credit Protection Act 2009.*
[40] ASIC Regulatory Guide 209 at paragraph 209.36.

- a lender overstates a consumer's financial position to make it appear that the insurance or warranty is more affordable than it is.[41]

Case study 12

Angela (not her real name) bought a used car for $25,000 in 2012. The car dealer arranged finance for her through a bank. Both the car dealer and the bank are well known companies.

Angela, who has a history of mental illness, was looking at a $15,000 car but was convinced by the car dealer to go for a more expensive model. The salesperson at the car dealer said that he wanted to help Angela which meant that he had to indicate on the application forms that she earned more than what she in fact did. The sales representative had access to Angela's bank statements so knew what her actual income was.

She was rushed into the contract and Angela only saw the car—and found out that it was a used car rather than a new one—after she signed the contract. Angela also did not realise she was entering a contract for 7 years. Angela could not afford the repayments without hardship, but she said she 'was not thinking straight' when she signed.

Angela bought comprehensive motor vehicle insurance for about $1,000 through the dealer, but she was not aware that a CCI policy of around $4,400 and Gap insurance of around $1,400 was added onto the finance.

Angela lost her job and in August 2013 the car was repossessed.

Financial advice and the 'best interests' test

Since 1 July 2013, authorised representatives of insurers have been subject to the 'best interests' requirements in the *Corporations Act 2001* (Cth).[42] For the best interests duty to apply, a representative must be providing 'personal advice'. Personal advice is defined closely in the *Corporations Act*, but

[41] For example, see ASIC's media release relating to the conduct of Get Approved Finance, 'Esanda compensates consumers for conduct by finance broker' http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-312mr-esanda-compensates-consumers-for-conduct-by-finance-broker/

[42] *Corporations Act 2001*, section 961Q. The exception is where an authorised representative is relying reasonably on information provided by a licensee.

broadly it describes an opinion or recommendation designed to influence a customer's decision in relation to a financial product, where that opinion is based on the objectives and needs of the customer.[43]

Personal advice should only be given if it would be reasonable to conclude that the advice is appropriate, after considering a number of things required by section 961B of the *Corporations Act*.[44] Where the best interests duty does apply, an adviser must prioritise their customer's best interests over its own interests or those of a financial service provider.[45]

A finance provider or car salesperson is unlikely to be found to have provided personal advice if they simply promote a product and mention some of its benefits unless they have specifically recommended that a particular CCI or Gap product was suitable for the customer. In addition, ASIC has provided guidance that a salesperson will be less likely to have provided personal advice if (among other things) a customer was warned that only general advice would be given, and the salesperson does not consider the customer's relevant circumstances in giving the warning.[46]

Even if it is clear that a customer has received personal advice, a carveout for sales of general insurance means that a person selling CCI can consider a shorter list of things required by section 961B *Corporations Act* and still meet their best interests obligations. For example, an adviser selling CCI need not conduct 'a reasonable investigation into the financial products' that might achieve relevant objectives of the consumer.[47]

We think it is possible that some car salespeople or representatives of credit providers are inadvertently providing personal advice in relation to CCI and Gap insurance without being entitled to do so. The vast majority of consumers would not be aware if this has occurred, and would have trouble proving it in a court or tribunal even if they did identify it. In some situations, even where the personal advice test is triggered, it provides very little protection to a consumer who is being sold CCI or Gap through an add-on sales process.

[43] *Corporations Act 2001*, section 766B(1) and (3).
[44] Corporations Act 2001, section 961G
[45] *Corporations Act 2001*, section 961J.
[46] ASIC Regulatory Guide 244 (December 2012), *Giving Information, general advice and scaled advice.* Paragraphs 244.243-244.247
[47] *Corporations Act 2001*, sections 961B(2), 961B(4) and 761G(5).

In our view, any intermediary should be required to prioritise a customer's best interests over their own, and those of any other party, when selling a financial product. Financial products are usually complex, and beyond the expertise of most consumers. When a customer sees promotional material or has a conversation with a salesperson about the nature of a financial product they rely much more heavily on the material and the conversation than when they are buying simpler or more familiar products. This unusual level of reliance, in addition to the presence of conflicted remuneration like sales commissions, means intermediaries selling financial products should be subject to higher legal standards, including obligations to act in the best interests of customers.

What we plan to do

Encouraging insurers to stop allowing their products to be sold as add-ons

Problems with add-on insurance, and particularly CCI, have been raised by consumer advocates for decades. Reports by ASIC from 2011 and 2013 demonstrated serious problems with CCI sales practices by Australian banks, and high profile Australian insurers collectively paid $2.4 million in refunds for CCI mis-sold through payday lender The Cash Store. Major banks have also been involved. Westpac has been required to repay consumers who have been mis-sold CCI associated with its home lending,[48] and Esanda (owned by ANZ) has agreed to compensate consumers for sales conduct of a broker which included selling add-on products without the knowledge or consent of the consumer.[49] In the UK, an estimated £22 billion in compensation has been refunded to consumers after widespread mis-selling of add-on financial products.

That's why we think that Australian insurers should be on notice that allowing their product to be sold as an add-on leads to mis-selling and poor value for consumers. We want insurers to stop allowing their products to be sold as an add-on.

Encouraging consumers to seek refunds

The UK experience suggests that the best way to solve these problems is to encourage as many consumers as possible to complain about the way their insurance was sold to them and seek refunds. If insurers are forced to pay out a large enough amount in refunds they will be more willing to avoid selling their products as add-ons in future.

We believe that Australians could legitimately claim tens of millions of dollars in refunds from Australian insurers for products mis-sold each year. In the last five years, Australians have spent on average over $370 million per year

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[48] ASIC Media Release 15-318MR, 29 October 2015, Westpac to refund premiums for unwanted insurance cover. http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-318mr-westpac-to-refund-premiums-for-unwanted-insurance-cover/

[49] ASIC Media Release 15-312MR (27 October 2015) Esanda compensates consumers for conduct by finance broker. http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-312mr-esanda-compensates-consumers-for-conduct-by-finance-broker/

on CCI premiums.[50] Research by the UK Financial Conduct Authority found that almost one in five consumers who bought an add-on financial product were unaware that they had bought it.[51] This result is mirrored in our casework. When we analysed 35 cases from 2014 involving add-on financial products handled by our lawyers, we found that one in five matters included claims from consumers that they had been sold the add-on without their knowledge or consent.

This suggests to us that it is quite likely that at least one in five Australian sales of add-on financial products involves mis-selling that would allow consumers to legitimately claim a refund. This means that insurers and warranty providers might be due to pay over $70 million dollars in refunds in relation to add-on financial products mis-sold each year. Note that this $70 million dollar figure has not even begun to consider any mis-selling in the Gap Insurance market (as we have no data available to us on the size of that market), or other kinds of mis-selling (such as selling products which are clearly unsuitable for the client, or selling products by telling customers they are compulsory).

Over the coming months we plan to make more consumers aware of the problems with add-on products and help them seek refunds for insurance they didn't want, didn't need or couldn't use.

Law reform – prohibiting on the spot sales of add-on financial products

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

- there should be a mandatory delay between the sale of the primary product and the sale of the add-on. The delay might be around 7 days, or could be as little as 2 days;
- 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

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[50] APRA, Quarterly General Insurance Performance Statistics, September 2015 (Issued 19 November 2015). The $370 million figure refers to the gross written premium for Consumer Credit Insurance each year since 2011. The years we are referring to are the 12 months to 30 September each year.

[51] This research found that 19 per cent of respondents who bought an add-on product were unaware they had bought it. *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, para 1.11.

- 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 have been introduced in the UK. In June 2015, the FCA made rules preventing GAP insurance from being 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.[52] This followed an order by the UK Competition Commission which, from April 2012, banned the sale of PPI at the same time as a sale of credit.[53]

The FCA has also made rules to ban 'opt-out selling' across all financial services.[54] An opt-out sale is

> 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.[55]

To be clear, we do not support the part of the UK reforms to the extent that they allow 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 when 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.

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[52] Financial Conduct Authority (June 2015).

[53] Competition and Markets Authority, 24 March 2011, PPI Markets Investigation Order 2011, *Explanatory Note to accompany the Payment Protection Insurance Market Investigation Order 2011* para 102-117. Accessed from https://www.gov.uk/government/publications/ppi-market-investigation-order-2011. See also Which? (6 April 2012) *PPI law changes aid consumers from today,* http://www.which.co.uk/news/2012/04/ppi-law-changes-aid-consumers-from-today-282944/.

[54] Financial Conduct Authority (September 2015).

[55] 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

Insurers we have spoken to argue that the mandatory delay will create risks for consumers who will be uninsured during the delay period (for example where someone wants to buy a car and drive it away the same day).

In reality that risk just doesn't arise. A mandatory delay would prevent a finance provider from pushing insurance added onto some other product, but it would not stop a consumer from buying the insurance direct from an insurer on the same day as buying a new car if that is what the consumer wants. Insurance can easily be purchased in a single phone call direct to an insurer and arranged so that cover is provided immediately. Insurers are used to providing comprehensive car insurance on the spot because they know that most lenders require consumers to have comprehensive cover before issuing a car loan, and that unless the cover can start immediately, the consumer will go elsewhere. There is no reason why CCI or Gap could not also be provided by an insurer of the consumer's choice on the same day the consumer wants to take delivery of their car. The only difference is that the consumer is buying from an insurer who is motivated to provide a product that meets the consumer's needs, rather than being sold insurance by an intermediary motivated by the possibility of a commission.

Even if consumers were left without cover for a few days, many would be no worse off than customers who end up unwittingly being sold the worst value class of insurance on the market. If consumers have to approach insurers directly for CCI and Gap Insurance, it might encourage insurers to build CCI and Gap policies that are worth buying.

The FCA also considered and rejected this argument during consultation on its deferred opt-in mechanism for Gap insurance, considering that the deferral period actually enhances consumer choice by overcoming behavioural biases at the point of sale, leading consumers to 'purchase in a more purposeful way having considered their options … and benefit from lower prices'. The FCA also pointed out (as we have just done) that consumers can still choose to buy Gap insurance immediately from a third party provider, and can choose to buy from the credit provider promoting the Gap cover the day after [56]

We will raise this issue with federal parliamentarians and campaign for reform to introduce a mandatory delay between the sale of primary products and add-ons.

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[56] Financial Conduct Authority (June 2015), pages 9-10.

Collecting consumer stories

The case studies above only tell the stories of a small number of people. However the problems with 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 these products.

We want to hear from more consumers who have bought CCI, Gap and other add-on financial products to learn more about sales practices and claims experience. We will use this information to build momentum for change. If you have an experience you want to share, please get in contact by emailing us at campaigns@consumeraction.org.au.

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