20 October 2016

By email: adjudication@accc.gov.au

Gavin Jones
Director, Adjudication
Australian Competition & Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Dear Mr Jones,

Submission: Applications for authorisation—A191556-A91557 Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors

Thank you for your invitation to comment on the application by insurers for authorisation to cap commissions on add-on insurance sold through motor vehicle dealerships at 20% of premiums (the **Application**).

This submission focuses on the public benefit and detriment of the proposal for consumers. Any benefits to motor vehicle dealerships or insurers are private and not public in nature, and we do not believe that these form part of the assessment of net public benefit.

Considering both the public benefit and public detriment of the proposed commissions cap, we do not believe that authorisation of the Application would deliver a net public benefit. We consider, however, that the Application may deliver a net public benefit if:

- it included a ban on single-premium policies;
- it proposed unbundling the sale of the add-on insurances from the sale of loans;
- it included a ban on the sale of life (trauma) insurance in dealerships; and
- it proposed limiting commissions to a much lower level (perhaps around 10% of premiums).

Our comments are detailed more fully below.

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About Consumer Action

Consumer Action Law Centre (**Consumer Action**) is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

The problem of add-on insurance sold in motor vehicle dealerships

The Application identifies several of the many problems associated with add-on insurance sold through motor vehicle dealerships. These include the 'reverse competition' at play as insurers vie for access to dealerships, and motor vehicle dealerships compensating for the lack of profitability in motor vehicle sales by selling finance and insurance.[1]

Recent reports by the Australian Securities and Investments Commission (**ASIC**)[2] and Consumer Action[3] have detailed the significant problems associated with add-on insurance sales. ASIC reports that 75% of add-on insurance (by dollar value) is sold through car dealers.[4] Over 65% of Consumer Action's DemandARefund users (see below) bought their insurance through a car yard.

The most significant problems—which have been seen repeatedly in Consumer Action's casework—include:

- low-value products being sold with high premiums;
- problematic sales practices that lead to people buying insurance which they:
  - do not want or understand;
  - do not know that they have bought;[5] and/or
  - thought was mandatory; and
- insurance being sold to people who are ineligible to make a claim.

Similar problems have occurred in the UK on a large scale[6] and led to restrictions on the sale of personal protection insurance (**PPI**) (the equivalent of consumer credit insurance (**CCI**)).

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[1] Application, p 11.
[2] ASIC, *Report 470: Buying add-on insurance in car yards: Why it can be hard to say no*, February 2016; *Report 471: The sale of life insurance through car dealers: Taking consumers for a ride*, February 2016; *Report 492: A market that is failing consumers: The sale of add-on insurance through car dealers*, September 2016.
[3] Consumer Action, *Donating Your Money to a Warranty Company: Why the motor vehicle warranty you bought might be worthless*, August 2015; *Junk Merchants: How Australians are being sold rubbish insurance, and what we can do about it*, December 2015.
[4] ASIC, Report 492, para
[5] Consumer Action, *Junk Merchants*.
[6] See UK Financial Conduct Authority (FCA), *General Insurance Add-Ons: Final Report—Confirmed Findings of the Market Study*, Market Study MS14/1, July 2014.

DemandARefund.com

Because of the widespread problems seen with add-on insurance sales, Consumer Action developed the DemandARefund.com website, which assists people to write letters of demand claiming refunds for add-on insurance which was mis-sold to them.

Since DemandARefund.com launched in March 2016, it has helped more than 180 people generate letters demanding nearly $400,000 in refunds for premiums for add-on insurance and warranties, usually sold through motor vehicle dealerships. Of the people claiming a refund:

- 22% say did not know they were buying insurance;
- 28% say they thought the insurance was mandatory;
- 33% say they felt rushed or pressured into buying the add-on insurance; and
- 39% say they thought the product was unsuitable/inappropriate.

Case studies

The following are real examples of people who bought add-on insurance through a car yard and used DemandARefund to claim a refund. Consumer Action's report *Junk Merchants: How Australians are being sold rubbish insurance and what we can do about it* also details 12 cases of people who Consumer Action has assisted.

Case study 1—Bernadette

A car dealer added 'gap' insurance and CCI to mother-of-two Bernadette's loan when she bought a Honda Jazz. She said she did not consent to buying the insurance and she did not understand what the insurance was for. She also realised later that it was of limited use to her because she was self-employed.

Bernadette got a $4,300 refund from MTA Insurance for the two policies through DemandARefund.com. This meant that she could pay off the car loan two years early.

Case study 2—Mark

When he bought a used car extended warranty, Mark told the car dealer that he did his own servicing. He wanted to be sure this would not invalidate the warranty. The car dealer said this was fine. Later, he read the terms and conditions and realised that this was in fact a breach and he could never make a claim. He felt like he had been ripped off by buying a product that was completely useless to him.

Mark got back $1,500 for the warranty by using DemandARefund.com. He found it easy to get a refund, saying, 'Anybody could do it, and everybody should'.

Add-on insurance sales in motor vehicle dealerships—is there public benefit?

While the net public benefit of the proposal is the relevant test for the ACCC, the broader question of relevance to this Application is whether there is any public benefit at all in the continued sale of add-on insurance in motor vehicle dealerships. In our view, all the benefits accrue to dealers and insurers, with consumers experiencing detriment.

The Application states that there is public benefit in the continued availability of add-on insurance products, because of the 'convenience' and 'peace of mind' it provides.[7]

However, ASIC's behavioural research[8] and Consumer Action's experience through our casework and DemandARefund.com suggest that the add-on model gives providers a clear point of sale advantage, and that sales are not driven by consumer need or demand.

Rather, the add-on mechanism has a real impact on consumer behaviour, affecting the way consumers make decisions. Research has shown that consumers who purchase through this channel are less likely to shop around and are less price sensitive. Consumers' attention is on the purchase of the primary product rather than the add-on, leading many consumers to buy add-on products which they do not need or understand.[9]

In this context, the availability of add-on insurance does not deliver 'convenience' or 'peace of mind', particularly because so many purchasers have such limited understanding of what they have purchased. Our report, *Junk Merchants: How Australians are being sold rubbish insurance and what we can do about it,* identified a raft of problems evidenced through consumer case studies, including:

- misrepresentations or failure by salespeople to explain the nature of the product, or important terms and exclusions;
- many consumers being unaware that they purchased the product;
- some consumers being left with the impression that the product is mandatory to obtain the finance;
- many instances of sales to people who would be ineligible to claim on CCI because of advanced age, pre-existing medical conditions and/or employment status;
- instances of sales to people who would be unable to claim on gap insurance because the car loan is small with a large deposit (no 'gap') or where comprehensive car insurance will already pay out the entire financed amount; and
- instances of people being sold life cover where they have equivalent protection already, such as life insurance associated with superannuation.[10]

ASIC's report, *A market that is failing consumers: The sale of add-on insurance through car dealers*, confirms the consumer detriment caused by these sales, finding:

- very low value products—consumers receive very low claim payouts relative to premiums, as low as nine cents for every dollar of premium paid; and

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[7] Application, pp 14-15.
[8] ASIC, Report 470.
[9] FCA, *General Insurance Add-Ons: Final Report—Confirmed Findings of the Market Study*, Market Study MS14/1, July 2014, p 7.
[10] Consumer Action, *Junk Merchants*.

- any benefits accrue to dealers—consumers receive much less in claims than dealers receive in commissions.[11]

In Consumer Action's view, unless there is a very substantial change to the value of add-on products, it is not possible to say that 'convenience' and 'peace of mind' amount to public benefits.

Public benefit of the proposal

There may be public benefit in addressing reverse competition and reducing the levels of conflicted remuneration in the sale of add-on insurance. In this sense, extending the current 20% commission cap on CCI sales[12] by covering a wider gamut of products and payments made in connection with them may provide a public benefit.

However, there a number of concerns are raised by the proposal, including:

- the fact that the existing commissions cap on CCI does not appear to have changed the sales practices of dealers;
- the lack of coverage of some warranties and other add-on products sold through dealers;
- the lack of distinction between private benefit for insurers and dealers, and public benefit for consumers;
- the lack of monitoring or enforcement mechanisms in the proposal; and
- the potential for the proposal to delay effective legislative and regulatory action to address the problems of add-on insurance.

For these reasons, which are detailed below, Consumer Action's view is that any public benefit stemming from the proposal would likely be extremely limited.

Effect of a 20% commission cap

While commissions may be driving problematic sales of add-on insurance, it does not necessarily follow that a 20% cap on commissions will reduce these sales practices. The Application does not detail why 20% would be an appropriate level for a commission cap.

When the current cap on CCI commissions was introduced, the Explanatory Memorandum did not detail why the cap was set at 20%.[13] That cap does not appear to have reduced the problems associated with add-on sales of CCI. According to ASIC, the existing cap 'has not been a sufficient means of producing good consumer outcomes' in relation to the life insurance components of CCI sold in motor vehicle dealerships.[14]

DemandARefund.com allows users to seek refunds for CCI, gap insurance and used car extended warranties. However, the most commonly complained about policy of the three is

[11] ASIC, Report 492, paras 19 - 20.
[12] Under s 145 of the National Credit Code.
[13] National Consumer Credit Protection Bill 2009 (Cth), Explanatory Memorandum, paras 8.252 - 8.254.
[14] ASIC, Report 471, para 132.

CCI, which 37% of users purchased. This suggests that a 20% commission cap across all types of add-on insurance may not change incentives for dealers.

The Trowbridge Report on retail life insurance recommended a 20% cap on commissions paid by insurers to financial advisers.[15] However, Trowbridge specified that the 20% level was 'expected to fund any shortfall of the [initial advice payment] against costs and also to fund regular insurance reviews for clients'.[16] A motor vehicle dealer selling add-on insurance under a general advice model clearly will not incur the same costs as a financial adviser selling life insurance under a personal advice model. It is therefore difficult to justify the same commission cap applying in both circumstances.

Consumer Action is opposed to any form of conflicted remuneration in financial services. However, it may be that a lower commission cap—for example, 10% or less—could work to genuinely shift the incentives for dealers to inappropriately sell add-on insurance, and to avoid the harm caused by these products being mis-sold. We encourage the ACCC to consider whether a lower commission cap is better justified and will deliver a net public benefit.

<u>Incomplete coverage of add-on products</u>

The Application does not cover the field when it comes to add-on products sold by dealerships. For example, the Application does not appear to cover used car extended warranties, unless they are underwritten by an insurer named in the Application. These warranties include:

- Discretionary-risk warranties, which are discussed in our report, *Donating Your Money to a Warranty Company.*[17] The three companies named in that report, National Warranty Company (**NWC**), Australian Warranty Network and Integrity Car Care are not named in the Application. These products give warranty providers discretion as to whether or not they pay a claim. Commissions for these sorts of warranties can be up to 80%.[18]
- 'Dealer-issued' extended warranties. An example of this is NWC's 'Extension to Manufacturer's Warranty', which purports to be issued by the dealer and administered by NWC. Consumer Action has concerns about consumer detriment arising from the sale of this product, for example, the terms and conditions appear to prevent consumers from enforcing their rights under the warranty against the dealership or NWC.

The Application also does not expressly cover other add-on products such as rust proofing and paint protection (paint deterioration and rust are commonly excluded from comprehensive insurance coverage). Dealers may respond to the commissions cap by increasingly selling these products in ways that harm consumers (that is, without fully understanding the purchase).

[15] Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, p 6.
[16] Trowbridge, p 27.
[17] Consumer Action, *Donating Your Money to a Warranty Company*.
[18] Consumer Action, *Donating Your Money to a Warranty Company*, p 25.

Given the Application is unlikely to cover all providers of add-on insurance or all products, there may be greater benefit in ASIC using its powers to achieve the desired outcomes. For example, ASIC could make a Class Order under sections 926A or 992B to modify the effect of the *Corporations Act 2001* (Cth)—this could state that the paying of commissions in excess of an effective cap is 'unconscionable conduct' under Division 7 of Part 7.8. Alternatively, ASIC could impose new licensing conditions to give effect to a cap or a requirement that there be an 'opt-in' process around the purchase of add-on insurance. The added benefit of this approach would be that ASIC's enforcement toolkit could be brought to bear to ensure compliance and enforcement.

<u>Delivering consumer benefit</u>

The Application states that 'the 20% cap on commissions will bring the interests of customers and distributors into closer alignment'.[19] Indeed, it may be that the proposal will address 'reverse competition', so that insurers are not solely competing on the basis of commissions or other benefits to dealerships. However, it is not clear that this will necessarily result in benefits for consumers. This is because:

- there no evidence that the cap will reduce add-on insurance premiums and the overall cost to consumers, and it may even operate to increase the cost for consumers (see further below);
- as the Application acknowledges, dealers will have an incentive to sell more expensive products;[20]
- the cap will not improve the value or suitability of add-on products for consumers; and
- the cap will not provide a disincentive for dealers continuing to pressure or mislead consumers into buying add-on insurance.

We also note ASIC's view that consumers are paying too much for add-on insurance 'in part' due to very high commissions, and that a cap is 'necessary' but not in itself 'sufficient' to improve consumer outcomes.[21]

<u>No industry monitoring or enforcement</u>

The Application leaves open significant questions as to how the proposed cap would operate. It does not propose compliance or enforcement mechanisms, and no individuals and/or chapters of the General Insurance or Life Insurance Code Compliance Committees have been nominated to monitor the industry and ensure compliance with the cap.

The apparent lack of consequences for breach, and the absence of ongoing evaluation by the industry, will obviously impede the effectiveness of the proposed cap.

[19] Application, p 10.
[20] Application, p 13.
[21] Application, *Attachment B: Letter from Michael Sadaat, ASIC, to Gina Cass-Gottlieb, Gilbert + Tobin*, 22 August 2016.

Delay of effective legislative and regulatory action

Finally, the Application acknowledges that without the proposal being approved, 'there is a real chance that ASIC or the government will intervene with regulatory or legislative action' which would have 'unpredictable results'. It points to the UK model, where the equivalent of CCI cannot be sold until days after a loan is taken out.[22]

In Consumer Action's view, regulatory and legislative action would have significant public benefit and be much more effective in tackling the consumer harm. The results would not be unpredictable or detrimental to the public, particularly in light of the UK experience.[23]

At best, this Application is a minor 'stop gap' until legislative and regulatory action is taken. At worst, it could delay effective action to address the consumer detriment caused by add-on sales.

Public detriment of the proposal

As noted, the proposal will not necessarily reduce the cost of add-on insurance or increase its value for consumers. The proposal could also potentially have alternate, perhaps unintended consequences, which would be detrimental to the public. These include:

- incentivising dealerships to sell higher-cost policies and/or sell products at increased premiums, to continue to allow dealerships to net high commissions on sales;
- simply shifting the profits made from problem products from motor vehicle dealers back to insurers; and
- providing unwarranted reassurance to consumers that they are not being sold worthless insurance.

In Consumer Action's view, these detrimental effects of the proposal would outweigh any public benefit it provides.

Dealer incentives to sell high-cost products

The proposal creates a clear incentive for dealerships and their sales representatives to sell consumers higher-cost add-on products, in order to maintain their commission revenue in spite of the cap. This means that consumers may continue to be sold unsuitable and worthless insurance products, and may be more likely to be sold the more expensive products.

Similarly, discretionary pricing of add-on insurance products means that dealers can simply increase the premiums of add-on products to maintain their commission revenue. This is particularly concerning where discretionary pricing already sees the same add-on products

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[22] Application, p 11.
[23] Changes to add-on insurance in the UK have seen the amount in refunds and compensation paid as a result of complaints about PPI steadily reduce from a high of £528m in July 2013 to £327.9m in July 2016: see FCA, *Monthly PPI refunds and compensation*, https://www.fca.org.uk/consumers/payment-protection-insurance/monthly-ppi-refunds-and-compensation.

priced up to ten times higher in some dealerships when compared with others.[24] Nothing in the Application will prevent dealerships from using discretionary pricing to bump up their commissions.

The proposal acknowledges but does not address the potential for more expensive insurance products to be sold. This potentially presents very high consumer detriment, because add-on insurance products are typically sold to consumers who have little or no awareness of the product or cost.[25]

Shifting profits from dealers to insurers

The Application aims to reduce the profitability of add-on insurance products for motor vehicle dealerships. In doing so it places the responsibility for problematic add-on insurance sales predominantly with motor vehicle dealerships. It proposes a solution which may be detrimental to dealerships.

However, insurers could stand to benefit significantly from the proposed commissions cap. Capping the profits of dealerships increases the profitability of these products for insurers while doing nothing to address the problems with add-on products and sales practices. The proposal lacks any incentive for insurers to address the obvious problems experienced by consumers who buy their products.

Unwarranted reassurance to consumers

The absence of a proposed monitoring and compliance mechanism in the Application gives rise to a significant risk of non-compliance or circumvention of the proposed cap. This lack of a clear implementation plan, coupled with the public assurances about the protections that the cap provides to consumers, could increase consumer trust in insurers and dealers without any genuine basis.

Reporting prices, claims payouts and loss ratios

The Application's proposed reporting of prices, claims payouts and loss ratios to ASIC is important, as transparency has been profoundly lacking in most aspects of the add-on insurance market.

For the reporting obligations to provide a net public benefit:

- this data should be made public, to ensure that consumers know the value of the products they are being sold; and
- metrics would need to be set—and publicly announced—to measure whether any change in loss ratios has provided public benefit. Consumer Action would expect this

[24] ASIC, Report 492, para 75.
[25] For example, several sources indicate that approximately one in five people who bought add-on insurance did not know they bought it: Consumer Action, *Junk Merchants*, p 29; FCA, Market Study 14/1, p 7; DemandARefund.com usage statistics.

to mean loss ratios are on par with other forms of general insurance, such as car or home insurance.

Alternatives with greater public benefit

The consumer experience does not show a public benefit in add-on insurance sales continuing in dealerships.

However, if add-on insurance sales continue in motor vehicle dealerships, changes that may deliver some public benefit include:

- an opt-in sales model, to ensure that consumers are engaged in and informed about the product features, purchase price and other key details;
- an end to single premiums, to ensure that the cost to consumers is not further inflated and hidden; and
- an end to life insurance as a component of add-on insurance sold in dealerships.

Our views as to why these changes would provide public benefit in the Australian market are detailed below.

Opt-in model

As the Application states, the UK's Financial Conduct Authority (**FCA**) 2014 market study points to some benefit in add-on products continuing to be available.[26] However, it is notable that this report led to the introduction of an 'opt-in' model in the UK.

Under an opt-in model, there is a mandatory delay between the sale of the primary product and the sale of the add-on product. The aim of this is to empower consumers to make informed decisions about whether they need add-on insurance and, if so, how they buy it.[27]

An opt-in model, which only allows consumers to buy an add-on product several days after the primary transaction would be a more effective way of addressing the detriment seen in add-on sales to Australian consumers. This would also entail banning 'opt-out' sales, where the insurance is pre-selected on forms signed at the time the primary product is sold. Opt-out add-on insurance sales have also been banned in the UK.[28]

Ban on single premium pricing

Add-on insurance is most commonly sold with a single premium price that is added to the motor vehicle loan, meaning that interest is payable on the premium, and repayments are hidden in the loan repayments. This pricing structure increases the total cost of add-on

[26] Application, p 15.
[27] FCA, Market Study MS14/1, July 2014, p 22.
[28] FCA, *General Insurance Add-Ons Market Study—Remedies: banning opt-out selling across financial services and supporting informed decision-making for add-on buyers*, Policy Statement PS15/22, September 2015.

products and reduces consumer awareness of the total cost. It also means that if a consumer pays off their loan early, the unused portion of the premium is not refunded.

Single premium pricing was banned on payment protection insurance (**PPI**)—the UK equivalent of CCI—due to the negative outcomes for consumers who bought add-on PPI.[29]

Consumers will always pay less by paying a premium in regular instalments over the period of the loan, rather than by way of a single premium tacked on to the cost of the loan. A ban on single premium pricing, in conjunction with an opt-in sales model, would more effectively address the consumer detriment seen in add-on insurance sales.

<u>An end to life insurance sold in car yards</u>

ASIC reported in early 2016 that life insurance as a component of CCI sold through motor dealerships was:

- very poor value, and could cost up to 18 times more than other forms of life insurance;[30]
- on average 50% more expensive than other available life insurance; and
- at times sold where the benefit was questionable (for example, to a young person without dependents), or to consumers who may not have wanted it.[31]

Given the significant problems with life insurance sold through motor-dealerships, insurers could mitigate the add-on insurance problem by no longer selling life insurance through the add-on model.

Net public benefit

For the reasons outlined above, Consumer Action does not believe that authorisation of the Application will provide a net public benefit. This is because the proposal:

- does not clearly address the systemic problems with add-on insurance sales in a way that will benefit consumers;
- shifts the profitability of problematic products from motor vehicle dealerships to insurers;
- creates new incentives for dealerships to sell high-cost add-on products;
- provides unwarranted reassurance to consumers that the problems with add-on insurance are being addressed; and
- does not propose adequate public reporting, monitoring and enforcement arrangements to ensure it has any public benefit.

Pre-decision conference

Consumer Action requests a pre-decision conference on the ACCC's draft decision as part of the authorisation process for this Application. This would enable us to expand on our views in this submission and more specifically respond to the draft decision. We understand that such

[29] See UK Competition Commission, *<u>Market investigation into payment protection insurance</u>*, 29 January 2009, p 243.
[30] ASIC, Report 471, p 7.
[31] ASIC Report 471, p 8.

conference would be held in December 2016 or January 2017 and look forward to your response on this point.

Please contact Susan Quinn on 03 9670 5088 or at susan@consumeraction.org.au if you have any questions about this submission.

Yours sincerely,

CONSUMER ACTION LAW CENTRE

Gerard Brody
Chief Executive Officer