ASIC

Australian Securities & Investments Commission

**REPORT 492**

# A market that is failing consumers: The sale of add-on insurance through car dealers

September 2016

## About this report

This report presents ASIC’s findings on the sale of add-on insurance through car dealers. Our findings are based on data collected from seven general insurers who issue add-on insurance products.

Our review suggests that add-on insurance sold through this distribution channel represents poor value for consumers and is designed and sold in a way that may not meet consumers’ needs.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers**: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides**: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets**: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports**: describe ASIC compliance or relief activity or the results of a research project.

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This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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# Executive summary

1 ASIC has undertaken a review of seven insurers who issue add-on general insurance products (add-on insurance) through car dealers. These insurers, estimated to make up over 90% of this market, are:

(a) Aioi Nissay Dowa Insurance Company Australia Pty Ltd;

(b) Allianz Australia Insurance Limited;

(c) Eric Insurance Limited (formerly known as AVEA Insurance Limited);

(d) Swann Insurance (Aust) Pty Ltd (part of Insurance Australia Group Limited);

(e) MTA Insurance Limited (part of AAI Limited, which is part of Suncorp Group Limited);

(f) NM Insurance Pty Ltd (acting as agent for AAI Limited); and

(g) QBE Insurance (Australia) Limited.

Note: In this report, unless the context specifies otherwise, 'insurers' means these seven insurers we reviewed and 'insurance' is general insurance. 'Car dealers' means any motor vehicle dealer selling cars and motorcycles to consumers.

2 'Add-on' insurance is a term used to describe an insurance product that is 'added on' to the sale of another product which is the main focus for the consumer. This review focuses on add-on insurance sold to consumers when they purchase a new or used car, which covers risks relating to the car itself (e.g. mechanical breakdown) or to a credit contract if the consumer takes out a loan to buy the car (e.g. insurance to cover loan repayments if the consumer becomes ill).

3 Due to the nature of add-on insurance, the primary product is typically the focus for the consumer at the time of purchase, while the add-on product is not actively sought. The distinction is sometimes expressed as the add-on product being 'sold to' not 'bought by' the consumer.

4 This report builds on previous work conducted by ASIC into the sale of life insurance products through car dealerships. That work reviewed the sale of the life insurance part of consumer credit insurance (CCI), typically designed to repay a consumer's outstanding car loan in the event of death. Our previous work found that the CCI products we reviewed provided poor value to consumers and were sold to consumers who did not need them.

5 ASIC has repeatedly raised concerns about these products with individual insurers and the insurance industry more broadly. We therefore require insurers to quickly respond to the findings of this report in a manner that delivers significantly better outcomes for consumers.

## Scope of ASIC's review

### What we did in this review

6 In early 2016, we requested quantitative data from the insurers on their level of sales, premiums, commissions and claims for add-on insurance products sold through car dealers over a three-year period (2013–15 financial years).

7 Our review focused on add-on insurance products sold through car dealers as this market has a number of inherent risks, including that:

(a) decisions about insurance are a third-order selection after the consumer has made choices on the car and the finance (and therefore receive less attention from the consumer);

(b) the number and complexity of the products sold to the consumer with multiple options of cover available demands greater understanding than if they were being sold as a single product; and

(c) features of this channel, such as the geographic dispersion of car dealers, increase the risk that insurers will be unable to adequately monitor the conduct of car dealers at the point of sale.

8 We focused on five add-on insurance products commonly sold by car dealers:

(a) *CCI*—This insures a borrower's capacity to make repayments under a car loan, including insurance against sickness, injury, disability, death or unemployment: see s204 of the National Credit Code (Sch 1 to the *National Consumer Credit Protection Act 2009* (National Credit Act)).

Note: The Insurance Contracts Regulations 1985 contain a similar, but not identical, definition of CCI: see reg 21. For this review, CCI is limited to insurance designed for personal loans, including car loans. It does not include all CCI products—for example, credit card and mortgage repayment insurance are not included in the data set.

(b) *Guaranteed asset protection (GAP) insurance*—This covers the difference between what a consumer owes on their car loan and any amount they may receive under their comprehensive insurance policy, if the car is a total loss.

(c) *Loan termination insurance*—This covers the difference between what a consumer owes on their car loan and the market value of the car if they return it because they cannot make repayments due to illness or injury.

(d) *Tyre and rim insurance*—This covers the cost of repairing or replacing damaged tyres and rims from blowouts, punctures or other road damage.

(e) *Mechanical breakdown insurance*—This covers the cost of repairing or replacing parts of the car due to mechanical failure after the manufacturer's or dealer's warranty has expired (often referred to as an 'extended warranty').

9 For the products included in this review, 75% of distribution (by dollar value) was through car dealers. This suggests that the demand for these products is driven by the car dealers. If there was a broad consumer demand for these products, it is likely they would be more broadly available.

10 As part of our qualitative research, we issued a questionnaire that captured information about the sales processes insurers used for add-on insurance products sold through car dealers. We also reviewed Product Disclosure Statements (PDSs) for these products.

11 Our qualitative research involved discussions with a range of stakeholders, including the insurance industry, lenders who provide finance through car dealers, consumer groups and other regulatory bodies.

12 For detailed information about the methodology of our review, see Appendix 1.

## Previous work on add-on insurance

13 This report builds on previous work on the sale of add-on insurance products, including two reports released by ASIC in February 2016.

14 In Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470), we analysed qualitative research on consumers' experiences of buying add-on insurance through car dealers. We identified a number of reasons why consumers bought these products, even when they had a poor understanding of the cover offered.

15 In Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471), we reviewed five insurers selling life insurance under CCI policies through car dealers. We found that this cover could be very expensive (e.g. some small businesses were charged up to 80% more than consumers offered the same product) and was sold to consumers who did not need it (e.g. to young people with no dependents).

16 After the release of these reports, we called for insurers to review and substantially improve the design and distribution of these products. In particular, we asked them to address high costs, poor value and poor claims outcomes, and the level of supervision of authorised representatives, to ensure these products deliver value to consumers and are sold appropriately.

17 Our actions have already produced positive results for consumers with insurers agreeing to remove an unfair pricing practice where business consumers were charged more for an identical product as a result of higher commissions paid to sell these products.

**MoneySmart Cars app**

ASIC's MoneySmart website has recently released the MoneySmart Cars app that helps consumers work out the real cost of buying a car, including the cost of add-on insurance. This app warns consumers to think twice before buying add-on insurance as it may not be good value for money, paying a claim only in limited circumstances and adding to the cost.

## Key findings

18 Our review found that add-on insurance products sold through car dealers provide significantly poor outcomes for consumers. For a more detailed summary of these findings and ASIC's response, see Table 1.

### Finding 1: Consumers receive low claim payouts relative to premiums

19 Across all the add-on insurance products we reviewed over the three years, the gross amount returned to consumers in claims was only nine cents for every dollar of premium paid, or $144 million paid in claims compared to $1.6 billion received in premiums. By comparison, car insurance can return 85 cents in the dollar in claims and home insurance 55 cents in the dollar.

### Finding 2: Consumers receive much less in claims than dealers receive in commissions

20 Across all add-on insurance products over the three years, insurers paid $602.2 million in commissions to car dealers (with some commissions as high as 79% of the premium) and only $144 million to consumers in claims. This means that car dealers earned *four times more* in commissions from these policies than consumers received in claims.

### Finding 3: Lack of price competition results in poor consumer outcomes

21 Some pricing practices (e.g. dual pricing and discretionary pricing) are unique to the car dealer channel due to the inability of consumers to take steps to encourage competition.

### Finding 4: Insurers sell products that are poorly designed

22 Many add-on products were poorly designed with consumers often paying for something they did not need or would not be eligible to claim for. The design and pricing of other products resulted in poor claims outcomes, even if consumers made a successful claim. For example, over a three-year period, across all insurers who sold mechanical breakdown insurance, on average consumers paid $1,482 in premiums and received a claim payment of $940.

### Finding 5: Single premium policies increase the cost for consumers

23 Products are commonly packaged into a car loan with a single upfront premium, substantially increasing the cost, reducing consumer awareness about the policy and creating unfair outcomes if a consumer repays the loan early.

### Finding 6: Sales processes inhibit good decision-making

24 The sales process insurers used was complex, requiring the consumer to make multiple decisions with minimal information, without the total cost of the cover being clearly disclosed in dollar terms before the sale was made. At least one insurer trained car dealers in how to avoid disclosing the price, even if asked.

## Further action

25 Our findings in this report and in REP 471 demonstrate that there are structural failings in the add-on insurance market.

26 The Financial System Inquiry (FSI) made it clear that community expectations of financial services providers, including insurers, have shifted. Insurers must take full responsibility for the products they design and the channels they choose to distribute through, such as add-on insurance products sold through car dealers.

27 ASIC supports the FSI recommendation that issuers and distributors of financial products must have greater accountability over the design and distribution of these products to ensure fair and appropriate outcomes for consumers.

28 Similarly, ASIC supports the FSI's recommendation that ASIC be given a product intervention power to help enhance our ability to improve market conduct where there is risk of significant consumer detriment.

29 Both of these reforms would help to address the market-wide failings apparent in the sale of add-on insurance through car dealers.

30 We will continue to closely monitor the practices of individual insurers who sell add-on insurance products through car dealers and work with industry to ensure that significantly better outcomes for consumers are achieved.

31 Insurers who fail to address our findings will be subject to further regulatory action by ASIC, which may include:

(a) taking targeted enforcement action against insurers or their authorised representatives selling the products;

(b) pursuing remediation for consumers who have been missold add-on insurance policies;

(c) publically naming individual insurers who fail to deliver significantly improved outcomes for consumers; and

(d) exploring law reform options to ensure fair and appropriate outcomes for consumers.

32 As part of our ongoing work, we will continue to conduct detailed reviews of practices we have observed through surveillances of insurers that are identified in this report as problematic. Where we find evidence of misconduct, we will pursue enforcement outcomes.

33 While this report focuses on concerns with the car dealer distribution channel, many of our findings have a broader application to add-on insurance products sold through other channels.

34 All insurers must consider the findings, how they apply to add-on insurance products they offer and take action to provide better outcomes to consumers. Any insurer who does not take action on our findings will be subject to further action by ASIC, including enforcement action where appropriate.

**Table 1: Key findings and ASIC's response**

| Finding | Explanation | ASIC's response |
|---|---|---|
| **Finding 1: Consumers receive low claim payouts relative to premiums**<br><br>(See Section A, paragraphs 42–52) | Across all add-on insurance products we reviewed, over a three-year period, the gross amount paid in claims was $144 million, or only 9% of gross premiums of just over $1.6 billion.<br><br>The claims ratio for the two products with the highest dollar value in sales were even lower:<br>• *for GAP insurance*, 6.3 cents in the dollar was paid back in claims (with total claims of $39.9 million, and premiums of $631.1 million); and<br>• *for CCI, covering both general and life insurance components*, 5 cents in the dollar was paid back in claims (with claims of $25.3 million, and premiums of $506.8 million). | Insurers must deliver better value products with significantly improved claims ratios.<br><br>We will consult with each insurer and seek information on their individual targets.<br><br>If we consider increases in claims ratios are inadequate, we will consider steps such as public disclosure of claims ratios to increase the visibility of these poor outcomes. |
| **Finding 2: Consumers receive much less in claims than dealers received in commissions**<br><br>(See Section A, paragraphs 53–62) | *Upfront commissions* of up to 79% of the premium were paid to car dealers arranging the sale of add-on insurance products.<br><br>Insurers paid $602.2 million in commissions to car dealers and only $144 million to consumers in claims. This means car dealers earned four times more in commissions than consumers received in claims.<br><br>This is illustrated in the two products with the highest dollar value for the 2015 financial year:<br>• for *GAP insurance*, dealers earned 8.2 times more than consumers ($328.8 million in commissions against $39.9 million in claims); and<br>• for *CCI*, dealers earned 3.8 times more than consumers ($97.2 million in commissions against $25.39 million in claims). | Insurers must:<br>• reduce the commissions and financial benefits payable to car dealers; and<br>• pass on the entirety of the savings from lower commissions to consumers through lower premiums. |
| **Finding 3: Lack of price competition results in poor consumer outcomes**<br><br>(See Section B, paragraphs 63–78) | *Dual pricing* was common—four general insurers charged premiums to business use consumers that were higher than the prices charged to personal-use consumers (where commissions are capped under the National Credit Code).<br><br>*Discretionary pricing* meant that some consumers paid nearly 10 times more for the same product, with two insurers giving car dealers discretion to vary the price that can be charged for add-on insurance. | Insurers must abandon pricing arrangements where the consumer can pay more for the same cover for reasons unrelated to the underlying risk (e.g. because the car dealer can earn higher commissions by arranging for the consumer to pay a higher premium). |

| Finding | Explanation | ASIC's response |
|---|---|---|
| **Finding 4: Insurers sell products that are poorly designed**<br><br>(See Section B, paragraphs 79–136) | Many add-on products were poorly designed, so that consumers were often paying for something they did not need or that offered poor value.<br><br>*Negative or low-value policies* in some cases meant that the average claim was less than or similar to the average premium paid:<br>• *for mechanical breakdown insurance*, the average claim was only 63.4% of the average premium ($940 against $1482); and<br>• *for tyre and rim insurance*, the average claim was only 80.4% of the average premium ($334 against $414).<br><br>Other examples included:<br>• *overlapping cover,* where some CCI policies bundle components of cover together, such as trauma and disability cover, in a way that appears to provide overlapping cover for certain claimable events, while each type of cover attracts a separate cost to the consumer; and<br>• *unnecessary cover*, such as mechanical breakdown insurance, which can be unnecessary as statutory consumer guarantees under the Australian Consumer Law require the dealer and manufacturer to meet the cost of repairs if the car is not of an acceptable quality. | Insurers must redesign their policies to ensure they provide cover in circumstances that can be reasonably expected to meet the needs of their customers.<br><br>Insurers must take immediate steps to stop the continued sale of policies where cover is unnecessary or overlaps with other cover.<br><br>This includes identifying classes of transactions where their products should not be sold (e.g. gap insurance where there is no gap) and preventing car dealers from selling products in those circumstances. |
| **Finding 5: Single premium policies increase the cost for consumers**<br><br>(See Section B, paragraphs 137–156) | The practice of having consumers pay for insurance upfront in a single premium can contribute to poor outcomes, including:<br>• *interest costs,* which the consumer will pay if they finance the premium through their car loan, reducing the value of the product;<br>• *reduced consumer awareness*, as the consumer pays for the policy in a lump sum at the start of the policy and may forget they have it; and<br>• *no refunds of unused premium*, which means a consumer may pay for insurance cover they do not receive as their insurance policy will terminate if they pay out their car loan early, further reducing the value of holding cover through these products. | Insurers should not sell single premium policies. Insurers who continue to do so will face continued focus from ASIC.<br><br>Single premiums lead to reduced claims and reduced consumer awareness and the risk of not getting a premium refund for paying out a car loan early.<br><br>Poor consumer outcomes produced by single premium policies outweigh any potential consumer convenience.<br><br>Monthly instalment premiums should be affordable and not 'loaded' to take account of increased claims due to increased consumer awareness. |

| Finding | Explanation | ASIC's response |
|---|---|---|
| **Finding 6: Sales processes inhibit good decision-making**<br><br>(See Section C) | The sales process adopted by insurers lacked adequate controls, was complex and inhibited good or informed decision-making:<br>• *GAP insurance* represented poor value to consumers, in that what they will receive back in a claim depends on the market value of the car reducing at a faster rate than the car loan so that a 'gap' exists and is payable in the event of a claim, which may not occur;<br>• *complex product choices* were offered to consumers (e.g. up to 10 products with multiple choices of cover available—the maximum from one insurer was 224 different product options and cover levels);<br>• *the full cost of the premium was frequently not disclosed to consumers* before the sale even though they were required to pay for the insurance upfront (some insurers gave a fortnightly or monthly figure); and<br>• *exclusions or eligibility criteria* were not discussed, with most sales scripts only presenting the benefits of the product (e.g. only two scripts addressed the need to alert consumers about meeting the eligibility criteria for unemployment insurance). | Insurers must redesign their sales practices taking into consideration:<br>• behavioural biases and the consequent poor consumer outcomes identified in this report and REP 470 and REP 471;<br>• failings identified in this report, including failure to provide adequate information about the price of products and the options within each product before the consumer makes a purchasing decision; and<br>• sales models that would better allow consumers to make informed choices (e.g. a deferred sales model).<br><br>Insurers must proactively audit and identify unfair sales practices, with appropriate consequences for misconduct including clawback of commissions and termination for repeated or serious failures. |

# A Who benefits from the sale of add-on insurance?

**Key points**

Add-on insurance products offer very limited benefits to consumers and many consumers are better off without these products. $1.6 billion was paid by consumers in premiums in the 2013–15 financial years and only $144 million paid out in claims—a claims ratio of just 9%.

Meanwhile, car dealers were paid commissions by insurers as high as 79% of the premium for selling add-on insurance, which can significantly increase the risk of misselling.

Across all add-on general insurance products sold during the 2015 financial year, car dealers earned over four times more in commissions than was paid to consumers in claims.

These outcomes are due, in part, to the sales environment for add-on insurance products, which limits the consumer's ability to adequately assess the value and benefit of these products, and incentivises car dealers to prioritise the sale of these products over consumer interests.

## The sales environment for add-on insurance

35 Given that add-on insurance products sold through car dealers represent such poor value to consumers, why do consumers buy these products?

36 Our findings in REP 470 indicated that many consumers who bought add-on insurance products through car dealers:

(a) had no awareness of add-ons, including their value, before entering the car yard;

(b) had already invested large amounts of time, energy and mental effort in buying the car and so, by the time they were offered the add-ons, found it hard to say no;

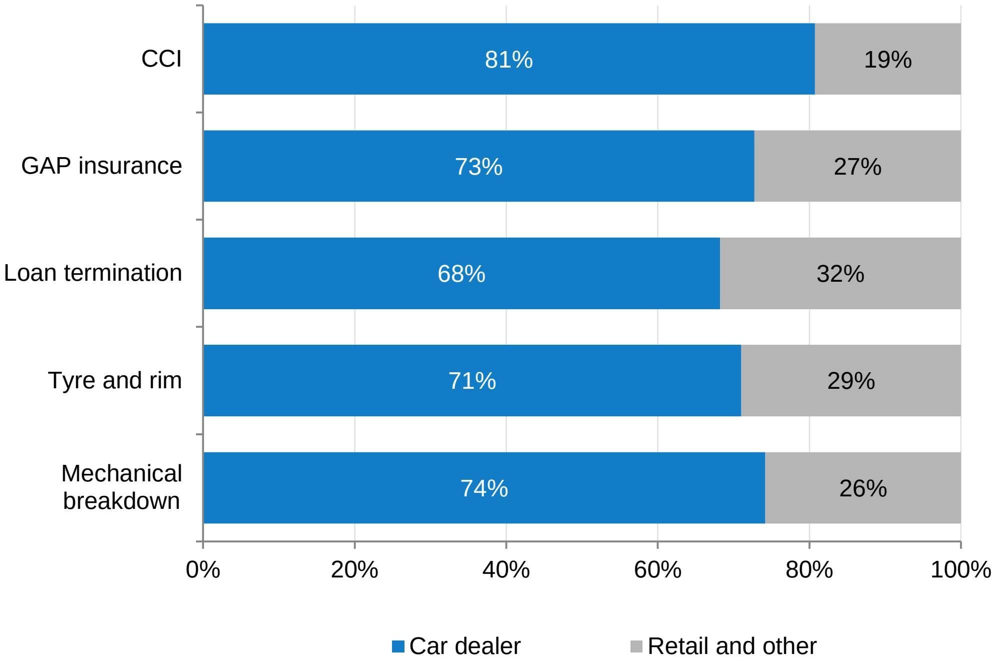
(c) said that they valued the insurance for providing peace of mind, although few could recall which products they had purchased, how much they cost and what they were actually covered for; and

(d) if they did remember what they had bought, in some cases regretted their decision.

37 These findings explain why consumers may not always make rational, well-informed choices when buying add-on insurance products through car dealers.

38 While our review focused on the sale of add-on insurance products through car dealers, we also obtained data where the insurer issued the same product through retail or other distribution channels: see Figure 1.

**Figure 1: Proportion of the products in this review sold through car dealers (by dollar value, FY2013–15)**




Note: ASIC is the source of all data in this report, unless otherwise specified. See Table 7 in Appendix 2: Accessible versions of figures for the data shown in this graph (accessible version).

39 The proportion of sales through the distribution channels varied for different insurers:

(a) three insurers distributed these products only through car dealers;

(b) one insurer consistently sold at least 99% through car dealers;

(c) one insurer consistently sold over 75% through car dealers; and

(d) two insurers' distribution varied across products with as little as 7% of sales through car dealers for one product and as high as 100% for another product.

40 Overall, the add-on insurance products we reviewed were primarily sold through car dealers. In this market, there is minimal competition on price as consumers are less likely to be familiar with these products.

41 Consumers may also feel pressured to buy these products due to tactics used by car dealers, which are further motivated by the high commissions paid. For a detailed discussion of sales practices, see Section C.

## Finding 1: Consumers receive low claim payouts relative to premiums

42 We analysed the value of premiums paid by consumers, compared to the value returned to consumers in claims (known as the 'claims ratio') and found that the amount paid to consumers in claims was only a small fraction of what consumers paid in premiums.

Note: The claims ratio used in this report is based on total premiums paid upfront by consumers for new policies compared to total claims paid out by insurers, during the 2013–15 financial years. For details on our methodology, see Appendix 1.

43 This means that, from a consumer's perspective, add-on insurance products provide very limited benefits and many consumers are better off without these products.

44 The claims ratio is an important indicator of the value consumers derive from an insurance product. The Financial Conduct Authority (FCA) in the United Kingdom has used claims ratios as a value measure for add-on insurance products as a simple and effective way to 'compare from the consumer perspective, what is paid in against what is paid out in claims'.

Note: See Market Study MS14/1, *General insurance add-ons: Final report—Confirmed findings of the market study*, FCA, July 2014.

45 Table 2 sets out the aggregate claims ratios for add-on insurance sold by the insurers over the 2013–15 financial years, based on the total amount received by consumers in claims relative to total premiums paid in the same period.

**Table 2: Add-on insurance claims ratios (FY2013–15)**

| Product | Claims ratio | Premiums ($) | Claims ($) |
|---|---|---|---|
| CCI | 5.0% | $506.8 million | $25.3 million |
| GAP insurance | 6.3% | $631.1 million | $39.9 million |
| Loan termination insurance | 4.4% | $98.1 million | $4.3 million |
| Tyre and rim insurance | 8.6% | $42.7 million | $3.7 million |
| Mechanical breakdown insurance | 22% | $321.4 million | $70.8 million |

Note: Some products were excluded as sales had only commenced after the 2013 financial year, which does not allow sufficient time to reflect claims for a multi-year product. Due to this, CCI data is based on 12 products across six insurers (two products excluded); GAP insurance data is based on nine products across six insurers (three products excluded); Loan termination insurance is based on two products across two insurers (one product excluded).

46 These claims ratios can be practically understood as the average cents returned for every dollar paid in premium. For example, five cents was paid in claims by the insurers for every dollar paid by consumers in CCI premiums.

47 For all add-on insurance products in the 2013–15 financial years, $144 million in claims was paid to consumers—just 9% of the $1.6 billion paid in premiums.

48 To help put this in context, a 9% claims ratio is substantially lower than other general insurance products: see Table 3.

**Table 3: Comparison of insurance claims to premiums**

| Type of insurance | Percentage of premium paid in claims |
|---|---|
| Car insurance | 85% |
| Home insurance | 55% |
| Travel insurance | 44% |

Source: APRA, *Quarterly general insurance performance statistics*, June 2016.

Note: The comparison of claims to premiums has been calculated by dividing the gross incurred claims with the gross written premiums for the 2013-2015 financial years.

49 We found that insurers had low claims ratios across the three years reviewed and across most add-on insurance products:

(a) *CCI*—Four of the 12 products offered by the insurers had claims ratios of less than five cents in the dollar; five of the 12 products had claims ratios of between five and ten cents in the dollar, across all three years.

(b) *GAP insurance*—Five insurers paid less than ten cents in the dollar across all three years.

(c) *Loan termination insurance*—One insurer paid less than two cents in the dollar across all three years.

(d) *Tyre and rim insurance*—Two insurers paid six cents in the dollar or less across all three years, for their product with a one-year term.

50 While mechanical breakdown insurance had a higher average claims ratio than the other products, this was not consistent across all insurers (one insurer paid less than five cents in the dollar across all three years). Two insurers offered mechanical breakdown insurance products with claims ratios between 20 and 75 cents in the dollar over the three years.

51 In addition, higher claims for these products do not necessarily reflect value for consumers, as the cover provided may duplicate or be reduced in value by the consumer's rights under Australian Consumer Law: see paragraphs 131–136.

52 Low claims ratios also indicate broader problems with these products and their distribution as discussed in Sections B–C of this report.

## Finding 2: Consumers receive much less in claims than dealers receive in commissions

53 We reviewed and compared the amount paid in commissions and other financial benefits to car dealers who sell add-on insurance products.

54 We collected data from insurers on:

(a) *commissions* (commission paid to car dealers for arranging an individual contract); and

(b) *volume bonuses* (payments made to car dealers calculated according to the volume of business placed or arranged with the insurer).

55 We found that in the 2015 financial year one insurer paid commissions as high as 79% of the premium to car dealers who sold add-on insurance. Five of the seven insurers also offered volume bonuses as an additional financial incentive to the car dealer when they reached a target level of sales for a particular product. These financial incentives result in a conflict of interest for car dealers, significantly increasing the risk of misselling.

56 In particular, volume bonuses encourage high volumes of sales of certain products, which could motivate car dealers to push add-on insurance products to consumers, even where they may not need or want cover. These bonuses were most commonly offered with GAP insurance, while other products were less likely to have a volume bonus attached to them.

57 The combined value of commissions and volume bonuses meant that, in the 2015 financial year, insurers were paying a high rate of total commissions:

(a) *CCI (sold to business use consumers)*— One insurer offered total commissions of between 51–60%, and three insurers offered total commissions of between 40–50% of the premium.

(b) *GAP insurance*—Three insurers offered total commissions of between 71–80%, and two insurers offered total commissions of between 60–70% of the premium.

(c) *Loan termination insurance (sold to business use consumers)*—Two insurers offered total commissions of between 40–50% of the premium.

(d) *Tyre and rim insurance*—Two insurers offered total commissions of between 60–70% of the premium.

(e) *Mechanical breakdown insurance*—One insurer offered total commissions of between 71–80%, and two insurers offered total commissions of between 60–70% of the premium.

Note: Commissions on policies sold to retail (personal-use) consumers relating to a credit contract regulated by the National Credit Act are capped at 20% of the premium: see s145 of the National Credit Code. Policies sold to business-use consumers are not regulated in this way. The maximum commission rates for CCI and loan termination insurance policies identified in this report are for unregulated policies only.

58 In comparison to these high commission rates, one insurer had a self-imposed cap on commissions of 20% of the premium. No other insurer had a consistent cap across their range of products, and the higher commissions offered by the other insurers are understood to be driven by reverse competition in this market: see paragraphs 63–78.

59 Table 4 sets out the average maximum commission offered by the insurers for each product as a percentage of the premium in the 2015 financial year.

**Table 4: Average maximum commissions paid to car dealers (FY15)**

| Product | Average maximum commission |
|---|---|
| CCI (business use) | 36% |
| GAP insurance | 55% |
| Loan termination insurance (business use) | 46% |
| Tyre and rim insurance | 51% |
| Mechanical breakdown insurance | 58% |

Note: Average maximum commission is an average of the maximum commission payable by each of the insurers on each product they offer. These averages are not weighted based on the proportion of insurance sold by each insurer.

60 For the two highest selling products (CCI and GAP insurance), the three insurers who offered higher than average maximum commissions sold the most policies. Across all add-on insurance products, these products made up 80% of all sales (by dollar value).

61 High commissions paid to car dealers combined with low claim payments for consumers means that car dealers receive a substantially higher financial benefit from the sale of these products than consumers. This reinforces the conflict of interest that high commissions create, and the potential for consumers to be subject to pressure-selling tactics.

62 Table 5 sets out the amount paid to consumers in claims, compared to the amount paid to car dealers in commissions for the 2013–15 financial years.

**Table 5: Commissions paid compared to claims paid (FY2013–15)**

| Product | Commissions paid | Claims paid | Commissions paid compared to claims paid |
|---|---|---|---|
| CCI | $97.2 million | $25.3 million | 3.8 times more |
| GAP insurance | $328.8 million | $39.9 million | 8.2 times more |
| Loan termination insurance | $30.4 million | $4.3 million | 7 times more |

| Product | Commissions paid | Claims paid | Commissions paid compared to claims paid |
|---|---|---|---|
| Tyre and rim insurance | $20.2 million | $3.7 million | 5.5 times more |
| Mechanical breakdown insurance | $125.6 million | $70.8 million | 1.8 times more |
| **Total** | **$602.2 million** | **$144 million** | **4.2 times more** |

Note: Some products were excluded as sales had only commenced after the 2013 financial year, which does not allow sufficient time to reflect claims for a multi-year product. Due to this, CCI data is based on 12 products across six insurers (two products excluded); GAP insurance data is based on nine products across six insurers (three products excluded); Loan termination insurance is based on two products across two insurers (one product excluded).

# B Poor value and design

**Key points**

We found that the poor value and design of add-on insurance products sold through car dealers resulted in poor consumer outcomes.

In particular, lack of price competition resulted in the following practices:

- *dual pricing:* four of the seven insurers reviewed charged higher premiums to business-use consumers, and higher commissions to car dealers, for the same insurance product sold to non-business consumers; and
- *discretionary pricing*: one insurer charged consumers different prices for the same product with the price varying between different car dealers (some consumers paid nearly 10 times more for the same product).

Other products were poorly designed, resulting in:

- *negative and low-value products*, where the average claim coud be less than or similar to the average premium paid;
- *restrictions in cover, additional 'extras' cover* and *overlapping cover*, where consumers may receive poor value for money; and
- *unnecessary cover*, for example, where a consumer already has the benefit of cover under the Australian Consumer Law.

We also found that *single premium policies*, where the consumer pays the premium through the car loan, increase the cost to the consumer while reducing price transparency and the likelihood that they will make a claim.

## Finding 3: Lack of price competition results in poor consumer outcomes

63 Our review identified a number of pricing practices that contribute to poor outcomes for consumers, which may only exist in the car dealer channel due to the inability of consumers to take steps to encourage competition.

64 In REP 471, we highlighted how competition in this market disadvantages consumers, increasing the price of add-on insurance sold through a car dealer.

65 This is due to 'reverse competition', where insurers compete on the price paid to car dealers in commissions to buy access to distribution channels, which increases the cost to consumers and decreases consumer-driven competition.

66 Transparent pricing is another key feature that enables consumer-driven price competition, but it is also absent in the car dealer distribution channel. This is because consumers cannot easily compare the cost of an add-on product sold by one car dealer to the same or a similar product sold by another dealer.

67 If a consumer could easily access information about the cost of a range of similar products, this would encourage insurers to compete on price.

68 However, selling insurance via the car dealer distribution channel reduces this transparency. This is because consumers are typically unaware of the cost of or value provided by add-on insurance products. This, coupled with the other substantial limitations in the sales process, reduces the ability of consumers to make an informed decision or take action to drive prices down.

## Dual pricing

69 In REP 471, we highlighted a practice where life insurers were offering identical personal-use and business-use life insurance products to consumers. However, some insurers were paying higher commissions to car dealers for selling policies to business-use consumers and were consequently charging a higher cost to the consumer for the same product (dual pricing).

70 After the release of REP 471, all of the life insurers who had been engaging in dual pricing agreed to cease this practice and apply one rate of commission and one price to the product, regardless of whether the consumer was a personal or business buyer.

71 The practice of dual pricing was also identified in our review of insurers for this report, particularly for CCI and loan termination insurance products.

72 Four of the seven insurers charged higher premiums to business-use consumers, while also paying higher commissions to car dealers (an average of 36% for CCI and 46% for loan termination insurance, compared to 20% for personal-use products), even though the insurance product was exactly the same. We hold the same concerns about this practice as we did for life insurance.

73 Since we commenced this review, all four of the general insurers engaged in this practice have abandoned or agreed to shortly abandon this practice.

## Discretionary pricing

74 Our review uncovered a practice by one of the insurers where the price of the same add-on insurance product can vary dramatically depending on which car dealer is selling it. As part of ASIC’s ongoing surveillance work, we have also identified another insurer who engages in this practice.

75 These two insurers charged consumers different prices for the same product with the price varying between different car dealers. In one case, the consumer could be charged nearly 10 times more for the same product.

76 Under this practice, the insurer sets a minimum and maximum price that can be charged for a product and then allows the car dealer to decide how much to charge consumers for an identical product, with the ‘default’ price being the maximum amount.

77 Similarly to dual pricing, discretionary pricing creates unfair outcomes for consumers who cannot negotiate on price in a market that lacks transparency and therefore pricing competition. This is likely to result in more expensive policies for vulnerable or less sophisticated consumers.

78 We are calling for insurers to abandon this practice and move to pricing models that provide fair and transparent outcomes for consumers. Failure to do so will lead to further regulatory action by ASIC.

## Finding 4: Insurers sell products that are poorly designed

79 In our review, we found examples of add-on insurance products that were designed in a way that offered very little value to consumers. These included:

(a) negative and low-value policies;

(b) restrictions in cover;

(c) additional ‘extras’ cover;

(d) overlapping cover; and

(e) unnecessary cover.

80 ASIC will continue to review these types of issues in add-on products and take further regulatory action where necessary, which may include seeking refunds to consumers where misselling of policies is identified.

### Negative and low-value policies

81 Insurance is typically sold to consumers on the basis that, if the insured event occurs, the consumer could not afford to cover the cost of the event, or it would have a significant impact on their financial situation.

82 This concept was reflected in the consumer research analysed by ASIC in REP 470, where consumers stated that they valued the ‘peace of mind’ offered by the insurance policies they bought, even though they could not necessarily recall what the policies covered.

83 An insurance policy fails to provide value if the amount the consumer claims under the policy cannot, or is unlikely to, ever exceed the cost of the premium. Restrictive caps on total claim amounts mean that the insurance will not relieve their financial stress as expected if they need to make a claim.

84 In this situation, even for the small percentage of consumers who have a claim paid, add-on insurance products can provide poor outcomes.

### Low-value policies

85 Our review identified add-on insurance products offered by insurers where the average claim is less than or similar to the average premium paid. This means that on average, a consumer who made one claim on their policy would be in a better position financially if they had not purchased the product and used the savings to cover the loss.

86 If a consumer is likely to pay more, or marginally less, in premiums than they would ever be eligible to receive back in claims, they may have been misled as to the product's benefits: see s12DF of the *Australian Securities and Investments Act* (ASIC Act).

87 Table 6 shows the average total premium paid compared to the average claim amount in the 2013–15 financial years.

**Table 6: Average premium compared to average claim (FY2013–15)**

| Product | Average premium | Average claim | Value of claim compared to premium |
|---|---|---|---|
| CCI | $1,696 | $2,641 | 1.6 |
| GAP insurance | $1,145 | $5,378 | 4.7 |
| Loan termination insurance | $1,185 | $3,341 | 2.8 |
| Tyre and rim insurance | $414 | $334 | 0.8 |
| Mechanical breakdown insurance | $1,482 | $940 | 0.6 |

Note: Some products were excluded as sales had only commenced after the 2013 financial year, which does not allow sufficient time to reflect claims for a multi-year product. Due to this, CCI data is based on 12 products across six insurers (two products excluded); GAP insurance data is based on nine products across six insurers (three products excluded); Loan termination insurance is based on two products across two insurers (one product excluded).

88 For some add-on insurance products, such as tyre and rim insurance and mechanical breakdown insurance, even if a consumer does make a claim, they may not claim back as much as they paid for the policy.

89 The difference in value will be even greater if the consumer finances the premium through the car loan, as the consumer will pay interest charges on the premium. Financing the premium in this way is common in the car dealer distribution channel: see paragraphs 137–156.

90 As well as low average claims, the design of some policies means it is very unlikely that a series of events will occur which will result in the consumer claiming more than the cost of the premiums: see Example 1.

**Example 1: Low value**

One insurer sold a tyre and rim policy where, even if a consumer had to replace two tyres in one year as a result of punctures, and the insurer paid the maximum claim amount, the consumer would still have paid more for the insurance policy than they would have been paid in claims.

For the consumer to make a claim for more than they had paid for the policy, they would also have had to damage the wheel rims within the same year. The likelihood of this is further reduced by the fact that any tyre or rim damage that occurs as a result of an accident with another vehicle is not covered by this policy; the damage is only covered for incidents such as driving through a pot hole or hitting the road curb.

### Negative-value policies

91 Our review identified a range of products where the caps applied to the maximum payable under individual or multiple claims were extremely low compared to loss that a consumer would likely suffer if that event occurred.

92 We are concerned that pricing design for certain add-on insurance products, combined with low caps on claim amounts, could result in situations where consumers pay more in premiums than they can ever claim back.

93 For example, CCI that is sold with a car loan is typically priced based on a percentage of the loan amount and the cost varies based on the length of the loan. The consumer can be covered for different risks under the policy and each risk may be priced individually or bundled together in packages.

94 One such risk is involuntary unemployment, which covers the cost of a consumer’s loan repayments if they become involuntarily unemployed.

95 These policies will typically provide three months’ worth of loan repayments, limited to the lower of the consumer’s regular repayment amount, or a single claim cap in dollar terms. The policy will also have a maximum dollar cap which applies to multiple claims (i.e. two or more different occasions where the consumer becomes involuntarily unemployed).

96 Because the cost of these policies is based on the amount of the loan rather than the loan repayment amount, consumers could be charged a premium that is higher than the maximum amount payable under the policy in a claim: see Example 2.

**Example 2: Negative value**

A consumer purchased a policy with a total cap on claims of $6,000 if they became unemployed. The premium was $3,746 and the interest was $2,762, resulting in a total cost to the consumer of $6,408.

This means the consumer had paid $408 more for the policy, including interest, than they could ever claim back.

97 Due to the risks involved in pricing add-on insurance in this way, we would expect all insurers to have internal controls to ensure that negative-value policies cannot be sold.

98 We require insurers to review policies where the value offered to the consumer might be marginal, compared to the amount paid for the policy, as policies designed in this way offer little value to consumers when they are experiencing financial stress.

99 We expect insurers to immediately cease selling policies and to provide refunds to consumers who have been sold negative-value policies.

100 For low-value policies, we expect insurers to make significant improvements to the value offered to consumers or to cease selling these policies.

101 We have also identified cases of negative-value policies being sold through car dealers as part of our ongoing surveillance work. We will continue to review the extent of this problem with insurers and where necessary we will take further regulatory action.

## Restrictions in cover

102 As set out in Section A of this report, most add-on insurance products pay less than 10 cents in the dollar to the consumer in claims. We are concerned that such low claims ratios are in part due to the sale of policies by insurers to consumers where the limitations in cover are inconsistent with the consumer's reasonable expectations about when they would be able to claim and the amount payable in the event of a claim.

103 Examples of these limitations include:

(a) broad exclusions for pre-existing injuries or illnesses; and

(b) restrictions in cover under unemployment insurance policies.

### Broad exclusions for pre-existing conditions

104 Insurers commonly include clauses in their contracts that exclude cover where the consumer is unable to work as a result of a pre-existing condition. For example, some insurers exclude cover for any condition for which the consumer had previously had treatment at any time in the past, while others only exclude cover where the consumer had experienced the condition in the 12-month or 24-month period before taking out the policy.

105 The greater the period of time referred to in the contract, the more broadly the exclusion operates and the more limited the cover offered by the insurer.

106 These types of clauses are also likely to have a disproportionate impact on consumers employed in manual labour who become unable to work over time due to degenerative failings of their back or knees.

107 These types of physical ailments usually get worse gradually and a consumer is likely to have seen doctors for medical treatment in the years before finally becoming disabled and unable to work. For example, a significant number of Australians with serious back problems experience them while quite young: 10.1% of people who report back pain do so by the age of 34.

Note: See Australian Institute of Health and Welfare (AIHW) analysis of unpublished ABS Australian Health Survey, 2011–12 (National Health Survey Component).

108 Exclusions for pre-existing conditions in these circumstances are therefore likely to exclude cover for a probable or reasonably foreseeable risk.

109 If insurers do not cover particular key risks, they need to make this abundantly clear to consumers. Without this disclosure, products will be sold in a way that may not meet the consumer's expectations or may adversely affect consumers with chronic illnesses.

### Limitations under unemployment cover

110 A consumer would reasonably expect that unemployment cover would:

(a) meet their needs in the circumstances in which they can make a claim; and

(b) allow them to keep possession of the motor vehicle if they make a claim.

111 Our review found a number of restrictions in some unemployment cover (in both CCI and loan termination insurance policies) causing them to operate in a way that is inconsistent with those expectations.

112 The first situation arises where an insurer offers unemployment cover where it will only meet payments that fall due under the loan during a 90-day period.

Note: Some insurers will provide cover that pays for longer periods (e.g. six months).

113 Under s72 of the National Credit Code, lenders must have in place enhanced procedures to deal with requests for financial hardship, including where the hardship arises from unemployment.

114 Many lenders will now regularly provide consumers with a moratorium of 90 days if they are unemployed, and simply extend the contract by 90 days, with the consumer making an additional three payments at the end of the contract. Such arrangements give the consumer an outcome that delivers similar benefits to the unemployment cover offered by insurers.

115 For example:

(a) under an unemployment claim, the consumer does not need to make payments on their loan for 90 days (as the insurer meets this liability), but may need to seek a variation in repayments from the lender after this time if they are still unemployed; and

(b) under a financial hardship variation, the consumer can defer repayments on their loan for 90 days and the variation may need to continue after this time if they are still unemployed.

116 This analysis demonstrates that some unemployment cover:

(a) does not deliver significant benefits to the consumer above those available for free through a hardship variation; and

(b) is unlikely to result in the consumer keeping possession of the vehicle if their unemployment continues for a significant period beyond 90 days.

117 The second situation is where the consumer is self-employed. Some loan termination insurance policies only provide cover where either:

(a) the consumer is declared bankrupt; or

(b) the consumer's business stops operating as it cannot pay its debts.

118 The effect of these terms is that:

(a) the consumer can only make a claim for unemployment cover if they have substantial debts to third parties that they cannot pay; and

(b) even if the payments under the unemployment insurance cover are sufficient for the consumer to discharge the liability to the car lender, there is a significant risk that their other creditors may seek possession of the car to pay those debts.

119 In ASIC's view, cover that only makes a payment when a self-employed person is declared bankrupt does not meet the needs of the consumer; in this case, cover that reduces the risk of bankruptcy would be more beneficial.

### Additional 'extras' cover

120 We reviewed add-on insurance products that contained additional 'extras' (claimable events) that appeared to offer very little value to consumers.

121 For example, one mechanical breakdown insurance product we reviewed provided additional cover for identity theft if a consumer's personal details were stolen and used to obtain funds (e.g. a stolen credit card). This cover was capped to a maximum benefit of $1,000 and limited to a 12-month period.

122 Events like credit card fraud are usually covered by credit card providers under the ePayments Code and as such consumers would be unlikely to need to claim under this cover.

Note: The ePayments Code is a code of practice that virtually all banks, building societies, credit unions and even some payment services have signed up to. It protects consumers when using electronic payments in certain defined circumstances, including credit card use over the phone or internet, which includes genuine cases of identity theft.

123 Another PDS for loan termination insurance provided additional cover for an international job transfer if a consumer was required to move overseas at the request of their employer for a period of at least 24 consecutive months. This benefit is unnecessary for many consumers who may be employed by a business that is only located in Australia and does not have any international branches or offices.

124 Add-on insurance products need to be 'consumer centric' in that the products should offer real and tangible benefits to consumers who purchase them. In this case, consumers would be better protected by an add-on insurance product that provided greater benefits or had lower prices, rather than protection against the risk of international job transfer.

## Overlapping cover

125 We reviewed a number of PDSs for CCI insurance which are designed in a way that creates a risk consumers may purchase two or more types of cover that protect against the same risk.

126 Some CCI policies bundle components of cover together, such as cover for trauma and disability, in a way that provides overlapping cover but without any consequent discount in price to the consumer.

127 A CCI policy may include:

(a) trauma cover, which is designed to pay out the balance of the car loan if the consumer suffers a specified trauma (e.g. cancer, coronary artery bypass surgery, heart attack or major stroke); and

(b) disability cover, which is designed to pay the car loan repayments for a period where the consumer is unable to engage in their usual profession, business or occupation.

128 In the event of a specified trauma (heart attack, cancer, coronary artery bypass surgery, or stroke), the consumer is likely to be unable to work in their usual occupation due to illness and would be eligible to claim under the disability policy. They would also be eligible to claim under the trauma policy, having suffered a 'defined event', but would only be allowed to claim for either disability or trauma.

129 Overlapping cover means the consumer is being overcharged. In some cases, the consumer will be paying for two types of cover when in practice they would only be able to claim under one of them.

130 We expect insurers to provide an appropriate discount in price to reflect the reduction in risk that occurs, particularly where the cover is bundled so that the consumer is not able to choose to buy only one type of cover.

## Unnecessary cover

131 Our review found circumstances where the need for mechanical breakdown insurance is questionable given that the cover offered can overlap with a warranty provided by the manufacturer of the car, or a consumer's right to quality under the Australian Consumer Law.

132 When a consumer buys a car, they have the right under s54 of the Australian Consumer Law to seek repairs for mechanical failures where the vehicle is not of an acceptable quality. This means that the consumer can seek compensation for the cost of repairs incurred if the vehicle fails to work for a reasonable period of time after the purchase.

Note: See *Advertising and selling guide: Consumer guarantees* on the Australian Competition and Consumer Commission (ACCC) website.

133 Further, car manufacturers usually offer warranties with the sale of new vehicles that can run for extended periods of time, typically from between three to seven years from the date of purchase, or for a specified number of kilometres. In some cases, the consumer can purchase an extension to the period of the warranty, so that it runs for a longer period.

134 Our review found that insurers generally sought to address this issue by providing that the period of cover:

(a) commences on the date on which any manufacturer's warranty expires; and

(b) ends either after a certain period of time has elapsed, or when the vehicle has travelled a certain distance.

135 This practice means that the cover can terminate at the same time as the manufacturer's warranty if the trigger for both is the distance travelled, rendering the need for insurance unnecessary. An example of this is where:

(a) the manufacturer's warranty ends when the vehicle has travelled 100,000 kilometres;

(b) the commencement date for the mechanical breakdown insurance is the date the manufacturer's warranty ends;

(c) the end date for the mechanical breakdown insurance is the date the vehicle has travelled 100,000 kilometres; and

(d) therefore, for a consumer who travels 100,000 kilometres in three years, the insurance will start and end at the same time.

136 This outcome reflects the failure by insurers to consider the needs of consumers when they are designing cover.

## Finding 5: Single premium policies increase the cost for consumers

137 Most add-on insurance products sold through car dealers are sold as 'single premium' policies—that is, the entire cost of the add-on insurance policy is paid upfront by adding it to the consumer's car loan.

**Alternative regulatory model: Ban on single premiums**

Single premium policies attached to CCI were banned in the United Kingdom, effective October 2010, due to the poor consumer outcomes associated with this way of selling products.

Note: See Competition Commission (now located at National Archives UK), *Market investigation into payment protection insurance*, p. 316.

138 Two concerns raised in REP 471 about the use of single premiums are that:

(a) the consumer incurs interest charges that increase the cost of the insurance; and

(b) if a consumer pays out their car loan early, they will not receive a full refund of the unused portion of the premium.

139 The impact of interest on the cost of the policy also exacerbates some of our concerns about negative and low-value policies: see paragraphs 81–101.

140 Single premium policies have clear benefits for insurers and car dealers. For insurers, they provide certainty in receiving the entire premium paid up front. Higher premiums mean higher commissions paid to car dealers.

### Payment methods and consumer behaviour

141 In addition to our concerns in REP 471, we are concerned that single premium policies reduce transparency about the product being sold and the cost of it.

142 Feedback from industry indicates that when insurance policies are paid for in a transparent way with a monthly instalment premium appearing on the consumer's bank statement, the consumer is more likely to be aware that they hold a policy, and therefore more likely to make a claim under it.

143 As monthly instalments appear to act as a reminder to consumers about the insurance they hold, it is also reasonable to assume that monthly instalment premiums would encourage consumers to periodically consider whether they want or need an add-on insurance product after they have left the car dealer, and cancel the insurance if they do not need it.

144 ASIC has strong concerns that single premiums lead to reduced claims and reduced consumer awareness, and increase the risk the consumer will not receive a premium refund if they pay out their car loan early. We will conduct further work on single premium policies and target insurers who sell policies in this way, due to the poor consumer outcomes they create.

## Failure to ensure consumers receive refunds on early termination of add-on insurance policies

145 While single premiums can mean that the consumer does not receive a pro rata premium refund if they pay out their loan early as noted in REP 471, we are also concerned that consumers may not be receiving a refund of premiums if certain events occur that result in early termination of CCI and GAP policies.

146 When buying a car through a dealer, consumers are often sold more than one add-on insurance product. For example, we are aware that many consumers are offered both CCI and GAP insurance policies. However, consumers with a GAP policy must have comprehensive car insurance to claim on that policy. Similarly, consumers that have a CCI policy should also have an associated credit contract.

147 The way these different insurance policies and credit contracts interact can create unfair outcomes for consumers.

148 Based on our review, we are concerned that insurers do not have adequate procedures, systems or controls in place to identify situations where consumers are entitled to a refund of premiums because of the following interactions:

(a) the associated credit contract, such as a car loan, had terminated or was paid out early so that the CCI or GAP insurance is no longer required;

(b) the comprehensive car insurance had ended or was cancelled without a replacement so that the GAP insurance (which requires a current comprehensive policy) may now be void; and

(c) the CCI policy pays out the car loan due to a trauma or death benefit claim so that the GAP insurance is no longer required.

149 Our review found that all insurers place the onus on consumers or lenders (i.e. car loan providers) to notify them that the relevant contracts had been paid out or cancelled.

150 Our inquiries indicated that some lenders' procedures for advising insurers a credit contract has been paid out early are inconsistent. This means insurers may not be informed of all consumers who have had their loan paid out early and that some consumers may not receive a refund they are entitled to.

151 To date, only three insurers have implemented proactive steps to improve their systems and processes. These include:

(a) investing in systems development to identify cancellation reasons and automatically identify consumers with multiple policies held with the same insurer when cancellation requests are received;

(b) producing and reviewing regular reports of cancellations to identify other policies that may also need to be cancelled and confirming this with the relevant consumer;

(c) working closely with lenders to require regular reporting of cancelled credit contracts;

(d) improving information exchange systems between lenders and insurers;

(e) requiring staff to ask more questions and review other policies that may need to be terminated (with premium refunds) when lenders and consumers contact them to seek refunds or to cancel a policy;

(f) for death benefit claims, requiring staff to contact the deceased person's estate to determine whether there are other policies in their name that will also need to be cancelled with premium refunds; and

(g) updating systems to prevent the sale of policies with terms that exceed the consumer age limit where the insurer will no longer provide cover.

152 To date, two insurers have agreed to review their data to determine if there are consumers who may not have received a premium refund and if necessary, implement an appropriate remediation framework for any impacted consumers.

153 Other disclosure initiatives that insurers are exploring include:

(a) a message on cancellation notices for comprehensive insurance policies reminding consumers to review their need to hold GAP insurance; and

(b) a message on claim letters that will remind recipients of a trauma benefit that they should notify the insurer to cancel their GAP policy if they use the trauma benefit to pay down their loan.

154 There are inherent limitations with relying on disclosure measures as a way to deal with this issue, given what is known of consumer inertia and other consumer behaviours. Insurers must take their obligations in this area seriously and take proactive steps to deal with this issue.

155 We expect all insurers to undertake this important work to ensure that consumers receive refunds they are entitled to. We will be following up with each insurer to ensure that consumers receive the refunds they are entitled to.

156 Our work in this area is continuing. ASIC will continue to engage with insurers on this issue, and consider taking further regulatory action if significant improvements and refunds are not addressed.

# C Sales practices of concern

**Key points**

ASIC has serious concerns about the sales practices used by car dealers to sell add-on insurance products, given the conflicts of interest created by very high commissions.

All insurers sell add-on products under general advice or no advice distribution models, where sales staff can promote the product but cannot tell the consumer whether or not it is suitable or meets their needs.

The sales process used by insurers was complex, requiring the consumer to make multiple decisions on minimal information without the cost of the cover being clearly disclosed. For example, consumers were asked to make decisions about buying up to nine different products with up to 41 different combinations of cover available within those products.

No insurers provided the consumer with the total cost of the different combinations of cover available. All insurers asked consumers to choose cover without advising them of the total price of other options available.

All these factors are likely to be influenced by commissions paid by insurers, which create a conflict of interest and increase the risk of consumers paying for unsuitable products that do not meet their needs (e.g. because they do not meet the eligibility requirements to claim).

## Finding 6: Sales processes inhibit good decision-making

157 As part of our review, we conducted a survey to obtain information about the content of sales scripts provided to car dealers to assess the information given to consumers about add-on insurance products. Three out of the six insurers who completed the sales questionnaire provided sales scripts. We also analysed information about disclosure of price and exclusions.

158 We found that:

(a) add-on products are sold under general advice models or ‘no advice’ models, which means that consumers are provided with insufficient or inadequate information to inform their decisions or to engage with the complexities of these products;

(b) consumers could be offered complex product choices, of up to 41 different products, options, cover levels and combinations;

(c) most insurers only disclosed the total price of the product at a very late stage of the sales process, after consumers have been sold a specific product and decided on the option of cover within that product;

(d) most sales scripts only presented the benefits of the product, and did not discuss the limitations or exclusions, or only discussed the exclusions in a minimal way, without providing examples; and

(e) only one of the insurers' sales scripts required staff to ask specific questions relating to the consumer's eligibility for the product.

149 These findings help explain why consumers buy poor value products, as they indicate the process is designed to maximise sales by minimising content of information about negative features such as price or exclusions.

## Limitations of advice models

150 Our findings indicated that all insurers sold add-on insurance products predominantly through a general advice model as defined under s766B of the *Corporations Act 2001* (Corporations Act), although some insurers also used a no advice model where only factual information is provided to the consumer.

151 The use of these models means that intermediaries:

(a) are under no obligation to ensure the product is suitable or meets the consumer's needs; and

(b) receive commission payments that could create conflicts of interest.

152 A general advice model is likely to have adverse outcomes for consumers in the add-on insurance context as it allows car dealers to promote the sale of the products without considering whether the consumer needs cover, and then places the responsibility for poor purchasing decisions on the consumer. Consumers must review a large amount of information and documentation to assess which add-on insurance products are most suitable for them.

153 Based on our findings in REP 470, we consider that most consumers are unlikely to read these documents before being asked to make a purchasing decision by the car dealer, increasing the risk of poor purchasing decisions.

154 Our review found some examples of sales scripts that may lead the consumer to believe they are being provided with advice that is personal to them, or based on their needs, even though they received a general advice warning.

155 For example, one script stated: *'I've prepared five options for you. As you can see option one provides…'*. Even though a general advice warning was included in the script to be provided to consumers in that instance, such a warning may not diminish the effect of the language of the sales scripts. This creates a risk that a consumer might think that the options presented to them have been tailored to their needs when in fact they have not.

156 Given the complexity of the decision making process involved in buying add-on insurance, we are concerned that the use of general advice models or 'no advice' models means that consumers are provided with insufficient or

inadequate information to inform their decisions, or to engage with the complexities of these products.

157 Examples of the range of matters consumers need to consider include:

(a) *for GAP and loan termination insurance*—the difference between the loan balance and the value of the car for the purposes of cover, both when the contract is entered into and during the term of the policy;

(b) *for disability and life cover under CCI policies*—the nature and value of any overlapping cover the consumer may hold through other insurance policies, such as through their superannuation fund; and

(c) *for mechanical breakdown insurance*—the nature and value of any cover the consumer may hold through a manufacturer's warranty or due to their rights under Australian Consumer Law (and their impact based on the starting and end dates for the cover under the insurance policy).

158 In Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146), we set out the required training standards for those who sell financial products including insurance. Higher training standards apply to financial products classified as Tier 1.

159 Tier 2 training standards apply to products that:

(a) are relatively straightforward;

(b) do not have any investment component;

(c) are subject to standard terms and conditions except for previously disclosed variations; and

(d) are of limited life, often 12 months.

160 Add-on insurance products are currently classified as Tier 2 financial products. Our detailed review of add-on insurance products sold through car dealers suggests that the previous rationale for treating these products as appropriate for Tier 2 requirements may no longer be applicable, with a consequent need for those advising on these products to meet the Tier 1 training standard.

161 As part of our ongoing work, we are assessing whether there is a need for Tier 1 training standards to apply in this market.

## Complex sales processes

162 During our review of the sales process, it became apparent that consumers would find it very difficult to make informed decisions about what they were buying, whether that product would best suit their needs compared to other products, and the options available and what they will cost.

163 We found that most sales processes were structured in a way that prompted consumers to disengage with the sales process through decision fatigue,

information overload and complex product offerings and options constraining a consumer's ability to make an informed purchasing decision.

164 One consequence of this disengagement is that consumers may have a poor understanding of the circumstances in which they are entitled to lodge claims. For example, in REP 470, we found that some consumers agreed to buy add-on products even though they were unaware of the cover they had been sold. This is illustrated by two quotes from consumers in that report:

> Q: What is the consumer credit insurance [you bought]? A: I don't know… but I should because it's quite a sum [$5,222 for five years]. (REP 470, paragraph 70)
>
> When I walked out, at the time, [I did not understand the policy] very well at all and even to this day I didn't truly understand it. (REP 470, paragraph 70)

165 Consumers who are unaware of the cover offered are likely to either not lodge claims at all or only when prompted by a third party, such as a lender.

166 Our review for this report found anecdotal evidence that some consumers only make claims after they have approached the lender because they are experiencing financial difficulty. We will follow up on this issue as part of our further work and take regulatory action where necessary.

167 Example 3, based on ASIC's ongoing surveillance work, illustrates the difficulties consumers may experience when they are unaware they can lodge a claim under their CCI policy.

**Example 3: Lack of consumer awareness**

A consumer borrowed $39,788 to buy a vehicle. He was also sold a CCI policy. He broke his leg in August 2011, was hospitalised in December 2011, and was then unable to work because of complications.

He only lodged a claim in May 2014 as he did not remember taking out the policy. He had to borrow money from his parents to keep making his repayments under the loan.

### Timing of the offer

168 We asked insurers at what point in the sales process add-on insurance products are discussed with consumers. Most of the insurers reported that add-on insurance products were offered to consumers any time from when a consumer walks into a car dealer to after the delivery of the vehicle.

169 In practice, we are aware from consumer research conducted for REP 470 that add-on insurance products are generally discussed with a consumer after the consumer has selected the vehicle. In such circumstances, consumers are more likely to have an increased emotional investment in the purchase and be more inclined to purchase, or spend more on, an add-on insurance product than if it had been offered earlier in the sales process: see Table 2 in REP 470.

170 Many consumers interviewed as part of the research for REP 470 explicitly mentioned that by the time they were offered insurance they were expecting the experience to be over and wanted to leave:

> And then you're too tired. At the end of the process you're tired. You just want to get out of there, so you just agree. It could be that you have some kids screaming. I had my kids with me too. (REP 470, paragraph 22)

### Multiple products, levels of cover and options

171 We are concerned that consumers are very unlikely to make an informed decision in a market where they are presented with a multitude of complex product offerings each with different levels of cover and options attached.

172 Our review found that consumers were offered up to 41 different add-on insurance product options, levels and combinations of cover.

173 With such a large and complex product offering, it is not surprising that our review found that four out of the six insurers did not require all add-on insurance levels of cover and options to be discussed with consumers before asking consumers to decide on what product or products they wanted to buy. This means that the consumer is likely to select the options discussed as this is the easiest choice, even though these options may not be the best ones for them.

174 Further, as add-on insurance is generally discussed after the consumer has already made a number of decisions about the car and possibly the car loan, consumers are likely to experience decision fatigue, information overload and disengage with the sales process. This increases the risk of consumers making purchasing decisions that are not in their best interests.

### Delayed disclosure of cost of insurance

175 Our findings indicated that the cost of add-on insurance products is only disclosed to consumers at a later stage in the sales process after they have chosen which products and options they want to buy. This process removes the ability for a consumer to compare the cost of different products and levels of cover as they are only provided with this cost *after* they have made a choice.

176 We also found that the total cost is often not clearly disclosed as sales staff may only disclose the cost in smaller monthly or weekly amounts when canvassing options to the consumer; the actual *total* cost is generally only provided after consumers have committed to buying a particular option.

177 We found that:

(a) no insurers disclosed the premium of each option to the consumer as part of the sales process;

(b) only four insurers disclosed the cost of the option being considered by the consumer as a monthly or periodic figure before they had made a purchasing decision (and the other insurers did not disclose the cost in this way or the total cost of the premium); and

(c) consumers were therefore only provided with the dollar cost of the product being sold when they were applying for insurance.

178 Scripts provided by insurers to car dealers suggested that they promote the products based on the value they offer rather than price. In practice, that value is very low, given that across all add-on insurance products over the 2013–15 financial years, the claims ratio was as low as 9 cents in the dollar.

179 This has the following consequences:

(a) the sales process requires consumers to make purchasing decisions before they know the total premium, taking advantage of less assertive or financially literate consumes, who do not challenge this; and

(b) consumers cannot assess the relative merits of different options if they do not know the price of each option and are asked to make purchasing decisions without having access to total cost.

180 We are concerned that consumers are buying add-on insurance policies without being properly informed of their cost, and in some cases may be misled about the cost of the policy. Failure to disclose pricing information can be potentially misleading.

## Pressure tactics

181 Our review of sales scripts found that most insurers did not give the consumer any opportunity to refuse to buy any add-on products, or to opt out of the sales process before it started. This tactic makes it harder for the consumer as they then have to make multiple decisions to reject each option put to them individually, rather than making a single decision.

182 In general, sales scripts automatically instructed staff to discuss an array of add-on insurance products with the consumer without asking the consumer to state whether they would be interested in purchasing such products and so terminate this discussion at an early stage.

183 Based on our research for REP 470, some consumers found it increasingly difficult to repeatedly refuse offers of add-on products. The process created a sense that they 'should' agree to something to be reasonable. As they had declined the majority of the offers, agreeing to one was a relatively small commitment. One consumer stated:

> They also gave me nine different terrible options that I didn't want to take, like fabric protection. This one actually seemed like, if I had to take anything, this was the better option. 'I'll take the gunshot to the knee, thanks'. (REP 470, paragraph 86)

184 Our review also indicated that some car dealers are trained to use sales tactics designed to encourage the consumer to purchase the maximum number of products. Examples of these tactics included:

(a) prepared responses to avoid disclosing the price to consumers;

(b) ways of framing the discussion to enable all products to be discussed with the consumer; and

(c) specific tactics to use for different types of consumers.

185 We are concerned by the use of these tactics within general advice or no advice sales models which mean that the car dealer can sell the policy irrespective of whether or not it meets the consumer's needs. These tactics increase the risk of poor outcomes for consumers as they are designed to maximise sales, without any balancing advice or assistance to the consumer to assist them to select products that are suitable for them.

186 Our work in this area continues and where identified, we will hold insurers accountable for any unfair tactics that their authorised representatives engage in to sell add-on insurance policies.

## Disclosure documents provided at same time as purchasing decision

187 Presenting consumers with too many products, features and levels of cover to compare can lead to confusion and random choice. Research has found that there are limits to the amount of information consumers can process. It follows that for add-on products, consumers are likely to be making decisions with significant information gaps.

Note: See Australian Media and Communications Authority (ACMA), *Behavioural economics and customer complaints in communication markets*, report prepared by Dr Xavier Patrick, 2011.

188 We are concerned that the procedures implemented by insurers envisage that consumers will be given multiple documents including PDSs, Financial Service Guides (FSGs) and policy schedules for a large number of add-on insurance products without having the opportunity to adequately read them. For example, some sales scripts offered consumers between 4 and 10 products with an option to provide all PDSs and associated disclosure documents to the consumer by email.

189 This means that a significant number of consumers may only review the disclosure documents *after* making their purchasing decision and may not recall which PDS relates to a particular product discussed by the sales staff.

190 Even though most contracts contain a cooling-off period, it is important that consumers are given an adequate oppourtunity to review disclosure documents *before* making their purchasing decision.

**Alternative regulatory model: Deferred sales**

In the United Kingdom, a deferred sales mechanism has been introduced so that certain add-on insurance products cannot be sold at the point of sale. Rather, consumers are provided with the relevant disclosures at the point of sale and only contacted after they leave, to allow time for the consumer to consider whether they need the products being offered.

The objective of this deferred sales mechanism is to allow increased competition in the add-on insurance market, as it had previously been dominated by point-of-sale distributors, which reduced competition (and therefore increased the cost to consumers) while also influencing consumer choice in that consumers felt pressured to buy CCI on the spot.

Note: See Competition Commission (now located at National Archives UK), *Market investigation into payment protection insurance*, p. 9 <http://webarchive.nationalarchives.gov.uk/20101109091748/http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/542.pdf>

### Sales scripts fail to assist consumer decision-making

191 Our review of sales scripts (provided by three out of the six insurers) found that most insurers' scripts did not discuss product exclusions and/or eligibility criteria. In particular, we found that:

(a) only one insurer referred to exclusions for pre-existing illnesses or conditions in its scripts;

(b) only one insurer asked the consumer specific questions relating to the consumer's eligibility criteria for unemployment insurance; and

(c) no insurers discussed whether consumers buying mechanical breakdown insurance should consider the existence and scope of manufacturer's warranties or their rights under the Australian Consumer Law, and the consequent risk of an overlap in cover.

192 Insurers generally relied heavily on disclaimers that the full benefits and features of certain products were in the PDS. However, disclaimers are not adequate because consumers are unlikely to read the PDS before they are sold the policy.

193 We require insurers to review their sales processes to address both the behavioural biases that result in poor consumer decision-making and the failure to clearly disclose important information to consumers.

## Consequences of poor sales processes

194 Complexities and limitations in the sales process result in poor consumer outcomes. Two examples we found are the sale of:

(a) add-on insurance to consumers who were never eligible to claim; and

(b) GAP insurance where there was no 'gap'.

### Sales to consumers who are ineligible to claim

195 We are concerned that add-on insurance is, in some cases, being sold to consumers who are not eligible to claim under the policy. This issue could arise, for example, with unemployment insurance (where the consumer may not be employed on a basis that enables them to claim) or GAP insurance and tyre and rim insurance (where the type or use of the vehicle can mean the consumer is not covered in the event of a claim).

196 For unemployment cover under CCI policies, to be eligible to claim, the insurer usually requires the consumer to be in permanent employment, or to not be self-employed or employed on a seasonal, casual, temporary or non-renewable contract basis.

197 For example, apprentices are usually employed on a fixed term contract and as such they will not be covered if they become unemployed at the end of their apprenticeship, as policies usually exclude cover at the end of a fixed-term contract.

198 There is a risk that current sales practices are inadequate to prevent policies being sold to consumers who are not eligible to claim. Based on anecdotal evidence, we are aware that most insurers do not obtain information about a consumer’s employment status at the point of sale so that they can verify or confirm that they meet the eligibility requirements. However, car dealers who also arrange a consumer’s car loan should be aware, from the finance application, of the consumer’s employment status.

199 This means policies could be sold to consumers who are ineligible to claim because of their employment status when they buy the insurance policy: see Example 4. We have also seen examples of this occuring in our ongoing surveillance work.

**Example 4: Consumer ineligible to claim**

One consumer was a 19-year old working in a fish and chip shop. She had bought an 8-year old car that had travelled over 200,000 kilometres at a cost of nearly $14,000. She was sold unemployment cover at a cost of $1040. She was not eligible to claim under the policy for two reasons: she was employed on a casual and a part-time basis.

200 Our work in this area continues. Where we find evidence of policies sold to consumers who were ineligible to claim at the point of sale, we will take further regulatory action, including requiring insurers to provide refunds to consumers for missold policies.

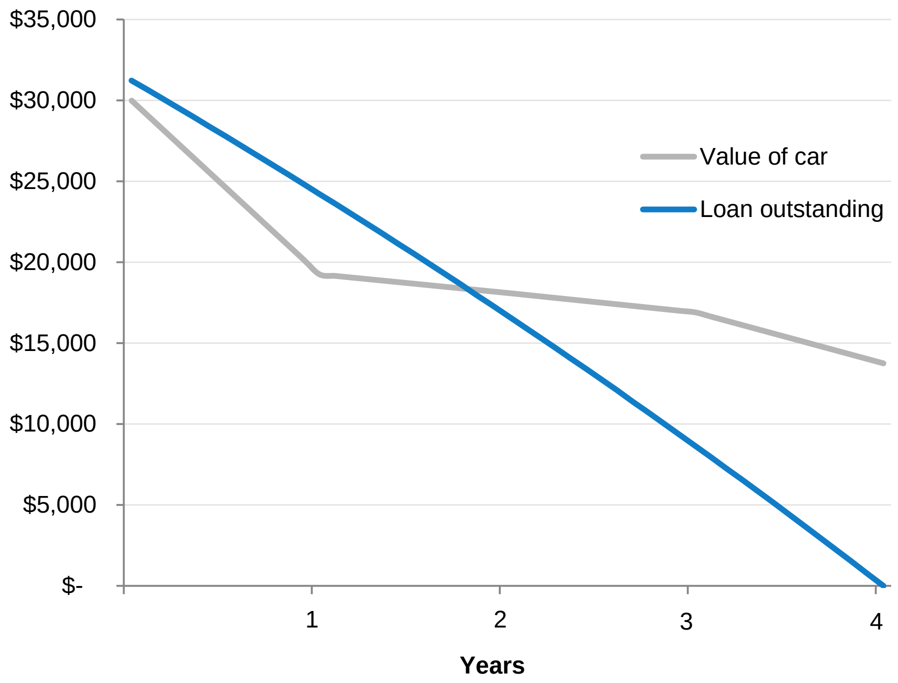
### Misleading sales of GAP insurance where there is no 'gap'

201 During our review, we saw examples of GAP insurance that was sold where there was no 'gap' at the time the consumer purchased the policy and it was unlikely that a 'gap' would ever exist, meaning that the consumer had paid for a policy they were unlikely to need.

202 For GAP insurance, the value to the consumer depends on the market value of the car reducing at a faster rate than the car loan, so that a 'gap' exists and is payable in the event of a claim.

203 This is illustrated in Figure 2, which demonstrates the 'gap' that would exist on a $29,990 car with a GAP insurance policy that has been financed.

**Figure 2: Difference between car value and outstanding loan value**




Note: See Appendix 2: Accessible versions of figures for a description of this graph (accessible version).The cost of the GAP insurance is based on the average cost charged by six insurers in our review who offered comparable GAP insurance with a maximum cap of $10,000. The loan outstanding is based on a new car costing $29,990, with a loan term of four years and an interest rate of 7%. The depreciation in the value of the car has been calculated using the trade in price guide for a Toyota Corolla Levin ZR Auto for the years 2011–15, with a new price of $29,990: see Automotive Data Services Pty Ltd (RedBook), Research & Value: Cars.

204 At a minimum, the sale of GAP insurance where there is no 'gap' is a failure in the insurers' sales processes and indicates that insurers do not have adequate controls in place to ensure that consumers are not sold unsuitable products.

205 The sale of GAP insurance where there is no 'gap' is also potentially misleading and deceptive. A reasonable consumer would not buy a policy if they knew they could never receive the promoted benefit (as there is no gap to make a claim).

206 We identified three situations where the design of GAP policies means that no benefit is payable to consumers who purchased policies they did not need:

(a) *No 'gap'* issue—If the vehicle is a total loss, the comprehensive insurer will pay an amount equal to or more than the balance under the loan.

(b) *Replacement vehicle issue*—If the comprehensive insurer provides the consumer with a replacement vehicle in the event of a total loss, the insurer will not pay anything to the credit provider. This is typically the case when a car is less than 12–24 months old at the time of total loss.

(c) *Agreed value issue*—If the consumer holds an 'agreed value' policy, in the event of a total loss, the insurer will pay an agreed amount which is usually more than the market value of the car and therefore more likely to be a larger sum than the balance under the loan.

207 The *no 'gap' issue* can arise when a consumer pays a significant deposit so that at all times the balance of the loan is less than the amount payable in settlement of a claim under the comprehensive insurance policy less the amount charged for the GAP premium: see Example 5.

**Example 5: No 'gap'**

A consumer bought a vehicle for $22,890. He traded in a vehicle with a value of $12,890, leaving a balance of $10,000 payable for the vehicle. He was sold a GAP insurance policy with a premium of $1,699, even though the loan was less than 50% of the purchase price of the vehicle.

This means that the car would have to depreciate by over 50% immediately following purchase in order for its market value to be less than the loan balance, or for there to be a gap at the point of sale.

208 The *replacement vehicle issue* arises because the GAP insurance policies we reviewed provide that a payment will only be made where the comprehensive insurer has first made a payment to the lender. If the comprehensive insurer meets the consumer's claim by providing them with a replacement vehicle, the insurer does not need to make any payment to the lender.

209 Depending on the wording of the specific GAP policy, the consumer has three choices:

(a) the GAP policy can cover the new vehicle, with the policy continuing under the same terms and conditions;

(b) some policies provide for a lump sum payment where there is no 'gap', which the consumer could claim where this option is available; or

(c) the customer could cancel the policy and have the premium rebated.

210 None of these options is likely to result in the insurer paying as much as if they had to pay an amount towards the loan if the vehicle was a total loss. The effect is therefore to significantly reduce or minimise the cover offered.

211 The *agreed value issue* arises because the ‘agreed value’ is an amount specified by the consumer that the insurer agrees to insure the vehicle for (usually the amount it would cost to replace the car). The agreed value is listed on the policy schedule, remaining constant for the period of insurance.

212 In some cases, the agreed value will be higher than the balance of the car loan on the day of purchase, so that there is no ‘gap’ either at the point of sale or at any other time during the term of the policy.

## Risk of unfair sales in the car dealer distribution channel

213 Features of this distribution channel, including the number of car dealers and their geographic dispersion, increase the risk that insurers will be unable to adequately monitor the conduct of car dealers at the point of sale. Lack of adequate supervision and high commissions create an additional risk for consumers—that the car dealer will use unfair tactics to secure the sale.

214 ASIC has previously taken action in relation to unfair sales, including where:

(a) add-on products were sold without the consumer’s consent; and

(b) sales were made to consumers with minimal or poor English, where it is unlikely the policy could have been clearly explained to them before sale.

Note: See, for example, Media Release (15-312MR) *Esanda compensates consumers for conduct by finance broker* (27 October 2015) and Media Release (16-132MR) *ASIC bans a fifth broker from Get Approved Finance* (9 May 2016).

215 We note that the Consumer Action Law Centre (CALC) is running a campaign called ‘Demand a refund’, which encourages consumers who have been sold insurance and warranties to complain and get their money back, including where they were unaware of the purchase or where they were led to believe the insurance was mandatory. As a result of this campaign, consumers have claimed over $200,000 in refunds.

216 The sale of add-on products without the consumer’s informed consent can have a series of adverse financial outcomes:

(a) the consumer will bear the cost of the premium for these products and the interest that applies if it is financed under the loan contract;

(b) the risk of default under the loan contract as a result of a higher loan amount to cover the add-on insurance products;

(c) the risk of default may be greater if the car dealer has misrepresented the consumer’s financial capacity to the lender to increase the amount that the consumer can borrow, and therefore increase their commission revenue from the sale of additional add-on products;

Note: ASIC has previously taken action for poor lending practices, including arranging loans where the consumer had an insufficient surplus after expenses to meet the repayments: see Media Release (16-019MR) *BMW Finance pays $391,000 penalty for breaching responsible lending and repossession laws*.

(d) the insurer may reject claims (e.g. if the car dealer includes false information about the consumer's circumstances knowing that the application for cover would be rejected if the correct information was disclosed and they would lose commissions as a result); and

(e) the consumer may be unaware that they are entitled to claim a rebate if eligible to do so (e.g. because they have paid out the loan contract early).

217 Currently, insurers generally seek to verify that the consumer consented to the sale of the add-on products by requiring them to sign documents confirming that this was the case. Some insurers also seek to ensure that the consumer is *eligible* to claim under a CCI policy by asking them to sign a declaration or statement confirming that they meet the eligibility criteria.

218 However, our ongoing surveillance work has identified transactions where the car dealer arranged for the consumer to sign a statement that they met the eligibility criteria when this was not true, even though the car dealer knew the statement was false (e.g. because they had seen payslips disclosing that the consumer was employed on a casual basis).

219 These outcomes illustrate the risk for insurers where they rely on paper-based consents to confirm the consumer has agreed to the sale of add-on products or confirmed their eligibility to claim under the policy.

220 In ASIC's view, paper-based consents are not a satisfactory control for managing the risks of this distribution channel.

221 Given the extent of the potential harm to consumers, insurers need to improve both their supervision of car dealers at the point of sale and the accountability for unfair sales (including by clawing back commissions and suspending or cancelling their authorisations to act on behalf of the insurer).

# Appendix 1: Methodology

## Quantitative research

### Data request

222 We issued a data request to the insurers for information about their add-on insurance products during the 2013–15 financial years. This data included:

(a) distribution channels, advice models and authorised representatives;

(b) number and dollar value of policies sold;

(c) criteria that disqualifies a consumer from purchasing a product;

(d) number and dollar value of claims paid;

(e) commission rates and dollar value of commissions paid;

(f) details of bonuses and incentives other than commissions; and

(g) pricing.

223 We identified a wide range of add-on insurance products offered through car dealers. However, our report focuses on five key product types commonly offered by multiple insurers:

(a) CCI was offered by all seven insurers;

(b) GAP insurance was offered by all seven insurers;

(c) loan termination insurance was offered by Eric and Swann;

(d) tyre and rim insurance was offered by Allianz, Eric, Swann and NM; and

(e) mechanical breakdown insurance was offered by Allianz, Aioi, Eric and Swann.

224 In addition to the five products that we analysed and included in this report, insurers provided data on comprehensive insurance. However, we excluded this product from our report as it did not raise the same concerns about value for consumers. Because comprehensive insurance is a product which consumers are more likely to seek out, insurers offered more competitive pricing for these products and claims outcomes for consumers were better.

225 Throughout this report, data is based on aggregate or average amounts across all of the insurers, unless otherwise specified. Where all insurers' data has not been used, this is because the products are incomparable, the data was unavailable, or the product was not offered by all insurers.

226 The claims ratio used in this report is based on total premiums paid upfront by consumers compared to total claims paid out by insurers during the 2013–15 financial years. We used this methodology as we believe it reflects value from a consumer perspective. It is a calculation that can be easily understood and does not rely on future estimates or adjustments.

227 Some insurers raised concerns about the methodology of this claims ratio. For example, this methodology does not adjust for premiums yet to be earned on multi-year policies, which would increase the claims ratio.

228 However, we also note that the claims ratio captures claims paid on all existing policies during the 2013–15 financial years, while only capturing premiums for new business. An adjustment to account for claims only for new business would subsequently decrease the claims ratio.

229 While we acknowledge industry’s view, we do not expect that these adjustments would result in a material change or reduce our concerns about the systemic issues identified in the pricing, design and sale of add-on insurance.

## Qualitative research

### Sales questionnaire

230 The sales questionnaire that was issued to the insurers captured information about the distribution of add-on insurance through car dealers, including:

(a) when and how add-on insurance is offered to consumers;

(b) when consumers are required to make a purchasing decision;

(c) how many different levels or types of cover are offered to consumers;

(d) what information is provided to the customer verbally (e.g. in sales scripts); and

(e) what documents are provided to consumers before they make a purchasing decision, including when they are provided with the written cost of the product.

231 We also asked insurers to provide copies of relevant documents including sales process maps, sales scripts used by the car dealer, and any documents given to consumers during the sales process.

### PDS review

232 We reviewed the PDS documents associated with the add-on insurance products offered by the insurers. The purpose of this review was to understand the design of the products (e.g. the inclusions, exclusions and caps on these products).

233 This review was also used to ensure we did not draw comparisons about policies where, even though they might have the same or a similar name, what the product offered was not comparable.

## Engagement with stakeholders

234 We engaged in discussions with each of the insurers involved in the review, relevant industry associations, and other regulatory bodies to understand different perspectives on our concerns and why certain features and practices have evolved in the sale of add-on insurance.

235 Where this report refers to information gained from these discussions, we have noted that the information is anecdotal.

## Surveillances

236 As part of our ongoing work, we have conducted individual surveillances of insurers, including insurers in this review and other industry participants. Practices observed through surveillances have been included in this report, and are identified as examples from ASIC's broader work in this area.

# Appendix 2: Accessible versions of figures

237 This appendix is for people with visual or other impairments. It provides accessible versions of the figures included in this report.

238 We show the underlying data for each figure, where appropriate, or we may include a text description of the figure's key messages.

**Table 7: Proportion of the products in this review sold through car dealers (by dollar value, FY2013–15)**

| Product | Proportion sold through car dealers | Proportion sold through retail and other distribution channels |
|---|---|---|
| CCI | 81% | 19% |
| GAP insurance | 73% | 27% |
| Loan termination insurance | 68% | 32% |
| Tyre and rim insurance | 71% | 29% |
| Mechanical breakdown insurance | 74% | 26% |

Note: This is the data contained in Figure 1.

239 In Figure 2, we show the value of a car reducing over four years compared to the value of a car loan reducing over the same period. The value of the car reduces at a faster rate than the car loan for the first year before levelling out. The value of the car loan reduces at a constant rate.

240 During the second year, the value of the car and the car loan intersect. This is the point when there is no longer a 'gap' between the value of the car and the value of the car loan that a GAP insurance policy if designed to protect.

# Key terms

| Term | Meaning in this document |
|---|---|
| 2013–15 financial years' | The three-year period comprised of the 2013–14, 2014–15 and 2015–6 financial years |
| ACCC | Australian Competition and Consumer Commission |
| ACMA | Australian Communications and Media Authority |
| add-on insurance/ products | General insurance policies that are 'added on' to the sale of a primary product, most commonly with the purchase of a motor vehicle |
| AIHW | Australian Institute of Health and Welfare |
| ASIC Act | *Australian Securities and Investments Commission Act 2001* |
| Australian Consumer Law | The national law for fair trading and consumer protection |
| authorised representative | Of a general insurer—a person authorised in accordance with s916A or 916B to provide financial services on behalf of the general insurer |
| car dealer | A motor vehicle dealer who sells directly to consumers, including the sale of both cars and motorcycles |
| car loan | The contract entered into by the consumer to finance the purchase of the vehicle |
| CCI | Consumer credit insurance (see paragraph 8 for an explanation of this insurance in the context of our review) |
| claims ratio | is based on total premiums paid upfront by consumers for new policies compared to total claims paid out by insurers, during the 2013–15 financial years. |
| Corporations Act | *Corporations Act 2001* |
| FCA | Financial Conduct Authority (UK) |
| guaranteed asset protection (GAP) insurance | General insurance that covers the difference between the amount a consumer owes on their car loan and any amount they receive under their comprehensive insurance policy, if the car is a total loss |
| Insurance Contracts Act | *Insurance Contracts Act 1984* |
| insurers | The seven insurers reviewed by ASIC in this review, unless the context specifies otherwise |

| Term | Meaning in this document |
|---|---|
| life insurance | A contract of insurance that generally provides for the payment of money on the death of a person and can include other events such as serious trauma which pays a lump sum for major illness |
| loan termination insurance | General insurance that covers the difference between what a consumer owes on their car loan and the market value of the car if they return it because they cannot make repayments due to illness or injury (sometimes referred to as 'walkaway insurance') |
| mechanical breakdown insurance | General insurance that typically covers the cost of repairing or replacing parts of the car due to mechanical failure after the manufacturer's or dealer's warranty has expired (often referred to as an 'extended warranty') |
| National Credit Act | *National Consumer Credit Protection Act 2009* |
| National Credit Code | National Credit Code at Sch 1 of the National Credit Act |
| REP 470 (for example) | An ASIC report (in this example numbered 470) |
| RG 146 (for example) | An ASIC regulatory guide (in this example numbered 146) |
| trauma insurance | Insurance that pays a lump sum if the insured person suffers a major illness |
| tyre and rim insurance | General insurance that covers the cost of repairing or replacing damaged tyres and rims due to blowouts, punctures or other road damage |

# Related information

### Headnotes

add-on insurance, business use, car dealers, CCI, claims ratio, commissions, consumer credit insurance, consumer outcomes, disability, GAP insurance, general insurance, insurers, intermediaries, life insurance, loan termination, mechanical breakdown, personal use, premium, trauma, tyre and rim, walkaway

### Legislation

ASIC Act, 12DF

Corporations Act, s766B, s916A–B

Insurance Contracts Act, s47, 57; Insurance Contracts Regulations 1985, reg 21

National Credit Act; National Credit Code, s145, 204

### Regulatory guides

RG 146 *Licensing: Training of financial product advisers*

### Reports

REP 470 *Buying add-on insurance in car yards: Why it can be hard to say no*

REP 471 *The sale of life insurance through car dealers: Taking consumers for a ride*

### Media and other releases

15-312MR *Esanda compensates consumers for conduct by finance broker*

16-019MR *BMW Finance pays $391,000 penalty for breaching responsible lending and repossession laws*

16-132MR *ASIC bans a fifth broker from Get Approved Finance*

### Other references

ACCC, *Advertising and selling guide: Consumer guarantees*

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AIHW, analysis of unpublished ABS Australian Health Survey, 2011–12 (National Health Survey Component)

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FCA, Market Study MS14/1, *General insurance add-ons: Final report—Confirmed findings of the market study*