ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 294

The sale of add-on insurance and warranties through caryard intermediaries

August 2017

About this paper

This paper seeks feedback from insurers, credit providers, car dealers, insurance and finance brokers, consumers, consumer representatives and other interested parties on options for reform to the sale of add-on insurance and warranties through caryard intermediaries.

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.

Document history

This paper was issued on 24 August 2017 and is based on the Corporations Act and the National Credit Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the impacts of our proposals and any alternative approaches. We ask you to comment on:

- the likely effect on competition; and
- other impacts, costs and benefits.

Note: We are not seeking responses on the likely financial impact at this stage as we propose to address this issue in detail in the second stage of the consultation process: see paragraphs 175–178.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear about any other issues you consider are important.

Your comments will help us develop our policy on this issue. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section F, 'Regulatory and financial impact'.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 23 October 2017 to:

add-on.consultation@asic.gov.au

What are the next steps?

Stage 1	24 August 2017	ASIC consultation paper released
Stage 2	23 October 2017	Closing date for submissions
Stage 3	December 2017	Consultation on implementation of reforms commences

A Executive summary

A market that is failing consumers

1 During 2016, ASIC released three reports into the design, distribution and sale of add-on insurance products sold through car dealerships:

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

(b) Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471); and

(c) Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492).

2 These reports found systemic problems in this distribution channel, resulting in a market that is failing consumers. In particular, we found that add-on insurance products were being 'sold to' rather than 'bought by' consumers, and that these products are both high cost (due to excessive commissions) and poor value measured in claims outcomes.

3 The findings in these reports demonstrated a clear need for broad changes in this sector. In a recent speech, ASIC Chairman Greg Medcraft said:

> Insurers have designed complex and extremely poor value products, and put their reputations at risk. And some of the most vulnerable consumers in society are paying the price.
>
> The general insurance industry has put forward a range of proposals to address ASIC's concerns. We are pleased to see industry engaging on these issues, but overall the proposals fall short of addressing the underlying issues in this space.

Note: See ASIC Chairman Greg Medcraft, 'Regulatory update to the general insurance industry', Insurance Council of Australia Annual Forum, Sydney, 17 February 2017.

4 Table 1 summarises the key findings from our three reports.

Note: For full details of our findings, see Section B of this paper.

Table 1: Summary of key findings from ASIC's reviews of add-on insurance

Report	Focus of review	Key findings
REP 470	This report analysed qualitative research on consumers' experiences of buying add-on insurance through car dealers.	• Most consumers were unaware of the cost of, or cover or value provided by, add-on insurance products. Most purchases were made solely on the basis of information provided in the car dealership. • Many consumers were actively sold and sometimes pressured to buy add-on insurance products both through explicit sales techniques and how the sales process was structured (e.g. several consumers reported that sales staff spent up to 40 minutes pre-filling applications forms for these products, even though the consumer had not requested this). • Many consumers had a very poor recollection of which policies they had purchased, how much each policy cost and what it covered.

Report	Focus of review	Key findings
REP 471	This report analysed quantitative data from five insurers selling life insurance under consumer credit insurance (CCI) policies.	• Insurers charged consumers substantially more for life insurance distributed through car dealers than for similar products (e.g. a low-risk consumer would be charged 18 times more than the cost of a similar level of cover under a term life insurance policy available online from the same insurer). • Most insurers charged business-use consumers more than personal-use consumers and paid higher commissions to intermediaries (up to 50% of the premium). • Over a five-year period, the gross amount paid in claims was $6 million, or only 6.6% of gross premiums of just over $90 million. • A significant number of sales were to young consumers who are unlikely to need life insurance: in the 2013–14 financial year 11% of life insurance policies sold through caryards were to consumers aged 21. • A significant number of sales were to consumers who did not want the product: 10% of consumers sold life insurance through caryards cancelled their policy during the cooling-off period.
REP 492	This report analysed quantitative data from insurers selling the five add-on insurance products.	• Consumers received low claim payouts relative to premiums: over a three-year period $144 million was paid in claims compared to $1.6 billion received in premiums (or less than 9 cents in the dollar). • Car dealers earned $602.2 million in commissions, or four times more than consumers received in claims. • These outcomes reflect the impact of reverse competition (where insurers do not need to compete on the price of their products, but rather on the level of commissions paid to intermediaries). • Many add-on products were poorly designed with consumers often paying for cover they did not need or would not be eligible to claim for. • Single premium policies increased the cost for consumers through interest charges under the related finance contract. • The sales process inhibited good decision-making, with consumers required to make multiple complex decisions with minimal information.

Proposals for reform

5 In this paper, we propose two options for reforms to help address the market failures we have identified and improve consumer outcomes. We seek stakeholder feedback on these options.

6 The reform proposals are:

(a) a deferred sales model which would insert a pause into the sales process for add-on insurance and warranties regulated by the *Corporations Act 2001* (Corporations Act) other than comprehensive or compulsory third party (CTP) insurance products (Proposal 1); and

Note: In this paper, we refer to these products generally as 'add-on products'.

(b) the introduction of more robust and targeted requirements for providers to meet when supervising and monitoring their authorised representatives (Proposal 2).

7 These proposals complement other work ASIC is undertaking, including:

(a) working with the insurance industry to drive voluntary changes to product design, distribution and sales practices; and

(b) commencing a data collection program with insurers to better assess and monitor the progress of change in this sector.

8 We are also negotiating directly with individual insurers on providing refunds to consumers for past unfair conduct. In August 2017 ASIC announced that QBE Insurance (Australia) Ltd will refund up to $15.9 million to more than 35,000 consumers who bought add-on insurance through car dealerships where the products provided little or no benefit: see paragraph 92.

9 We propose to implement any reforms developed through this consultation process by using ASIC's existing statutory powers to modify provisions of the Corporations Act. This means that any changes would be comprehensive for financial products regulated by the Act. However, our powers are subject to limitations that prevent us from making some types of modifications.

10 There are other reforms that could also be considered to address the poor consumer outcomes in this market, including:

(a) capping the amount of commissions paid to car dealers for the sale of add-on products;

(b) prohibiting the payment of premiums for add-on products as an upfront lump sum through the related finance contract; and

(c) prohibiting the sale of an add-on product where the consumer cannot reasonably be expected to benefit from it.

11 While such reforms would complement the proposals canvassed in this paper—and therefore secure more effective outcomes for consumers—our view at this time is that there would be an unacceptable risk in seeking to introduce them by relying on our modification powers given the limitations in their scope.

12 We also note that the Government is currently consulting on the form and content of new product intervention powers for ASIC.

B A market that is failing consumers

Key points

During 2016, ASIC released three reports into the design, distribution and sale of add-on insurance products through car dealerships.

These reports found systemic problems with the sale of add-on products through this distribution channel. In particular, we found that:

- add-on insurance products represent poor value for consumers;
- insurers pay more in commissions than claims;
- insurers do not need to compete on price or value; and
- consumers are at risk of adverse outcomes from unfair sales practices.

We consider that consumers are likely to experience similar risks and outcomes from the sale of other add-on products through this channel (e.g. warranties).

ASIC's reviews of add-on insurance

13 During 2016, ASIC set out a detailed analysis of the add-on insurance market in three reports which examined the experiences of consumers with these products, the sales processes and practices of intermediaries, and the outcomes for consumers.

14 In REP 470 we analysed qualitative research on consumers' experiences of buying add-on insurance through car dealers. We found that some consumers would buy these products for reasons other than because they needed them, and that they would agree to buy them even when they were unaware of basic matters, such as the cost or the risks covered by the product.

15 In REP 471 we reviewed five insurers selling life insurance through car dealers under consumer credit insurance (CCI) policies. We found that this cover was:

(a) not competitively priced;

(b) very expensive for some consumers (e.g. some small businesses were charged up to 80% more than consumers offered the same product); and

(c) sold to consumers who did not need it (e.g. young people with no dependents).

16 In REP 492 we analysed data from seven general insurers selling five different add-on insurance products. We identified systemic problems in the design and distribution of these products, including that less than nine cents in the dollar was returned to consumers in claims.

17 Our reviews focused on five add-on insurance products:

(a) *CCI*—This insures a borrower's capacity to make repayments under a car loan, including insurance against sickness, injury, disability, death or unemployment.

(b) *Loan termination insurance*—This product covers similar risks to CCI but provides less cover. The consumer needs to elect to return the vehicle for the primary cover to be triggered. The insurer will then pay the difference between the outstanding loan balance and the assessed value of the vehicle. It is sometimes called 'walkaway insurance'.

(c) *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.

(d) *Tyre and rim insurance*—This meets the expense of repairing or replacing damaged tyres and rims from blowouts, punctures or from road hazards.

(e) *Mechanical breakdown insurance*—This covers the cost of repairing or replacing parts of the car due to mechanical failure. Policies sold with a new car can have a delayed commencement date of several years, as cover only begins after the manufacturer's warranty has expired.

18 These add-on insurance products cover risks relating to:

(a) the car itself (i.e. tyre and rim and mechanical breakdown insurance); and

(b) the consumer's liability under a related finance contract (e.g. loan or lease) used to obtain the car (i.e. CCI, GAP and loan termination insurance).

The role of caryard intermediaries

19 Most sales of add-on insurance products (approximately 75%) are made by authorised representatives of the insurer located in car dealerships. Some car dealers, instead of selling these products directly, refer consumers to finance brokers who can arrange the car loan and also sell add-on products. These brokers may be located at or near the dealership, or may deal with the consumer by phone and email, without face-to-face contact.

20 We are also aware that these products (or similar products) are distributed through a number of other types of intermediaries (e.g. auction houses that sell cars and entities that offer them as part of salary packaging services).

Note: In this paper, the term 'caryard intermediaries' refers to a range of entities who distribute add-on products, where the sale of these products is associated with the acquisition of a car by the consumer.

21 Regardless of the distribution channel, there is an absence of a broad competitive market for these products in that generally they are:

(a) only offered by a small number of insurers;

(b) only available with the sale of a vehicle or a loan; and

(c) not available for direct sale from the insurer, but only through caryard intermediaries.

22 By comparison a competitive market for add-on insurance products would be characterised by features such as those associated with the sale of home insurance, including advertising and promotion through different mediums, distribution through a range of channels (including online), and innovation in product design to deliver benefits to consumers.

23 Add-on insurance products are typically sold using 'no advice' or 'general advice' models, which means that the seller is under no obligation to select or recommend a product based on the needs of the consumer, and can promote the sale of products on the basis of the commissions they may earn.

Note: By comparison, a person providing personal advice must consider one or more of the consumer's objectives, financial situation or needs, and have a reasonable basis for recommending the sale of an add-on insurance product.

24 The current business models have significant commercial advantages for product providers in that:

(a) the consumer bears the cost of a poor purchasing decision, as insurers place the onus on them to assess the product's suitability; and

(b) insurers have sought to avoid being accountable for designing and distributing products with manifestly unfair consumer outcomes (e.g. insurers have used 'general advice' sales to offer products with a negative value, where the maximum amount the consumer can claim is less than the premium, so the consumer always loses money when they buy the product).

25 The use of 'no advice' or 'general advice' models also results in significant levels of sales to consumers who do not want the product. This is shown by the propensity of consumers to cancel the sale during the cooling-off period. In REP 471, we found that 10% of purchasers cancelled life cover bought under CCI policies during 2010–14 in the cooling-off period.

26 The effect of these business models is that:

(a) caryard intermediaries cannot advise the consumer on what is the best product for them, or even what is a suitable product, and so do not add value to the quality of the consumer's purchasing decision;

(b) caryard intermediaries are currently incentivised to maximise sales through significant commissions; and

(c) for the percentage of purchasers who cancel the sale in the cooling-off period, these products create unnecessary expense or waste in the transaction (measured in the time spent on the sale and subsequent cancellation of the product).

27 The industry body for new car dealers, the Australian Automotive Dealer Association (AADA) has stated that new car dealerships have a significant dependency on the revenue from the sale of add-on insurance products. In a recent submission to the Australian Competition and Consumer Commission (ACCC) it stated:

> A modern well run dealership will generally achieve a net profit of around 2% to revenue—that is to say two dollars of profit for every one hundred dollars of sales revenue. Coles and Woolworths by comparison generally achieve 5–7%. Most dealers attempt to breakeven in the new and used car departments and rely on parts, service and the finance and insurance revenue streams to deliver an acceptable net return. Not all operators are equally successful however and a recent Deloitte survey showed that about 19% of all new car dealers failed to make a profit in 2015.
>
> Note: See AADA, *New car retailing industry market study*, Submission to the ACCC, 21 November 2016.

28 The AADA also stated that one of the factors placing car dealers under commercial pressure was the terms of their agreements with car manufacturers. In the same submission to the ACCC it also stated:

> Some agreements [between manufacturers and car dealers] contain clauses or requirements that could be considered restrictive depending on individual circumstances. Examples that will benefit from further examination include:…
>
> Clauses that allow manufacturers to issue sales targets linked to margin without proper justification of the target setting process. These target pressures can lead to undesirable practices including pre-reporting of vehicles not actually sold to consumers…
>
> Some agreements allow manufacturers to vary fundamental terms of the contract by way of general dealer bulletin. This includes critical terms such as margins, facility requirements and stock levels.

Key findings of our reviews

29 In ASIC's view, insurers in the add-on market have largely agreed with requests from car dealers to pay higher commissions, without properly understanding and addressing the causes and implications of that conduct.

30 Our analysis found key failings in the add-on insurance market:

(a) *Add-on insurance products represent poor value for consumers*—Less than nine cents in the dollar was returned to consumers in claims across the five products reviewed (and the return was as low as 4.4 cents for loan termination insurance).

(b) *Insurers pay more in commissions than claims*—Insurers plainly preferred the interests of caryard intermediaries to those of consumers, paying them over four times more in upfront commissions than consumers received in claims.

(c) *Consumer outcomes are considerably worse than in markets where there is competition*—The cost of products could be substantially higher compared to products sold in a competitive market, resulting in poorer consumer outcomes.

(d) *Consumers are at risk of unfair sales and adverse outcomes*—The payment of high commissions increased the risk of add-on insurance products being sold unfairly, and may also contribute to adverse outcomes in the related finance contract (including an increased risk of default).

Add-on insurance products represent poor value for consumers

31 Across the five add-on insurance products we reviewed in REP 492 for the 2013–15 financial years, the gross amount returned to consumers in claims was less than nine cents for every dollar of premium paid ($144 million in claims compared to $1.6 billion in premiums).

32 Table 2 sets out the aggregate claims ratios for each add-on insurance product 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 paid	Claims paid
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
Total	**8.9%**	**$1.6 billion**	**$144 million**

33 These claims ratios compare unfavourably to car and home insurance, which typically return more than 50 cents in the dollar (and can be even higher).

34 They are also significantly lower than historic loss ratios in the United States. A review found that loss ratios in 1997 across all states for the different components of CCI cover were:

(a) life cover—41.6%;

(b) disability cover—48.6%; and

(c) unemployment cover—12.6%.

35 Even though loss ratios in the United States are significantly higher than in Australia, they have also been the subject of criticism in that country. A report by the Consumers Union and the Center for Economic Justice stated:

> These loss ratios are unconscionably low—far below any reasonable measure of benefit in relation to the premium charged to consumers.

Note: See *Credit insurance: The $2 billion a year rip-off—Ineffective regulation fails to protect consumers*, March 1999, p. 2.

36 We consider the low Australian claims ratios reflect a high level of sales of add-on insurance products to consumers who do not need cover in that they do not make claims (as the risk of the insured event occurring is very low), or they only make claims for very small amounts, relative to the premiums charged.

37 It is clear that insurers do not need to compete on either price or value (measured through the amount paid in claims). The sales process means that insurers are under no external competitive pressure as they do not risk losing sales to other providers offering better value products.

38 It may be that insurers have been designing or pricing products without taking into account, in some cases, the low probability of an event occurring. For example, our review found, across a five-year period, there was only a one in 1,082 chance of an insured person aged 18–29 making a claim under the life cover of their CCI policy.

Insurers pay more in commissions than claims

39 We reviewed the amount of upfront commissions paid by insurers to caryard intermediaries for the sale of an individual contract. The results, for the 2013–15 financial years, are set out in Table 3.

Note: These figures do not take into account additional financial benefits paid by insurers to caryard intermediaries, such as ‘volume bonuses’ (i.e. payments made based on the volume of business placed or arranged with the insurer in a specified period).

Table 3: Commissions paid compared to claims paid (FY2013–15)

Product	Commissions paid	Claims paid	Difference
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
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 (37.6% of total premiums)**	**$144 million (8.9% of total premiums)**	**4.2 times more**

40 We also reviewed the amount paid in commissions as a percentage of the premium paid by the consumer. Table 4 sets out (in the 2015 financial year):

(a) the average maximum commission across all insurers for each product as a percentage of the premium; and

(b) the highest maximum commission offered by any insurer.

Note: These figures do not include CCI where the related credit contract is for personal use as s145 of the National Credit Code (Sch 1 of the *National Consumer Credit Protection Act 2009* (National Credit Act)) caps upfront commissions on these products at 20% of the premium.

Table 4: Commissions paid to car dealers as a percentage of the premium (FY15)

Product	Average maximum commission paid	Highest commission paid
CCI (business use)	36%	53%
GAP insurance	55%	73%
Loan termination insurance	46%	50%
Tyre and rim insurance	51%	65%
Mechanical breakdown insurance	58%	79%

41 The level of commissions earned by caryard intermediaries in an individual transaction can be significant, as illustrated by the following examples.

Case study 1: Commissions from the sale of multiple add-on products

Example 1

A caryard intermediary arranged a credit contract for a consumer for the purchase of a motor vehicle.

The loan contract financed the sale of three add-on products:

- a CCI policy with a premium of $2,150, and a commission of $825;
- a mechanical breakdown insurance policy with a premium of $1,495, and a commission of $495; and
- a GAP policy with a premium of $1,795, and a commission of $910.

The consumer paid a total of $5,540 in premiums. The caryard intermediary earned $2,230 in upfront commissions (or 40% of the cost of the add-on products).

Case study 1 (cont.)

Example 2

A caryard intermediary arranged a credit contract for a consumer for the purchase of a motor vehicle.

The loan contract financed the sale of three add-on products:

- a CCI policy with a premium of $3,787, and a commission of $713;
- a GAP policy with a premium of $2,515, and a commission of $950; and
- a tyre and rim policy with a premium of $679 and a commission of $195.

The consumer paid a total of $6,982 in premiums. The caryard intermediary earned $1,858 in upfront commissions (or 26% of the cost of the add-on products).

42 We consider that the dollar amount earned by caryard intermediaries in commissions is excessive by comparison with other professionals who provide financial advice:

(a) Caryard intermediaries typically operate under a general advice model, which means they do not exercise any skill or judgement in relation to product selection and do not add value to the transaction by helping the consumer choose a product that meets their needs.

(b) The amount earned may be similar to or higher than the fees charged by financial planners for providing advice that is more complex and sophisticated and that considers the needs of the consumers. As a guide, consumers can expect to pay between $200 and $700 for simple advice from a financial planner, and between $2,000 and $4,000 for more complex advice.

43 The findings in Table 3 show that for the 2013–15 financial years caryard intermediaries earned four times more in upfront commissions alone from the sale of these policies than consumers received in claims.

44 The total amount received by caryard intermediaries was even higher, given that the figures in Table 3 do not include additional financial benefits paid by insurers, including volume bonuses.

45 These outcomes demonstrate that insurers have been prepared to pass on the cost of high commissions to consumers through higher prices and poor claims outcomes, rather than absorbing them internally or refusing to pay inflated commissions to caryard intermediaries.

46 The fact that insurers paid commissions at such high levels:

(a) demonstrates the negotiating power of caryard intermediaries; and

(b) creates significant financial incentives for caryard intermediaries to maximise sales (including through unfair tactics where the insurer has failed to take reasonable steps to prevent this type of conduct).

There is limited competition on price

47 The findings in Table 2–Table 4 demonstrate that the market for add-on insurance products is not one where insurers compete with each other on price or value to the benefit of the consumer. Instead, insurers compete with each other to pay higher commissions to caryard intermediaries to buy access to their distribution network. This outcome is called 'reverse competition' as it is competition that increases the cost to the consumer.

Note: A recent report by the Senate Economics Reference Committee noted that healthy competition is integral to insurance affordability and accessibility. It also concluded that a lack of competition in insurance markets can result in negative consumer outcomes, such as premium increases, underinsurance, or coverage that is inappropriate to consumers' needs. See Commonwealth of Australia, *Australia's general insurance industry: Sapping consumers of the will to compare*, August 2017, paragraph 2.49.

Comparison with products in a competitive market

48 We assessed the extent of the adverse financial impact on consumers by measuring the outcomes for add-on insurance products against those for products where insurers are selling products in a competitive market.

49 We compared the cost of two similar life insurance products:

(a) life cover under a CCI product, based on a loan of $50,000 over four years; and

(b) term life insurance based on the cost of purchasing insurance of $50,000 for a four-year period.

50 The cost of term life insurance varies according to age, gender and smoking habits. We therefore used the cost of term life cover for:

(a) a low-risk insured person (a 20 year-old female non-smoker); and

(b) a medium-risk insured person (a 40 year-old male smoker).

51 CCI and term life insurance are similar products in that they:

(a) insure the same risk (of the insured person dying) with similar exclusions; and

(b) have similar, straightforward application processes with minimal eligibility requirements.

These similarities minimise any distortions in the price comparison based on the type of cover being offered.

52 Table 5 summarises the findings from REP 471 on the price difference between these two products in both dollar terms and as a multiple (i.e. the extent to which personal-use life insurance sold through a caryard is more expensive than term life insurance for a low-risk and medium-risk person).

Table 5: Price comparison of products sold in competitive and non-competitive markets (FY2013–15)

Pricing	Personal-use CCI	Term life: 20 year-old female non-smoker	Term life: 40 year-old male smoker
Cheapest	$1,120	$147 (7.6 times higher)	$537 (2.0 times higher)
Most expensive	$1,675	$382 (4.3 times higher)	$1,278 (1.3 times higher)
Average	$1,373	$243 (5.6 times higher)	$763 (1.7 times higher)

53 The findings in Table 5 show that the absence of any need to compete on the cost of CCI sold through caryard intermediaries means that:

(a) for a low-risk insured person, the cost of CCI is between 4.3 and 7.6 times more expensive than a similar product sold in a competitive market (e.g. term life insurance); and

(b) for a medium-risk insured person, the cost of CCI is between 1.3 and 2 times more expensive than a similar product sold in a competitive market.

Other price comparisons

54 We also compared the cost of two add-on products distributed through caryard intermediaries with an alternative product that was also not competing in a broad market. We found that the add-on products were still more expensive than the alternative product that was not subject to competitive pricing.

55 In the first scenario, we compared the cost of life cover under CCI according to whether it was distributed by caryard intermediaries or an uthorised deposit-taking institution (ADI).

56 Based on our analysis in REP 471, we reviewed the cost of cover on a loan of $50,000 with a four-year term and found that:

(a) consumers could pay the same insurer *up to four times more* for life cover distributed through caryard intermediaries compared to a similar product distributed through an ADI; and

(b) the smallest difference was where life cover distributed through caryard intermediaries was *1.3 times more expensive* than the similar product offered by the same insurer distributed through an ADI.

57 In the second scenario, we compared products that provide similar protection to the tyre cover under tyre and rim insurance. Some tyre manufacturers provide cover for a similar risk to tyre and rim insurance in that they cover damage to the tyre from road hazards, including accidental curb damage.

58 Our review found that these products were offered with the sale of tyres for free or for a nominal amount, such as $20. This is substantially lower than $414 (the average premium for tyre and rim insurance in our review).

Consumers are at risk of adverse outcomes from unfair sales

59 We found that the dependency by caryard intermediaries on the commissions earned from selling add-on insurance products:

(a) increases the risk of unfair sales, including sales without the informed consent of the consumer; and

(b) may contribute to adverse outcomes under the related finance contract.

Unfair sales

60 As discussed earlier, the level of financial incentives paid to caryard intermediaries creates a risk of unfair practices at the point of sale.

61 Insurers themselves have recognised this issue. In September 2016, 16 insurers applied to the ACCC to impose a voluntary cap of 20% on commissions paid to car dealers. In this application, insurers recognised the risks created by high commissions (emphasis added):

> The applicants consider that *high commissions paid in the motor vehicle dealership channel contribute significantly to the market failure identified by ASIC by providing incentives to engage in the inappropriate sales practices* identified in the recent ASIC reports into that channel, such as providing incomplete information or explanation of the products, pressuring or rushing customers, downplaying the cost of products, using pre-filled application forms, and in some cases misrepresenting the value or necessity of add-on insurance products.
>
> Note: See Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors, Submission to the ACCC, 2 February 2017.

62 There is a related risk that caryard intermediaries will engage in unfair conduct to ensure the loan is approved (because if the lender rejects the application for credit, the opportunity to sell add-on insurance products will be lost).

63 We have identified individual instances of such conduct, including:

(a) overstating the consumer’s income or understating their expenses;

(b) incorrectly stating the number of dependants the consumer has; and

(c) misrepresenting that the vehicle is covered by a comprehensive insurance policy (a requirement of the lender to protect their interest in this asset) when this is not the case.

64 This includes the systemic use of unfair practices to arrange both finance and the sale of add-on products even though the consumer was not eligible for finance: see Table 6.

65 ASIC has also taken action against a number of caryard intermediaries to ban or exclude them from the industry where they have engaged in unfair conduct in either arranging the credit contract or the sale of add-on products.

> Note: For a recent banning action, see Media Release 17-134MR ASIC acts against car yard loan-writer, 11 May 2017.

Table 6: ASIC action on unfair practices in financing of car loans

Issue	Situation	Reference
Systemic non-compliance with responsible lending obligations	ASIC took action against BMW Australia Finance Limited (BMW Finance) for a failure to comply with the responsible lending obligations when assessing the capacity of consumers to meet repayments under their car loan contracts. BMW Finance has agreed to provide a remediation program covering at least 15,000 customers who may have suffered hardship as a result of this failure.	Media release 16-417MR *ASIC action sees BMW Finance pay $77 million in Australia's largest consumer credit remediation program*, 6 December 2016
Arranging for a third party to be nominated as the borrower (rather than the person needing the motor vehicle)	ASIC negotiated compensation from Esanda (a division of Australia and New Zealand Banking Group Ltd) for more than 70 borrowers for car loans. The borrowers were friends or relatives of a consumer who was not eligible for credit as they did not meet Esanda's lending criteria. The friend or relative was misled about the effect of the documents they were signing (e.g. they were told they were a guarantor rather than the borrower). The conduct was engaged in by over 15 brokers employed by Jeremy (WA) Pty Ltd (trading as Get Approved Finance) during 2011–14.	Media release 15-312MR *Esanda compensates consumers for conduct by finance broker*, 27 October 2015
Misrepresenting the borrower's home address	Between June and August 2015, Ms Vu (a finance analyst at the Darwin branch of Alldrive Holdings Pty Ltd, trading as United Financial Services (WA)) submitted nine loan applications containing false information and documents in which she misled the lender, Esanda, as to the address of the borrowers. She represented to Esanda that the loan applicants lived in suburbs of the commercial centres of Darwin, Katherine or Alice Springs when in fact they lived in regional or remote locations. The false information resulted in loans being approved that the lender would otherwise have rejected or referred for further assessment. Ms Vu also misrepresented the consumer's address to the comprehensive insurer, creating a risk that the insurer could reject claims on the basis of false disclosure.	Media release 17-147MR *Former finance analyst convicted on charges relating to falsified car loan applications*, 22 May 2017

66 The example in Case study 2 illustrates the interaction between the incentives to sell multiple add-on products and the risk that matters relevant to the consumer's eligibility will be concealed from the lender.

Case study 2: Unfair sale of multiple add-on products

A caryard intermediary arranged a credit contract for a consumer for about $23,200 for the purchase of a motor vehicle. The loan contract financed the sale of three add-on products:

- a GAP policy with a premium of about $2,200;
- a loan termination policy with a premium of about $2,000; and
- a (non-insurance) warranty product with a premium of $3,000.

Case study 2 (cont.)

In fact, the consumer did not hold a driver's licence and was unable to drive. The vehicle was for her de facto, who was subjecting her to domestic violence. If the lender had become aware during the loan application process of suspected duress, intimidation or violence towards the consumer, they would not have approved or settled the application. If the loan had not proceeded, the caryard intermediary would have lost the opportunity to earn commissions on the add-on premiums of over $7,200 financed under the credit contract.

Impact of unfair sales on loan outcomes

67 The sale of add-on products financed through a loan increases the amount the consumer needs to borrow, which means they need to meet higher repayments or extend the loan term.

68 The following transaction reviewed by ASIC demonstrates how the sale of add-on products increased the term of a loan from four to five years:

(a) A consumer borrowed $23,221 over five years (including $4,212 for two add-on insurance products) at an interest rate of 16.99%. The total amount repayable was $34,580, or 260 weekly payments of $133.

(b) If the consumer had borrowed only $19,009 (without financing any add-on insurance products) at the same interest rate, the total amount repayable would be $28,496 (or $6,084 less), or 208 weekly payments of $137. This means the consumer could have reduced the loan term by one year for only a negligible higher weekly repayment.

Note: The figures above have been rounded up to the nearest dollar.

69 We reviewed data by one lender, covering a single financial year. We found that a significantly higher percentage of consumers who financed even a single add-on insurance product had longer loan terms. We found that:

(a) 56% of all loans where *no add-on insurance products* were financed had a term of four years or less;

(b) 29% of all loans where *a single add-on insurance product* was financed had a term of four years or less; and

(c) 22% of all loans where *two or more add-on insurance products* were financed had a term of four years or less.

70 Similarly, a consumer who purchased one or more add-on products was significantly more likely to have a loan term of six years or more:

(a) 11% of all loans where *no add-on insurance products* were financed had a term of six years or more;

(b) 30% of all loans where *a single add-on insurance product* was financed had a term of six years or more; and

(c) 33% of all loans where *two or more add-on insurance products* were financed had a term of six years or more.

71 Although we have not conducted a broad review across multiple lenders, ASIC's view is that the data raises an inference that the financing of add-on insurance products will contribute to increased loan terms.

72 We also examined the relationship between the number of add-on products financed and default rates. We were given information on default rates from one lender, based on loans which were 60 days in arrears. This data suggested that there was an increase in arrears where the dollar value of all add-on insurance premiums financed was over $3,000 (although this was not as strong an indicator of default risk as a number of other factors, including other liabilities or the borrower's debts or credit score).

73 We are concerned that the financing of add-on products can have indirect adverse consequences, including increasing the risk of default. It can also encourage systemic unfair practices to ensure the loan contract is approved (as discussed in paragraph 62).

Warranties covering the risk of mechanical failure

74 Caryard intermediaries also distribute warranties that are functionally similar to mechanical breakdown insurance products in that they cover the cost of repairing or replacing parts of the car due to mechanical failure.

75 Warranties are structured in two different ways:

(a) third-party warranties, where the benefits are provided through a contract between the consumer and a third party; and

(b) dealer warranties, where the warranty contract is between the dealer and the consumer.

Note: While vehicle manufacturers also provide warranties, these products are not relevant to this paper as they are included at no separate cost to the consumer with the purchase of a new vehicle.

76 The providers of these products have two distinct business models:

(a) Providers of third-party warranties will hold an Australian financial services (AFS) licence and offer the products in accordance with their obligations under the Corporations Act.

(b) Providers of dealer warranties usually consider that they are not required to comply with the licensing and conduct obligations of the Corporations Act. They will therefore also not be a member of an approved external dispute resolution (EDR) scheme, such as the Financial Ombudsman Service, which has the effect of limiting the ability of consumers to resolve disputes or have complaints paid without recourse to legal action.

Note: The Corporations Act has exemptions that mean some providers do not need to comply with its requirements. The application of these exemptions to dealer warranties has not been the subject of litigation.

77 Insurers offering mechanical breakdown insurance are subject to additional obligations under the *Insurance Contracts Act 1984* (Insurance Contracts Act), including restrictions in the way they must respond to claims. While warranties are functionally similar to mechanical breakdown insurance, they are typically structured to avoid being classified as insurance, so that the providers do not need to comply with the obligations under that Act.

Note: Some warranty contracts will include a term providing that the consumer does not have a contractual right to have a claim paid if it falls within the terms of cover, but only has the right to have their claim considered with the provider having a broad discretion whether or not to pay it. They are therefore commonly referred to 'discretionary risk' products. The effect of having a discretion to pay is that these products are not regarded as providing insurance (as insurance refers to products where the consumer has a contractual right to payment if they meet the conditions for a claim).

78 Table 7 sets out the differences in the regulatory framework for the various products covering repairs to the vehicle.

Table 7: Different regulatory regimes for insurance and non-insurance add-on products

Product	Hold an AFS licence	Member of an EDR scheme	Conduct and disclosure requirements	Compliance with the Insurance Contracts Act
Dealer warranty	No	No	No	No
Third-party warranty	Yes	Yes	Yes	No
Mechanical breakdown insurance	Yes	Yes	Yes	Yes

79 ASIC's view is that consumers are likely to experience similar systematic adverse outcomes from the sale of warranties as from add-on products offered by insurers as:

(a) caryard intermediaries are under the same commercial pressure to maximise revenue;

(b) the sales process is the same as for add-on insurance products, in that consumers are making decisions subject to the same behavioural biases (see Section C) and the same limitations (e.g. no visibility of the value of the product as measured through claims outcomes);

(c) there is a lack of competition as consumers cannot identify or buy better value products and so are unable to drive changes to price or cover; and

(d) in relation to dealer warranties—the risk of poor sales practices is increased as providers of those products do not comply with the licensing or conduct obligations of the Corporations Act, while consumers cannot take action against misconduct at the point of sale by complaining to an EDR scheme.

80 While we have not conducted a detailed review of the warranty add-on market, our surveillances have identified some systemic unfair practices, including:

(a) sales of warranties that provide unnecessary cover;

(b) the absence of any contractual right to a rebate if the warranty is cancelled before the end of its term; and

(c) unfair arrangements that increase the price of warranties for financially vulnerable consumers.

Unnecessary cover

81 Some caryard intermediaries have sold warranties on new cars that provide unnecessary cover as the term of the warranty starts on the date the car is purchased. This means that the cover under the warranty overlaps with that provided for free under the manufacturer’s warranty.

82 Similarly, we have found sales where the warranty was unnecessary because the cover overlapped with the statutory obligations on a car dealer under either the Australian Consumer Law or state-based legislation (e.g. the *Motor Dealers and Repairers Act 2013* in NSW).

83 Selling a warranty with the sale of a new car also provides a significant advantage to the provider of the warranty in that they will receive the premium three to seven years before there is any prospect of a claim and can use the funds during this period (e.g. to earn investment income).

No rebate for cancellation

84 Some warranty contracts do not give the consumer the contractual right to obtain a rebate if they cancel the policy. This means the consumer cannot get a rebate even where the warranty provider is no longer at risk, such as where the consumer has traded in the car. Similarly, if the consumer defaults or is having difficulties in meeting repayments under the related loan contract they cannot reduce their liability to the lender by cancelling the policy and having the rebate credited to the loan balance.

Unfair pricing arrangements

85 Some caryard intermediaries have entered into ‘maxi-pricing’ arrangements with providers, under which the price of the warranty is not fixed and the price can be set by the intermediary. Under this model, the cost can vary significantly—in some cases by thousands of dollars—with vulnerable consumers disproportionately more likely to pay higher premiums for the same cover as more financially literate consumers.

86 ASIC has conducted a detailed review of sales of warranty products by one provider across a period of approximately 18 months. We found that there

was a significant difference between the lowest and highest prices charged to consumers for the same product. Table 8 sets out the difference in these prices for the provider's six highest-selling products.

Table 8: Consumer harm caused by maxi-pricing arrangements in the sale of warranties

Pricing	Lowest sale price	Highest sale price	Difference
Product 1	$480	$2,235	$1,755
Product 2	$495	$2,100	$1,605
Product 3	$550	$2,995	$2,445
Product 4	$590	$3,500	$2,910
Product 5	$659	$2,625	$1,966
Product 6	$775	$2,495	$1,720

87 We also identified individual examples of sales of other products where some consumers were charged a price that was many thousands of dollars higher than that charged to other consumers:

(a) A warranty where the lowest sale price was $1,995 and the highest sale price was $8,500—an additional cost of $6,505 for the same product.

(b) A warranty where the lowest sale price was $2,000 and the highest sale price was $8,750—an additional cost of $6,750 for the same product.

(c) A warranty where the lowest sale price was $2,495 and the highest sale price was $8,316—an additional cost of $5,821 for the same product.

88 These findings suggest that:

(a) financially vulnerable consumers are being sold warranties at prices that are significantly inflated relative to the price charged to other consumers; and

(b) the sale of warranties by caryard intermediaries is characterised by similar consumer outcomes to those ASIC has found for add-on insurance products sold through the same distribution channel.

89 We also identified some providers who targeted low-income consumers, selling them high-cost products when they did not need cover, due to the consumer's lack of bargaining power or access to mainstream finance: see Case study 3.

Case study 3: Unfair sale of non-insurance warranty

A 27-year old on a low income could only afford to buy a car that was more than 11 years old, for $2,999. The consumer was sold a warranty at a cost of $3,650. The car dealer earned a commission of over $3,100 from the sale of the warranty—that is, more in commission than the value of the car.

C The consumer experience

Key points

In our reviews, we found widespread sales of add-on insurance products where the consumer did not need or understand the cover provided under the product sold to them.

Factors contributing to this problem included consumers' lack of familiarity with add-on products (given that they are only sold with the purchase or financing of a vehicle), complexity in product design (including the availability of multiple options), and the complexity and length of the sales process.

The lucrative nature of this market for insurers and car dealers can also result in the use of sophisticated sales techniques that take advantage of behavioural biases and may include manipulative or unfair sales tactics in a pressured sales environment.

Consumer behaviour and add-on products

Lack of understanding about the need for insurance

90 Our reviews identified that consumers were systematically sold add-on insurance products in a range of circumstances where, if they had understood the way in which the product operated, they would not have bought them.

91 These include the following situations:

(a) *Negative value insurance*—The cost of the product is more than the maximum amount that can be claimed, so that the consumer will lose money on the transaction, even if they make a claim and have it paid.

(b) *Consumer is ineligible to claim*—The consumer is not covered as, at the point of sale, they do not meet the eligibility criteria for a claim. The cover provided by the policy is therefore illusory and unnecessary.

(c) *Consumer is sold unnecessary insurance*—Under a GAP policy, the consumer typically cannot claim the primary benefit (an amount to discharge the debt to the lender) if the consumer's comprehensive insurer provides them with a replacement vehicle instead of making a cash payment. Many comprehensive insurance policies also provide replacement vehicle cover, making this cover redundant or illusory.

(d) *Consumer is upsold more expensive and unnecessary cover that over-insures them*—The consumer is sold a GAP policy under which they can never claim the maximum amount payable under the policy. For example, a consumer who only borrows $10,000 does not need a GAP policy under which the maximum payment to discharge the loan is $30,000, as there are no circumstances in which the consumer can claim more than $10,000.

(e) *Consumers are sold policies that do not deliver expected outcomes*—Some CCI policies only allow a self-employed person to make a claim if they are declared bankrupt, or their business stops operating as it cannot pay its debts. The policy therefore does not meet the needs of the insured person, which would presumably be to have cover that helps them to keep operating their business.

(f) *Consumers are sold policies with overlapping cover*—The cover offered under mechanical breakdown insurance policies invariably overlaps with the statutory consumer guarantees under the Australian Consumer Law that require the dealer and manufacturer to meet the cost of repairs if the car is not reasonably durable.

(g) *Consumers are sold policies where cover commences many years later*—Under mechanical breakdown insurance policies, cover often starts on the date on which any manufacturer's warranty expires. Some manufacturers provide warranties that can run for five or seven years. The consumer is therefore paying for cover they may never claim under (e.g. because kilometre limits for claiming under the policy have expired, or because they have traded in the vehicle).

92 ASIC has recently negotiated for one insurer to refund up to $15.9 million: see Case study 4.

Case study 4: ASIC secures refunds of $15.9 million from QBE

In August 2017 ASIC announced that QBE Insurance (Australia) Ltd (QBE) will refund up to $15.9 million to more than 35,000 consumers who bought add-on insurance through car dealerships where the products provided little or no benefit.

The refund program covers sales of QBE GAP insurance products where:

- there was unlikely to be a gap between the insured value of the car and the loan balance (e.g. because the consumer paid a large deposit);
- it duplicated existing cover held by the consumer, as they could obtain a replacement vehicle under their comprehensive insurance policy rather than receiving a lump sum (if the vehicle was a total loss); or
- it provided the consumer with a higher level of cover than they needed, in that they would never be able to claim the maximum cover available under the policy sold.

QBE also agreed to refund the cost of the life or trauma insurance element of CCI premiums where this product was sold to young people who had no dependents and were under 25 years of age.

See Media release 17-258MR *QBE refunds $15.9 million in add-on insurance premiums*, 2 August 2017.

93 In ASIC's view:

(a) if consumers had understood how these products worked they would have been less likely to buy them, placing competitive pressure on insurers to redesign them before ASIC's review of the market; and

(b) the failure by the industry to address these issues is further evidence of the inability of consumers to drive better outcomes in this market.

Lack of understanding about important features of add-on insurance products

94 We also found evidence in our reviews that consumers did not understand how their policies operated over the lifecycle of the product in that they:

(a) were confused about when they could claim and would delay in making claims; and

(b) did not understand when they no longer needed cover and failed to cancel their policies or claim rebates from insurers.

95 Our review found anecdotal evidence that some consumers were unaware that they were entitled to claim on their CCI policies if, for example, they were disabled or unemployed. These consumers would initially approach the lender (not the insurer) because they were experiencing financial difficulty in making their repayments. The consumer would only lodge a claim with the insurer when advised to do so by the lender. For example, we are aware of one instance where the consumer only lodged a claim more than two years after the insured event occurred: see REP 492, paragraph 167.

96 We found that consumers consistently failed to cancel their policies when they no longer needed cover. For example, under a GAP policy, if the loan contract is paid out early, the consumer cannot have a claim paid as there is no longer any 'gap'. If consumers were well-informed about the cover, they could be expected to cancel the policy and claim a rebate from the insurer. Our review identified a systemic failure by consumers to claim these rebates, indicating a widespread lack of understanding about how the policy operated.

Note: The value of the unclaimed rebates on GAP insurance policies is several millions of dollars. ASIC is currently negotiating with insurers to identify consumers who paid out their loans early and provide them with rebates.

97 These outcomes are consistent with our findings in REP 470 that many consumers purchased add-on insurance products without having a sufficient understanding of those products to make an informed purchasing decision.

98 In REP 470 we found that consumers demonstrated very poor recall and understanding of which add-on insurance products they had actually purchased or even how much they had paid for them:

> 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)

99 Further, few consumers had any awareness of the limitations in cover.

> Q: Do you know the main exclusions under the policy, so when they would not pay? A: No, I don't, not at all. Q: Were they explained to you? A: No. (REP 470, paragraph 69)

> No, I didn't know anything about exclusions. I knew we had an excess of about $500, that's all. It's utterly gross now you say it out loud and you think about it. (REP 470, paragraph 70)

> When people are selling you insurance, they don't talk about the exclusions. They talk about the inclusions … she never at any point talked about the exclusions… She just kept on saying what we will get, not what we won't get for that price. (REP 470, paragraph 69)

Factors inhibiting consumer understanding of add-on products

100 A number of factors contribute to inadequate understanding of these products by consumers, including:

(a) lack of familiarity with the products (given that they are not generally available);

(b) complexity in product design and operation;

(c) limitations of paper-based disclosure;

(d) inability to assess the value of the product based on potential claims outcomes; and

(e) the complexity and length of the sales process.

Lack of familiarity

101 In REP 470 we found that before entering the dealership few consumers had:

(a) done any research to assess their own insurance needs; or

(b) shopped around to check:

  (i) whether the insurance they already held might give them cover;

  (ii) what insurance products were available and which of these they may need; and

  (iii) which products provided best value for money.

102 To quote some consumers with whom we spoke:

> All our time and energy went into finding and buying the right car, we didn't even think of insurance. (REP 470, paragraph 42)

> I just focused so much on every single detail of getting the right car for the right price that when we got into the insurance I felt really bad because usually I am an insurance-research nut, but I was like, "Oh God, I had not even thought about it." (REP 470, paragraph 42)

> Knowing I was going to walk away with a financial product, this was something I'd never considered so it was something that I was caught—a bit short about, I suppose—to a degree I wasn't prepared. Because of the way that I prepared, I knew so much about the car—being the product—that nothing about insurance or GAP cover, or paint protection, or that kind of thing … (REP 470, paragraph 42)

103 These comments are not surprising given that add-on products are only sold with the purchase of a car or, in the case of CCI, with finance. Consumers make repeat purchases of add-on products infrequently and so have only limited opportunities to become familiar with them over time. This is consistent with our research findings that most consumers were largely unaware that add-on insurance products even existed until they were offered them at the end of the car purchase process.

104 This is in contrast to consumers' general awareness of other types of insurance such as home, home contents, travel and life insurance. It reflects a lack of transparency around add-on insurance and a narrow distribution channel through caryard intermediaries.

Complexity in product design and operation

105 The difficulties created by a lack of experience with add-on products are exacerbated by the way in which they are designed and the risks they cover. This means that to make an informed decision, a consumer first needs to identify that a range of external factors are relevant to their decision, and then understand the relationship between the policy and those factors.

106 For example, the way in which GAP insurance operates means that consumers need to consider the following matters:

(a) the amount they are borrowing relative to value of the motor vehicle;

(b) the rate of depreciation of the vehicle (the extent to which it holds or loses its value following purchase will affect the size of the gap);

(c) the rate of decrease of the principal under the credit contract (the shorter the term of the credit contract the more quickly the consumer will reduce the outstanding principal, and the more quickly that any gap at the point of sale will disappear);

(d) whether rebates are payable for other add-on products financed under the credit contract (where rebates are payable, the cost of the add-on product has minimal impact on the size of any gap); and

(e) the relationship between the comprehensive insurance policy and the benefit under the GAP policy (the need for cover will vary according to whether the consumer's comprehensive insurance policy is an agreed value or market value policy, and whether the comprehensive insurer will provide a replacement vehicle, rather than a cash settlement).

107 Similarly, for mechanical breakdown insurance products, the consumer needs to assess:

(a) the reliability of the vehicle they are buying; and

(b) for some policies, the rate at which the value of the car will depreciate, where the contract limits the maximum amount payable to the market value of the vehicle at the time of claim.

108 Most add-on products present additional difficulties for consumers in that they are presented with a range of options of cover within a product. In REP 492 we found that, across multiple products, insurers could offer up to 41 different add-on insurance product options, levels and combinations of cover. This increases the risk of poor product selection, with insurers and caryard intermediaries then benefiting from sales that take advantage of consumer confusion and ignorance.

109 Further, one of our findings in REP 470 was that most 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.

110 This made it more likely that the consumer would decide on the options presented to them by the caryard intermediary, as this was the easiest choice, even though these options may not be the best ones for them. In short, this complex and rushed decision making process was far from ideal from the consumer perspective:

> If you go home … you have got time to think. You have got time to go, "Ah, do I need that?" You do get overwhelmed and tired by all the … like the insurance lady, I think she went for 10 minutes just like a one-way street … It's part of their tactic I think. (REP 470, paragraph 26)

Limitations of paper-based disclosure

111 For most consumers, the sales process at the car dealership is their only opportunity to gain an appropriate understanding of the insurance cover being offered to them before making a purchasing decision. This process can be assisted by the provision to the consumer of a Product Disclosure Statement (PDS).

112 However the timing of the requirement on insurers to provide a PDS means that, in practice, consumers only receive and review these documents after they have chosen an add-on product from the range of options presented to them by the caryard intermediary—therefore after they have made a purchasing decision.

113 This is consistent with our findings in REP 470 that while some consumers were provided with a brochure (e.g. a promotional document), only a few recalled being given a PDS (noting that it may have been given to them in

circumstances where they did not read it—for example, with a number of other documents or when it was considered no longer relevant as they had already made their decision).

114 Our research found that consumers often tended to rely on what they were told by the salesperson rather than information in the documents they were given. To quote one consumer:

> I had a brochure given to me but it did not give an explanation; the conversation was more informative than reading the brochure. (REP 470, paragraph 68)
>
> The person that handles your insurance…they explain it all to you. They hand you something but I don't think we have got time to read it…You don't sit there and read. It was so long that you don't. (REP 470, paragraph 68)

115 Moreover, the discussion about insurance options was generally quite brief, lasting only 20–25 minutes on average. This meant that despite potentially being exhausted by the car selection process, the consumer had to make multiple decisions in quick succession about several products within a compressed timeframe.

116 This necessarily limited their ability to assess their own insurance requirements, identify what (if any) insurance products they needed, and determine whether the products discussed offered value for money. Two consumers with whom we spoke described how they felt during this process in the following terms:

> It's like a conveyor belt of decision making, you're on that belt. (REP 470, paragraph 22)
>
> … it was a bit overwhelming, you know, all the features and options and all the tech terminology and also I guess the complexity of all the different options. (REP 470, paragraph 26)

117 There were similar findings in recent research commissioned by the Insurance Council of Australia (ICA) on the sale of comprehensive and CTP insurance products. This research found that consumers often do not read the PDS. 21% of the car owners surveyed indicated they had not looked at their policy document at all, with the proportion increasing to 34% for those aged 18–29 years. 59% of all consumers surveyed acknowledged that they did not understand all the details in their policy document.

Note: See Quantum Market Research, *Understand car insurance research report*, June 2014. A recent report by the Senate Economics Reference Committee concluded that a lack of transparency in the general insurance industry with regard to disclosure has resulted in significant barriers to consumers' ability to make efficient use of product information. It also noted that this issue is exacerbated by the inherent complexity of general insurance products. See Commonwealth of Australia, *Australia's general insurance industry: Sapping consumers of the will to compare*, August 2017, paragraph 3.4.

Inability to assess value based on potential claims outcomes

118 Even where consumers are provided with a PDS, their capacity to decide whether or not to purchase add-on insurance products is limited in that they cannot assess the value of the products based on the expected claims outcomes.

119 Providers of add-on insurance products are currently under no obligation to disclose matters such as:

(a) the likelihood of an insured event occurring;

(b) the likelihood of any claim being accepted or rejected;

(c) the amount that may be paid in the event of a claim (noting that, for CCI, loan termination and GAP policies, this amount can reduce significantly over the life of the contract);

(d) the usual time the insurer takes to decide a claim;

(e) the usual time the insurer takes to respond to disputes or complaints; or

(f) the value of the product, based on the amount paid in claims relative to premiums paid to the insurer.

120 This issue is common to many types of insurance. However, its effect is exacerbated for add-on insurance by the other features of this market that inhibit consumer decision-making.

Complexity and length of the sales process

121 One of the factors adding complexity for the consumer is that they are not being asked to make a decision just about the add-on products. Instead, the nature of the sales process means that the decision about these products is part of a broader transaction that also encompasses the sale or leasing of the motor vehicle and, often, the arrangement of finance.

122 The extent and nature of ‘information overload’ consumers may experience is demonstrated by the range of documents they receive when they buy a vehicle on finance (as well as documents associated with the purchase of the add-on products themselves). This may include documents about:

(a) the contract of sale for the motor vehicle;

(b) changes in car registration or ownership and personal property securities registration;

(c) CTP insurance, third-party property insurance and comprehensive insurance;

(d) servicing and engine maintenance requirements, including authorised servicing agents;

(e) the application for finance, and subsequent disclosure and contract documents from the lender;

(f) other after-market products (e.g. paint protection or rust protection); and

(g) for used cars—a pre-delivery condition report.

123 Consumers are also unlikely to be aware of the implications of choices about one product on other products, or the terms on which finance is provided. Some examples of these complex relationships are:

(a) the need for GAP insurance will vary significantly according to whether the consumer has an agreed value or a market value comprehensive insurance policy;

(b) the cost of CCI is calculated as a percentage of the amount borrowed, and so will increase by the amount of any premiums for other add-on products (e.g. tyre and rim insurance or any warranties); and

(c) the cost of CCI and GAP insurance may also increase with the length of the loan term, so that if the loan term is extended due to financing of premiums for other add-on products, this will also result in a higher premium for the CCI policy (see paragraphs 67–73).

124 To make an informed decision, the consumer is not faced with a simple choice of whether or not to buy a product, but needs to consider the consequences or impact of a purchasing decision for each add-on product on other decisions in the transaction.

Sales practices

125 It is necessary to look at the market from the perspective of insurers and car dealers to understand why consumers may agree to buy add-on products despite not seeking them out or being aware of their basic operation.

126 For these entities, this is an especially lucrative market in that:

(a) insurers benefit from high premiums and low payout rates; and

(b) car dealers benefit from high commissions that may make selling add-on products more profitable than selling the cars themselves.

127 The nature of this market means that insurers and car dealers are highly motivated sellers who can use sophisticated sales techniques to persuade consumers to purchase insurance products they do not seek or understand. These techniques take advantage of behavioural biases and may include manipulative or unfair sales tactics. The decision process also occurs in a highly pressured sales environment.

Behavioural biases

128 REP 470 discussed in detail a number of behavioural biases that can operate to adversely influence consumer decisions at the point of sale.

129 For example, one such bias is ‘anchoring’ where initial exposure to a number serves as a reference point and influences subsequent judgements about value. In the add-on context, this means that the value a consumer places on the price of add-on insurance can be influenced by the price of the vehicle,

when this is in fact irrelevant to that assessment. The cost of add-on insurance can seem minor when viewed against the cost of the motor vehicle, and make the consumer more prepared to incur this cost. If, however, the consumer considered the cost in isolation or in comparison to premiums they pay for home or contents insurance, they are likely to form a different view on the price and whether they consider it is reasonable.

130 RB Cialdini discussed the operation of this bias in his book *Influence: The psychology of persuasion*:

> Automobile dealers use the contrast principle by waiting until the price for a new car has been negotiated before suggesting one option after another that might be added. In the wake of a fifteen-thousand-dollar deal, the hundred or so dollars required for a nicety like an FM radio seems almost trivial by comparison. The same will be true of the added expenses of accessories… [or add-on insurance] that the salesman [sic] might suggest in sequence. The trick is to bring up the extras independently of one another, so that each small price will seem petty when compared to the already-determined much larger one.
>
> Note: See RB Cialdini, *Influence: The psychology of persuasion*, Collins Business, 2007, p. 14.

131 REP 470 identified a number of other behavioural biases, including;

(a) *Priming*—If add-on insurance is only offered after purchase of a vehicle, the consumer may have an increased emotional investment in the purchase and be more inclined to either buy an add-on insurance product or spend more money on the product than if it had been offered earlier: see Case study 5 for similar findings in the United Kingdom.

(b) *Decision fatigue*—Consumers who have already made multiple complex or important decisions (which car, colour of car, what extras to include, how to finance) may be more likely to make poor decisions because they are exhausted by the number of decisions they have already made.

Case study 5: Behavioural biases (UK study by the FCA)

In the United Kingdom, research by the Financial Conduct Authority (FCA) found that delaying disclosure of the price enabled the provider to charge higher prices for their products (demonstrating that simple changes in sales processes and techniques can make it easy to manipulate consumers).

The experimental consumer research component of the FCA study examined how decision fatigue and information overload can influence, to the consumer's detriment, the take up of and price paid for insurance.

The experiment showed that not offering the add-on insurance until the point-of-sale of the primary product, as opposed to displaying the insurance offer upfront, can be detrimental to consumers. It found that:

- delaying the offer of add-on insurance resulted in:
  - a 15% increase in the price consumers paid for the add-on insurance (compared to insurance that was offered upfront); and
  - a 20% increase in profits for the entity that sold the insurance;

Case study 5 (cont.)

- including the option to shop around for alternative insurance halved profits made through the sale of add-on insurance products;
- where consumers did shop around for alternative insurance, the cost paid for insurance was reduced by one-third; and
- there was no significant difference in the take-up rate of the insurance, regardless of whether the insurance was offered upfront with the primary product or at the point of sale.

Failure to tailor sales approaches to different consumers

132 A further significant limitation of current sales practices is that they are not tailored for the needs of different consumer groups. Typically insurers have adopted a 'one size fits all' approach in their sales manuals. They therefore do not have specific instructions or tailored approaches for dealing with people of different cultural backgrounds or differing levels of financial literacy.

133 While this issue applies generally across all financial products, it is particularly relevant the greater the complexity of the choices.

134 Two groups that are particularly likely to be disadvantaged by the absence of tailored sales approaches are:

(a) *Indigenous Australians*—The cultural practice of 'gratuitous concurrence' is common among indigenous Australians. A person will appear to agree to propositions put to them, even when they do not, as a mark of respect or cooperation or to avoid 'losing face'. This means that products can be sold to them without their active and informed consent.

(b) *Non-English speaking background (NESB) consumers*—Sales practices commonly assume fluency in English, but some consumers with NESB backgrounds may not have the language skills to fully understand insurance products when described to them.

Manipulative or unfair sales tactics

135 Our review identified a range of sales tactics that are designed to make it difficult for the consumer to say 'No' and to refuse to buy add-on products. In REP 470 we found that it was common for the salesperson to place the burden on the consumer of having to explain why they did not want to buy a product, and that this exploited their behavioural biases:

> Every product was rolled out and every product I had to justify why I did not want to get it (paragraph 85).
>
> 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 (paragraph 22).

136 Another commonly used sales tactic was to delay disclosure of the cost of add-on insurance products to a very late stage in the sales process after the consumer has chosen which products and option within a product they will buy. This process is known as 'price shrouding'. It 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.

137 In REP 492 we also found that it was common for insurers to only disclose the premium in monthly or weekly amounts (which can be relatively small compared to the total premium). The consumer was only advised of the total premium when they were given a finalised contract and policy schedule. This process effectively prevents the consumer from assessing the value of the product, tested against price: see Case study 6.

Case study 6: Price shrouding

One insurer had a documented sales process in which they instructed car dealers how to increase sales by requiring a consumer to twice refuse to buy add-on insurance.

The sales process stated that if the consumer initially declined or refused to discuss any of the options, the car dealer should:

- ask the consumer if they would like to borrow enough money to pay for the insurance to leave their options open; and
- when they arrived to take delivery of the vehicle, ask them whether they wanted to purchase the add-on products.

We consider this sales process is unfair as it ignores the initial refusal by the consumer to buy add-on products and uses the pressure of an ancillary matter—delivery of the vehicle—to place additional pressure on the consumer to agree to purchase the insurance product.

This insurer has now abandoned this sales practice.

138 We also found evidence, through individual surveillances, of unfair sales practices by car dealers, such as unfair pressure: see Case study 7. Other tactics included representing that the lender had endorsed the sale of the add-on products, presenting the insurance as mandatory, and failing to obtain the consumer's consent before adding the insurance premium to the car loan.

Case study 7: Unfair pressure

A car dealer had a practice of offering consumers a package of add-on products. The consumer would be given some information outlining various add-on products and the price of each item explained.

The dealer then advised them that if they signed up that day they would get a discount of $500 off the nominated price. However the discount was only available if the consumer purchased a 'package' (defined as at least three products costing several thousand dollars). The consumer was given a separate voucher stating that they were entitled to a discount of $500.

Case study 7 (cont.)

If the consumer expressed reluctance to sign up to the package, they would be asked whether they were sure about this decision. If they still did not agree to the purchase, they were told that this would void the voucher, and the sales representative would write the word 'VOID' on the voucher.

This practice is likely to increase the pressure on the consumer to make a decision about the products that day to avoid 'missing out' on the discount, and seeks to exploit 'loss aversion' in a dramatic way by writing on the voucher in front of the consumer. This suggests to the consumer they have lost $500, when this was only available if they spent several thousand dollars.

Pressured sales environment

139 In REP 470 we found that a number of consumers described the sales environment as a highly pressured one (paragraph 85):

> Pretty much, it really felt pressured. It was a really high-pressure sell.
>
> I think they sucked us in to buy [add-on] insurance …

140 An estimate of the impact of behavioural biases and unfair sales practices on the extent to which consumers are being sold products that they do not want can be made by assessing the percentage of consumers who cancelled the sale of an add-on insurance product during the cooling-off period.

141 Cancellations in this period are presumably made by consumers who decide they do not want or need the product once they have an opportunity to reflect on the purchase after leaving the dealership, and may therefore only have bought it because of the distortions in the sales process.

142 In REP 471, for life cover under CCI policies during 2010–14 we found that:

(a) 10% of consumers decided they did not want the product and cancelled in the cooling-off period; and

(b) the level of cancellations varied between insurers, ranging from 9–12%.

143 The sale of add-on insurance to consumers who subsequently cancel the policy imposes unnecessary and significant costs on all parties to the transaction: consumers, caryard intermediaries and insurers. A modified sales process that does not result in consumers being sold products that they do not want or need would avoid these costs.

D The need for reform

Key points

The lack of competitive pressure and the significant financial benefits that can be earned from the sale of add-on products through caryard intermediaries mean that consumers are at risk of continuing harm of adverse outcomes through unfair sales practices.

Given this risk and the limitations of other measures in response to ASIC's reviews of this market, we consider there is a need for reform in this area.

See Section E for our proposals for reform and objectives of the reforms.

Risk of continuing consumer harm in the add-on market

144 There is a risk of continuing consumer harm in the add-on market as providers are not subject to competitive pressure to improve the value offered by their add-on products from either:

(a) consumers (who cannot, for example, tell whether a product is offered at a reasonable price or an excessive price); or

(b) other insurers (as the main distribution channel for these products is caryard intermediaries).

145 Car dealers have developed a commercial reliance on the revenue flows from commissions and other financial benefits: see paragraphs 125–127. They have been able to use 'reverse competition' between insurers for access to their sales networks to drive up commission rates to as high as 79% of the insurance premium. Unless there are changes to their business models, they can be expected to continue to seek revenue at similar levels.

146 As a result of our reviews, insurers have begun making changes on a voluntary basis, such as reducing premiums and commissions or addressing shortcomings in the design of their products. However, we consider that there are significant limitations in the scope and nature of these changes.

147 In particular, we consider there is a significant risk of reverse competition driving up commissions and therefore premiums over time, notwithstanding that some insurers have recently lowered commissions.

148 If caryard intermediaries direct business to insurers who still offer higher commissions (even if they are lower than before), the remaining insurers face losing access to this distribution channel. Their choices would be to exit this market or increase their commissions to regain market share. Since the market has already sustained a business model in which high commissions were consistently paid, ASIC's view is that this risk continues and if it eventuates, the benefits to consumers from reduced commissions would be eroded over time.

149 Without regulatory intervention we consider there is a significant risk of:

(a) insurers resiling from the improvements they have made if they come under pressure to increase the financial benefits they pay caryard intermediaries; and

(b) the unfair practices ASIC has identified in relation to add-on products migrating to other areas as caryard intermediaries replace the lost revenue from these products by selling other products or services at excessive or inflated prices.

International experience

150 The problems with add-on products distributed through this channel have also been indentified in comparable international markets such as the United States and the United Kingdom. The persistent systemic problems in the supply side here and overseas demonstrate that comprehensive and sustained improvements will not come through demand-driven behaviour alone.

151 The adverse financial impact of CCI products has been recognised in the United States for some time, where these products are subject to a high degree of regulatory intervention. The National Association of Insurance Commissioners' model for regulation of life and disability cover under a CCI policy specifies a 60% loss ratio as the minimum benefit consumers should expect for premiums paid. Some states have implemented this model by requiring life insurers to meet a minimum return in claims (e.g. the expected return in claims should be 60 cents in the dollar).

Note: See, for example, Insurance Regulation 9 (Consumer Credit Insurance), issued by the Division of Insurance in the Department of Business Regulation of the State of Rhode Island and Providence Plantations.

152 In the United Kingdon, the FCA introduced a deferred sales model for GAP insurance in September 2015: see Case study 8. The reform was based on a detailed analysis of this sector, which found that the market was characterised by poor competition, price insensitivity and poor claims ratios.

153 In particular, the study found that selling GAP insurance as an add-on product, rather than on a standalone basis where it was offered online, allowed insurers to charge much higher prices. For example, premiums for a three-year GAP policy for a car of up to £25,000 would range from around £140 for standalone policies to £300 for add-on policies.

Note: See FCA, Market Study MS14/1, *General insurance add-ons: Provisional findings of market study and proposed remedies,* March 2014 (PDF, 464 KB).

154 Since the deferred sales model was introduced, we understand that:

(a) it has had a negligible impact on the price of GAP insurance, with the amount charged for the average premium largely unchanged (premiums in the United Kingdom are typically lower than in Australia);

(b) it has resulted in a minor reduction in the volume of face-to-face sales through car dealerships (with a fall in sales of approximately 6% in 2016 against small increases in the number of cars sold);

(c) some insurers have increased the cover offered, so that there may be an increase in the claims ratios over time; and

(d) there has been little change in the volume of online sales.

155 The UK model is instructive in identifying the key features of any deferred sales model. We consider that its relevance is mainly in assisting analysis of the objectives and key issues in an effective model.

Case study 8: UK deferred sales model for GAP insurance

A deferred sales model was introduced by the FCA from 1 September 2015, following a market study to test whether competition in the markets for add-on insurance was effective.

The study raised significant concerns about the add-on mechanism in the GAP insurance market, including that GAP insurance sold as an add-on often represented poor value for consumers, with only 10% of premiums being paid out in claims.

The deferred sales model introduced by the FCA only applies to GAP policies sold in connection with the sale of a vehicle. Before a GAP contract is concluded, a firm must give the customer the following information:

- the total premium of the GAP contract, separate from any other prices;
- the significant features and benefits, significant and unusual exclusions or limitations, and cross-references to the relevant policy document provisions;
- whether or not the GAP contract is sold in connection with vehicle finance, that GAP contracts are sold by other distributors;
- the duration of the policy;
- whether the GAP contract is optional or compulsory;
- when the GAP contract can be concluded by the firm; and
- the date the above information is provided to the customer.

A GAP contract cannot be concluded until at least two clear days have passed since the product information specified above has been provided to the consumer. That is the deferred sales period is a total of four days comprising the first day on which the information is provided to the consumer followed by two clear days with no contact between the parties with the GAP contract able to be concluded on the fourth day.

The model includes a ‘deferred opt-in’ arrangement under which the GAP contract can be concluded one day after the specified product information has been provided to the consumer where the consumer:

- initiates the conclusion of the GAP contract; and
- consents to the early conclusion of the contract and confirms they understand that a four-day deferral period normally applies.

Note: See FCA, Policy Statement PS15/13, *Guaranteed asset protection insurance: Competition remedy*, June 2015 (PDF, 267 KB).

Responses to ASIC's reviews

Changes in price

156 Insurers responded to the findings in ASIC's reviews by acknowledging that there were deficiencies in this market. 16 insurers applied to the ACCC for authorisation to impose a voluntary cap of 20% on commissions paid to caryard intermediaries.

Note: See Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors—Authorisation—A91556 & A91557.

157 In March 2017, the ACCC denied the authorisation. In its determination of 9 March 2017 it stated:

> However, the ACCC is not satisfied that the Applicants' proposal, in and of itself, is likely to redress this market failure to any significant degree. In particular, the ACCC considers that a commission cap is unlikely to:
>
> - remove incentives for the sale of poor value add on insurance policies;
> - reduce the overall price paid by consumers for add on insurance policies;
> - improve the quality of add on insurance policies;
> - remove the risk of inappropriate sales practices in the car dealership channel; or
> - ensure that consumers have access to adequate information to make an informed purchasing choice at the time of purchase.

158 ASIC agrees with the ACCC that a cap on commissions would, on its own, not be sufficient to improve consumer outcomes on a sustainable basis, and that a package of measures is needed.

159 We consider that the recent conduct in this market provides support for this view. We are aware that some insurers accepted the need for structural change and moved to lower premiums by voluntarily reducing commissions to the 20% figure in the application to the ACCC, or a slightly higher figure (before the ACCC's determination). ASIC welcomed these changes.

160 However, other insurers responded to these changes with opportunistic conduct to increase their market share. These insurers continued to pay commissions at their previous rates (well above 20% of the premium), and so were able to attract new business away from those insurers who had reduced their commissions.

161 While we accept that insurers are now engaging with our concerns, we consider that recent conduct by some market segments (i.e. soliciting further business from caryard intermediaries by continuing to pay higher commissions than their competitors) demonstrates that the risk of insurers seeking to move away from any improvements over the short or medium term is a real one.

Other changes

162 ASIC has also taken action to improve consumer outcomes through:

(a) chairing a working group in early 2017 to develop our views on the nature of the changes to the design, distribution and sales of add-on insurance products that insurers can be expected to make;

(b) commencing a data collection program with insurers in this market to assess and monitor the value offered by these products through a number of metrics; and

(c) requiring insurers to provide refunds to consumers who had been sold policies in unfair circumstances.

163 These actions complement the initiatives of insurers. In September 2016 insurers who were members of the ICA advised ASIC that they would seek to implement a number of non-price related initiatives on a voluntary basis to address poor value and poor claims outcomes, and the inadequate level of supervision of their authorised representatives

ASIC's working group

164 ASIC established an add-on insurance working group in early 2017 with broad participation from stakeholders, including insurers, car dealerships, industry bodies and consumer groups.

165 The working group analysed current practices. As a result, ASIC has written to insurers asking them to review their businesses against our regulatory expectations in the following areas:

(a) *Product design*—Products should be designed to meet the needs of a clearly identified target market and should provide a tangible benefit for these consumers for reasonable value.

(b) *Product distribution*—Good distribution means that insurers and their representatives take reasonable steps to ensure that the product reaches the consumers for whom it is designed and does not reach consumers for whom it is not suited or offers no benefit.

(c) *Sales*—Insurers should adopt a sales process that enables consumers to make an informed decision about the product.

Data collection

166 ASIC has asked insurers to provide information at an individual contract or transaction level on both sales and claims outcomes for add-on insurance products. A pilot request has been sent to insurers covering February and March 2017.

167 The information provided will allow us to test and quantify the value of each insurer's add-on products, including:

(a) assessing the extent to which insurers prefer the interests of intermediaries over consumers, by tracking over time the value of financial benefits and commissions paid against the claims paid; and

(b) measuring the effect of the caryard intermediary distribution channel on consumer outcomes (e.g. in relation to price, commissions and claims) by comparing data from insurers who offer CCI products through both this channel and through ADIs.

Refund programs

168 We consider that insurers who have mis-sold add-on insurance products should provide refunds to consumers. Examples of situations where ASIC expects refunds include sales of:

(a) unnecessary GAP insurance (e.g. because there was no gap at the point of sale or because the consumer had replacement vehicle cover under their comprehensive insurance policy);

(b) negative-value insurance (e.g. where the maximum amount payable in the event of a claim is less than the premium); and

(c) add-on insurance products to consumers who are ineligible to claim.

169 We are negotiating with insurers to secure refunds to consumers for past unfair conduct, with the first outcome achieved in August 2017 with QBE: see paragraph 92. These discussions are at different stages with other insurers; ASIC is prepared to consider using our enforcement powers if necessary.

E Proposals for reform

Key points

We seek stakeholders' views on two proposals for reform:

- a deferred sales model for add-on products (Proposal 1); and
- enhanced supervision obligations for product providers (Proposal 2).

We consider that these proposals would apply to all add-on products sold with a new or used car through caryard intermediaries (i.e. excluding comprehensive and CTP insurance products).

We have clearly articulated the objectives of the proposed reforms in this paper, so that their outcomes can be tested against these objectives.

Objectives of the proposed reforms

170 Given the risk of continuing consumer harm and the limited effectiveness of other measures, we consider there is a need for reforms to the sale of add-on insurance through caryard intermediaries.

171 This paper considers two proposed reforms:

(a) introduction of a deferred sales model for add-on products when sold by caryard intermediaries (Proposal 1); and

(b) enhanced supervision obligations on product providers (Proposal 2).

172 Our objectives in proposing these reforms are that:

(a) add-on products should offer improved value;

(b) premiums for add-on products should be more competitive;

(c) sales processes should be fairer and assist consumers to make better decisions;

(d) add-on products that offer no benefits to consumers should not be sold and products that offer minimal benefits should be reduced; and

(e) changes should be market-wide and competitively neutral.

173 The proposals do not apply to comprehensive or CTP insurance products.

Note: As noted earlier, in this paper the term 'add-on products' refers to add-on insurance and warranties regulated by the Corporations Act other than these products.

174 Table 9 sets out key aspects of the objectives and what they mean. We have articulated our expectations in some detail, and would expect stakeholders to provide responses which engage with these expectations and identify how they can be met.

Table 9: Key aspects of the objectives

Key aspect	Our regulatory expectations
Improved value	• There should be significant improvements in the claims ratios for add-on products. • Cover should be designed to meet a genuine need and offer a tangible benefit, based on the expected claims outcomes for consumers. • Improved value should be driven by a reduction in premiums and/or commissions, to increase the benefits to the consumer through claims outcomes relative to premiums.
Fairer sales processes	• Providers should adopt improved sales processes which take into account behavioural biases and other factors that currently inhibit or prevent consumers from making informed purchasing decisions. • Insurers should offer products where the terms of cover (including features and exclusions) can be communicated to and understood by the target market. • Insurers should prohibit the sales of products in transactions where there is no or minimal benefit to consumers. • Insurers should have reasonable controls in place to prevent caryard intermediaries engaging in unfair conduct at the point of sale, and should be able to effectively identify and compensate consumers who have been sold add-on products as a result of such conduct.
Fewer sales where consumers do not benefit	• Insurers must not design or offer products that provide negative or very low value. • Sales of add-on products should be driven by consumer demand and need, rather than the financial benefits that can be earned by caryard intermediaries.
Changes should be comprehensive and competitively neutral	• As far as possible, any changes should apply to all add-on insurance and warranties regulated by the Corporations Act (other comprehensive or CTP insurance products) and across all sales channels used by caryard intermediaries.

175 The introduction of any reforms will involve costs to industry. At this stage, we are not seeking responses on the financial impact as we propose to address this issue in detail in the second stage of the consultation process.

176 Our preliminary views are that the impact of lower premiums and higher claims ratios would not be significant on product providers where this reduction is mainly the result of lower distribution expenses, with providers having similar internal costs. The main impact would therefore be likely to be on caryard intermediaries, through reduced revenue.

177 We note that car dealerships across Australia employ approximately 66,000 people and pay annual wages to employees of over $4 billion annually. The AADA estimated that in 2015 the revenue from insurance commissions was $297 million (or approximately 23% of the industry's net profit before tax).

178 We do not propose any changes to training requirements for add-on products at this time as these products will not be subject to the enhanced education and training standards that apply to providers of personal financial advice from 1 January 2019 (i.e. they are specifically excluded from the definition of 'relevant financial product' under s910A of the Corporations Act).

Proposal 1: Deferred sales model for add-on products

Proposal

E1 We propose that the sale of add-on products by caryard intermediaries for a new or used car should be permitted only after a certain period of time has elapsed (the deferral period).

During the deferral period:

(a) providers would be restricted from offering, or entering into, a contract for an add-on product with a consumer;

(b) caryard intermediaries would be restricted from:

(i) arranging for a consumer to apply for an add-on product; or

(ii) referring a consumer to a product provider in relation to an add-on product; and

(c) consumers would be restricted from initiating the purchase of an add-on product directly with the provider, or opting-out of the deferral period.

Table 10 sets out key issues in the design of any deferred sales model.

Note: The proposed options in Table 10 are not intended to be definitive. We welcome further suggestions.

Table 10: Key issues in the design of a deferred sales model

Feature	Proposed options
Commencement of the deferral period	**E1.1** We do not propose in this paper a specific trigger event for the commencement of the deferral period and seek stakeholders' views on this. The deferral period could commence when the consumer: (a) receives a consumer communication (with mandated content); (b) finalises the vehicle purchase and receives the consumer communication; or (c) takes delivery of the vehicle and receives the consumer communication.
Duration of the deferral period	**E1.2** We propose that the total duration of the deferral period for add-on products (except those discussed in proposal E1.4) could be a: (a) minimum of four days; and (b) maximum of 30 days.
Consumer communication	**E1.3** We propose that the consumer communication should: (a) address the current limitations in consumers making informed decisions (as discussed in Section C); (b) include information about each type of add-on product being offered through the car dealership (e.g. in a standardised format), and how they interact with other elements of the transaction; (c) provide information to consumers that is accessible and addresses different levels of comprehension or financial literacy; and (d) make use of innovative techniques to deliver this information to the consumer.

Feature	Proposed options
Mechanical breakdown insurance and warranties	**E1.4** Where these products are sold with new cars or used cars that are still covered by the manufacturer's warranty, we consider that: (a) a different deferral period could apply; and (b) the consumer communication could be tailored to explain that cover will not commence for some time and set out the consequent risks in buying the product.

Your feedback: Deferred sales model

E1Q1 Do you consider that it is appropriate to apply a deferral period to the sale of add-on products by caryard intermediaries?

E1Q2 To what extent would a deferral address the consumer harms identified in this market?

E1Q3 How would the proposal affect businesses (e.g. insurers, car dealers, finance brokers, credit providers)? Would it have a different impact on small businesses?

E1Q4 Would the model need to apply differently to the new and used cars markets? In what ways could the model differ to be effective across the two markets?

E1Q5 What are the preconditions for a competitive online market? How can a deferred sales model contribute to this outcome?

E1Q6 Could the objectives of a deferred sales model be achieved in a different way or could any complementary measures better ensure our objectives are achieved?

E1Q7 If a deferred sales model was introduced, are there any existing related obligations on insurers, finance providers and car dealers that would no longer be appropriate and could be removed?

E1Q8 What is the most effective way of testing whether consumer understanding has improved due to a deferred sales model? What metrics would provide the best way of measuring consumer comprehension?

E1Q9 Should a consumer opt-out mechanism be included?

Rationale

179 The decision whether to take out add-on products is complex. Consumers are typically presented with multiple different products with varying levels of cover.

180 In assessing suitability and product value, consumers need to consider a range of factors, including:

(a) the level of premium versus the level of cover (including limitations and exclusions);

(b) the likelihood of making a claim;

(c) the extent to which they are willing to bear the risk via self-insurance (especially for products with low average or median claim amounts);

(d) the extent to which they may already have relevant cover or alternatives;

(e) the cost of the products, which may vary depending on lump sum or instalment payments, and the associated interest costs where the premium is paid through related finance contract; and

(f) the lost opportunity, if add-on products are purchased, to use the money for other purposes (e.g. buying accessories for the vehicle or even buying a more expensive car).

181 In the current sales environment, combining the sale of the car, finance and add-on products into one process restricts the capacity of consumers to consider these matters and make rational, informed purchasing decisions. The deferred sales model aims to address this by inserting a pause in the sales process.

182 We consider that a well-designed model would give consumers additional time to navigate the complexities of add-on products and facilitate improved decision making.

183 Consumers would have the opportunity during the deferral period to be provided with targeted information about the add-on products so they could consider in detail the merits of the product offered to them. They could use this information to assess their needs and match them to specific products outside the inhibiting sales environment of the car dealership.

184 They would also be able to access online information about the product. This could include information about the performance of these products based on ASIC’s data collection work: see paragraphs 166–167 (if we elect to publish this). For example, this could include value measures on price and claims to help consumers in deciding whether or not to buy these products.

185 They could also research other products that may become available to them through other distribution channels (noting that there is already an online market for insurance products that cover similar risks to CCI and loan termination insurance).

186 The introduction of a deferred sales model could also enhance competition if these products become more widely available. Currently, consumers only have the choice of buying the products offered to them by the caryard intermediary, as insurers do not make them available through other distribution channels (e.g. online or direct sales by phone).

187 Because consumers would have a greater opportunity to obtain information about other competing products, providers currently locked out of car dealership distribution points could be encouraged to offer add-on products online. If online distribution becomes widespread, it could generate

increased competition between providers and improve transparency on product price and cover, benefitting all parties.

188 We acknowledge that it is difficult to predict if insurers would introduce online or direct sale distribution models and if so, what effect this would have on consumer outcomes. However, we consider it desirable that the design of any deferred sales model should allow for this possibility.

189 Regardless of the delivery and content of any required consumer communication, we consider that a deferred sales model should include a mechanism for testing the effectiveness of the communication and enhancing its design in response to any identified deficiencies.

190 This could be achieved by trials involving a post-sale review of the extent to which consumer understanding of the products has improved (e.g. by testing consumers' understanding of the cost and circumstances in which these products may be helpful or where they do not offer significant benefits). The communication could then be refined over time in response to these findings.

191 We are not proposing to give consumers the opportunity to voluntarily opt-out of the deferred sales process, as is permitted under the deferred sales model for GAP insurance in the United Kingdom: see paragraphs 152–155.

192 We consider it essential that a pause be inserted in the sales process for all consumers. Given the range of problems we have identified in this market our view is that:

(a) it would not be straightforward to identify a class of consumers who readily understand the complexities of add-on products (while self-assessments by consumers are unlikely to be reliable); and

(b) there is a risk of abuse of any 'opt-out' mechanism that would disadvantage consumers (with this likely to fall on vulnerable or less financially sophisticated consumers).

Commencement of the deferral period

193 We suggest three points at which the deferral period could commence:

(a) *When the consumer communication is provided*—Under this option, the timing of the deferral period is not fixed by reference to an external event but commences when the consumer communication is provided.

(b) *When the agreement to purchase the vehicle and/or arrange financing is finalised and the consumer communication has been provided*—Under this option, commencement could be before or after vehicle delivery, depending on when this occurs relative to the time of purchase.

(c) *When the vehicle has been delivered to the consumer and the consumer communication has been provided*—This option would give consumers the opportunity to assess their needs based on their experience with actual use of the vehicle.

Timing and purpose of consumer communication

194 We consider that the consumer communication is important in facilitating informed consumer decision making and that the deferral period should not commence until this information has been provided.

195 The point at which the deferral period commences and its duration could result either in the current sales process remaining broadly similar to current practices or changing significantly. This has implications for the content of the consumer communication.

196 For example, if the deferral period ends before delivery of the vehicle, the add-on product is likely to be purchased at the same time as or before vehicle delivery. The deferral period may therefore be less effective in allowing consumers to review and possibly purchase products through a different distribution channel. This option therefore may need to be targeted at helping consumers to make better purchasing decisions about the products offered to them by the caryard intermediary.

197 Under the first option, caryard intermediaries would have the flexibility to determine when they provide this communication to the consumer. If adopted, this option should encourage them to provide the communication early in the sales process to maximise the time available to the consumer to consider and act on the information in the communication.

198 Conversely, if the deferral period commences at the time of vehicle delivery and is of 30 days duration, this would be more disruptive to the distribution of add-on products through car dealerships. It would change the sales context in that the caryard intermediary could presumably only arrange the sale if the consumer returns to their premises, or by an exchange of emails. It also limits the involvement of lenders, given that the consumer would necessarily have entered into the finance contract before delivery of the car and therefore before the sale of the add-on products.

199 However, it would remove the biases and distortions that currently arise from the sale being linked to delivery of the vehicle. It may also encourage the development of online competition, and meet the needs of consumers whose preference is to engage online with insurers, noting that a significant number do so for finance and comprehensive insurance.

200 A recent report by ACA Research included findings about the percentage of consumers who shop around for finance when buying cars. The report found that 29% of 797 respondents surveyed in 2016 obtained a quote for finance online (compared to 35% of 810 surveyed respondents in 2015).

Note: See ACA research, *Automotive finance insight: The facts behind the customer journey*, 5th edition, Australia, 2016.

201 The report also looked at why consumers selected a particular comprehensive insurance product. In response to the question 'Why did you choose this comprehensive insurer?' (noting that more than one response could be given):

(a) 11% of 797 respondents specified the ability to apply for the insurance online; and

(b) 7% of respondents stated all necessary information was easily available on the insurer's website.

Interaction with car purchase and finance

202 A further issue for the deferral period is how it interacts with the purchase of the car and the provision of finance, given that these matters will affect the decision about any add-on products offered by the caryard intermediary.

203 Some examples of these complexities are:

(a) it would be difficult for the consumer to decide whether they need mechanical breakdown insurance or a warranty if they have not yet selected a vehicle; and

(b) purchasing add-on products could increase the term and the repayments under the related finance contract and therefore the cost of finance to the consumer.

204 Figure 1 sets out our initial views on the advantages and disadvantages of different approaches in providing consumer communication, based on the following three sequences of events:

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

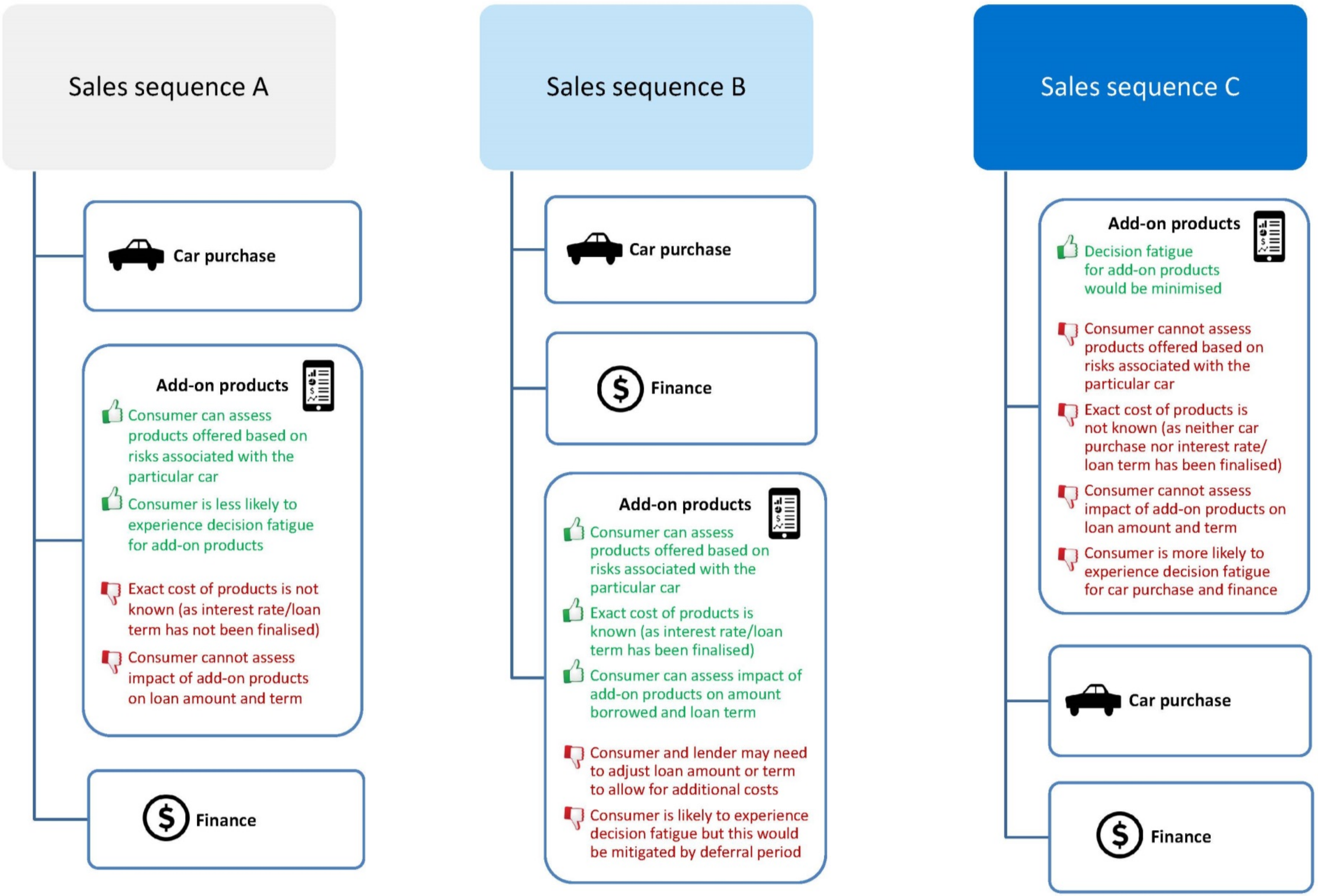
(b) *Sales sequence B*—The consumer is asked to select the add-on products they want to buy after they have chosen the vehicle and finance is approved.

(c) *Sales sequence C*—The consumer is asked to select the add-on products they want to buy before they have chosen the vehicle and before financed is approved.

205 This analysis suggests that there is no simple or obvious solution for the timing of the deferral period relative to the other elements of the transaction, in that each approach has some advantages and drawbacks.

206 Because of the important issues involved in the commencement of the deferral period and the impact of a move to a significantly different sales model, we seek detailed views from stakeholders on these issues.

Figure 1: Interaction of add-on products with car purchase and finance



Note: See Table 12 in the appendix for an accessible version of the data in this figure.

Easily documented and readily verifiable

207 We consider that the commencement trigger for the deferral period should be a point in time or an event that can be easily documented and readily verified by all relevant parties.

208 We consider there is a risk in verifying the trigger by, for example, the consumer signing a document confirming receipt of the communication. In REP 492 we found that paper-based consents were not a satisfactory control or means of confirming information.

209 Our reviews have found regular instances of caryard intermediaries arranging for the consumer to sign a statement that was false. For example, we found that intermediaries could manipulate consumers to sign statements that they were in permanent employment, even though the intermediary knew the statement was false (e.g. because they had seen payslips disclosing that the consumer was employed on a casual basis).

210 If the commencement event is the sale or delivery of the car, this date would be clear from existing information documenting these events.

211 We seek specific feedback from stakeholders on possible ways to define the commencement point so that is readily verifiable.

212 Some stakeholders have raised with us a concern that consumers may be uninsured during the deferral period. We consider this risk is likely to be very small, and should not be decisive in determining how the deferral period operates.

Your feedback: Commencement of the deferral period

E1.1Q1 Which of the proposed options in paragraph 193 for commencement of the deferral period would be preferable and why (please suggest other options if relevant)?

E1.1Q2 Which sales sequence (see Figure 1) is most likely to meet our stated objectives, and why?

E1.1Q3 How could the point at which the deferral period commences be easily documented to be readily verified by all relevant parties?

E1.1Q4 If the deferral period commenced at vehicle delivery, could short-term ‘bridging’ insurance be offered to cover the deferral period (only)? What does insurers’ claims data demonstrate about the likelihood of a claim shortly after delivery?

Duration of the deferral period

213 The deferral period should be of sufficient duration to give consumers the opportunity to assess their needs, consider the scope of cover offered to them and match their needs to those products. Depending on how the deferral period operates, they will also need sufficient time to do so while selecting and buying a vehicle and arranging finance.

214 The deferral period should also allow the consumer to obtain other information that is relevant to their purchasing decision (e.g. details of life and disability cover they hold through their superannuation), which would help them decide whether to take out CCI or loan termination insurance.

215 We think that a deferral period shorter than four days would not provide a sufficient pause in the sales process to enable all of these steps to occur. At the other end of the spectrum, we question whether a deferral period longer than 30 days is required. For this reason, we consider that the deferral period should be between four and 30 days.

216 We welcome feedback on the implications for stakeholders of various duration options. We also seek information about typical periods for delivery of cars to the consumer and for finance to be approved, to inform our consideration of this issue.

Your feedback: Duration of the deferral period

E1.2Q1 What would be the appropriate duration of the deferral period within the range of 4–30 days and why?

E1.2Q2 Should the duration of the deferral period be different for new and used cars?

E1.2Q3 What is the average period of time between the sale of a new car or a used car and its delivery to the consumer? What is the shortest period of time and how common is it?

E1.2Q4 What is the average period of time between when a consumer applies for finance and approval? What is the shortest period of time and how common is it?

Consumer communication

Delivery of consumer communication

217 Before arranging for the sale of an add-on product we propose that the caryard intermediary must provide a ‘consumer communication’ directly to the consumer (i.e. they cannot rely on a communication given to the consumer by another party). The consumer communication is intended to help consumers determine whether they need any add-on products, and, if so, which ones. The effectiveness of the communication is therefore crucial to driving better consumer outcomes.

218 Our view therefore is that it would be preferable to avoid a model that relies solely on the consumers being given access to information as sufficient compliance, even though the consumer may not read or access the communication (or may not understand it if they do). Given the many limitations of paper-based disclosure, we consider that the consumer communication could use innovative and interactive forms of engagement that better assist consumers while still being cost effective.

219 For example, interactive disclosure could be made through an online ‘app’ provided by the insurer. A consumer who accesses the app could be presented with information that is mandated in a standard form or template with standard terms, and that also uses graphics or presents the information in sequence. Standardisation would make it easier for consumers to compare similar products offered by other insurers.

220 The app could also enable the consumer to test their understanding of the product, including:

(a) the risks that it does and does not cover;

(b) the costs of different options; and

(c) the probability of certain insured events actually occurring (where those probabilities are well defined and understood by the insurance industry).

221 The use of online disclosures and apps may also have the indirect benefit of facilitating development of an online distribution channel with its potential benefits to competition.

222 Consumer comprehension could be tested either:

(a) *before a consumer buys the product*—for example, by requiring them to correctly answer some questions about the cover being offered; or

(b) *after a consumer buys the product*—by monitoring trends in consumer behaviour that indicate their understanding, such as the period of time between an insured event occurring and the consumer making a claim.

Content of consumer communication

223 There are a number of issues that need to be considered in developing the content of the consumer communication.

224 First, the form and content of the disclosure needs to take into account the number of different products available to consumers, and the ways in which they interact with each other and with the other elements of the transaction. For example, the cost of CCI is typically calculated as a percentage of the amount borrowed, so that the financing of any other add-on products will increase the CCI premium.

225 Secondly, to be effective the consumer communication needs to be adapted for different target markets and consumers with different levels of personal and financial literacy and numeracy: see paragraphs 132–134.

226 We note that the Life Insurance Code of Practice has introduced a commitment by life insurers to have procedures to assist consumers who need additional support. Clause 7.2 of the Code states:

> We will have processes in place to train our staff to help identify and engage appropriately with consumers who are having particular difficulty

with the process of buying insurance, making an inquiry, making a claim or making a Complaint, or who may not be capable of making an informed decision, and to refer these consumers for appropriate additional support where required. We will take into account someone's capability when making decisions that impact them.

227 While we accept that providing tailored information will be more costly for providers, we consider that if this is not done there is a significant risk that the communication will be ineffective for some classes of consumers.

228 There are also difficulties for providers in helping consumers to understand the total cost of the products, including finance costs. This is a particular issue for products sold with leases, where the lessors are currently under no obligation to disclose the cost of finance as an interest rate, or to set out the amount the consumer is paying above the value of the goods or services.

229 Finally, there is a need to balance providing sufficient relevant material about each different product with the risk of burdening the consumer with too much information.

Your feedback: Consumer communication (delivery and content)

E1.3Q1 Should providers be required to take active steps to ensure consumers read and understand information about their products before they can buy them?

E1.3Q2 What forms of innovative disclosure could be used to better inform consumers about their insurance decision?

E1.3Q3 What information should the consumer communication include?

Availability of other cheaper products

230 For CCI and loan termination insurance, alternative or competing products are readily available that offer similar cover (e.g. term life insurance, trauma insurance and income protection insurance).

231 The cost of alternative products may be significantly cheaper. As noted in REP 471 (see Table 5), we found that the cost of life cover under CCI products sold through caryard intermediaries compared to the price of a term life product was between:

(a) 4.3 and 7.6 times more expensive for a low-risk insured person; and

(b) 1.3 and 2 times more expensive for a medium-risk insured person.

232 The market for term life insurance, trauma insurance and income protection insurance is well developed with a large number of insurers offering products where the consumer can apply online. These products also provide better coverage as:

(a) *compared to CCI*, the amount payable does not reduce to zero over the life of the related finance contract; and

(b) *compared to loan termination insurance*, the consumer could obtain sufficient insurance cover to retain ownership of the vehicle (whereas a consumer can only claim the primary benefit under a loan termination policy if they hand back the vehicle).

233 This raises the question of whether providers of add-on products should be required to inform consumers not only of the cost of their products, but also that cheaper products may be available or products that offer better coverage (e.g. a term life insurance product rather than loan termination insurance so the vehicle could be kept). This could also encourage insurers to offer CCI and loan termination insurance products that are more competitively priced.

Your feedback: Consumer communication (other products)

E1.3Q4 Should providers be required to inform consumers about the availability of other products that provide similar cover, but may be cheaper?

E1.3Q5 If so, what information should the consumer communication include?

Mechanical breakdown insurance and warranties

234 There are particular issues arising with the sale of mechanical breakdown insurance and third party warranties sold with new cars or with used cars where the vehicle is still covered by the manufacturer's warranty.

Note: We refer to these products collectively as 'mechanical risk products'.

235 The cover under these products typically commences when the manufacturer's warranty ends. There is no consistency in the cover offered by manufacturers. Warranties can run for between three to seven years from the date of purchase of the car and can operate for a specified distance (e.g. 100,000 km) or an unlimited distance (so that only the time limitation applies).

236 Consumers lose money by paying a premium for a mechanical risk product with the purchase of a new car when cover will not start for three to seven years. Table 11 sets out the loss to the consumer based on a premium of $1,482 (the average figure identified in REP 492 for the cost of a mechanical breakdown insurance policy), assuming that they could have otherwise earned either 3% or 5% a year during the period before cover commences.

Table 11: Cost to consumers by paying in advance for mechanical breakdown insurance

Assumed earning rate (p.a.)	Three years	Seven years
3%	$137.42	$340.67
5%	$233.60	$603.32

237 This analysis shows that a consumer will bear a significant additional cost relative to the price of a mechanical risk product.

238 In addition to this financial disadvantage, a consumer who is sold a mechanical risk product with a new car may pay a premium for a policy that they do not need. The length of time before cover commences means that the consumer will not be able to claim under the mechanical risk product in some circumstances, including where:

(a) *Cover under the mechanical risk products expires when the vehicle has travelled a specified distance*—If this limit is set at 100,000 kilometres, the consumer may have driven this distance during the period in which the vehicle is covered by the manufacturer's warranty. Cover under the mechanical risk product could therefore expire before the consumer is entitled to make a claim.

(b) *The consumer sells or trades in the car before cover starts*—The consumer may decide to sell or trade in the car within three to seven years after buying it, and therefore while it is still covered by the manufacturer's warranty. The consumer has never needed cover and may not be entitled to seek a refund or rebate of the premium (depending on the warranty contract) or may forget to do so.

239 There is no commercial reason why the sale of mechanical risk products could not be deferred until or even after delivery of the car, given that cover may not commence for three to seven years. However, if the deferral period for these products was different than for other add-on products, providers would need to develop and manage two different sales processes.

240 Alternatively, a different deferral period could simplify the sales process for the remaining add-on products, in that the consumer communication would address or include information about one less product.

241 Our preliminary view is that:

(a) a different deferral period could apply to mechanical risk products; and

(b) the consumer communication for these products could specifically inform the consumer that cover will not commence for a considerable period of time, and of the consequent risks and disadvantages in purchasing the product.

242 The consumer communication could also include specific references to terms of cover that, in practice, restrict the capacity of consumers to assess the future value of the product. Examples of these clauses include the following:

(a) *Clauses which restrict the maximum amount payable to the market value of the vehicle at the time of any claim*—This means that the consumer is being asked to buy the policy when the maximum amount payable cannot be known at the time of sale and will vary for factors beyond the control of the consumer.

(b) *Exclusions for faults that develop during the term of the manufacturer's warranty*—The consumer will be unaware of what faults may develop in the three to seven years of the manufacturer's warranty and therefore, of their impact on the cover offered.

Review of warranties by Consumer Affairs Australia and New Zealand

243 In April 2017, Consumer Affairs Australia and New Zealand (CAANZ) released a final report on its review of the Australian Consumer Law. The report included proposals for reform for all extended warranties that are not financial products (i.e. not only warranties covering cars) such as a cooling-off period of 10 working days from the time the consumer receives the written agreement. This would allow a consumer to cancel the agreement within 10 working days and receive a refund if they decided not to go ahead with the product. Where the trader does not meet all of the proposed disclosure obligations, the cooling-off period would be extended to an unlimited time.

Note: See CAANZ, Australian Consumer Law Review, Final report, pp. 23–26.

244 Our proposal for a deferred sales model for mechanical risk products is broader than the cooling-off period proposed by CAANZ. We consider this is appropriate given the length of cover offered under manufacturer's warranties for cars, noting that some car manufacturers are considering extending their warranty periods (to demonstrate the quality of their cars to the consumer).

Your feedback: Mechanical breakdown insurance and warranties

E1.4Q1 Should a separate deferred sales model be introduced for these products? If not, how could the particular risks associated with these products be addressed?

Proposal 2: Enhanced supervision obligations for product providers

Proposal

E2 We propose to introduce specific requirements for the supervision and monitoring of a provider's authorised representatives, based on the risks for consumers in this distribution channel.

Rationale

245 We consider that providers of add-on products should have reasonable controls in place to prevent caryard intermediaries engaging in unfair conduct at the point of sale, and should be able to effectively identify and compensate consumers who have been sold add-on products as a result of such conduct.

246 This proposal complements the introduction of a deferred sales model in that the proposed change to sales practices (including standardising procedures) could make supervision more straightforward.

247 The current level of supervision and monitoring by providers of their authorised representatives is manifestly inadequate. For example, we found that some caryard intermediaries engaged in unfair conduct at the point of sale for extended periods of time that clearly demonstrates a failure to properly supervise or monitor their conduct: see paragraphs 60–65.

248 Further, it is extremely rare for insurers to sanction or discipline their authorised representatives. Paragraph 117 of REP 471 stated:

> We found that life insurers had approximately 5,900 authorised representatives who sold add-on insurance products, of which around 96% were car dealers. However, no authorised representatives had their authorisations cancelled for misconduct, and only nine were warned in writing in relation to misconduct (0.16%, or one in every 644 authorised representatives).

249 We consider that there is a correlation between:

(a) the low levels of supervision and monitoring; and

(b) the greater risks of mis-selling in the caryard intermediary distribution channel, including risks that arise from the amount and form of the commissions arrangements.

250 In particular, insurers have explicitly accepted that high commissions drive unfair sales practices. In their application to the ACCC in September 2016 (to impose a voluntary cap of 20% on commissions paid to car dealers), insurers stated that the level of commissions contributed to unfair or misleading conduct at the point of sale, and that a reduction in commissions would only mitigate the extent to which this conduct occurred (rather than preventing it).

Note: See Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors, Submission to the ACCC, 2 February 2017.

251 Further, insurers typically offer commissions where payment is solely dependent on the caryard intermediary achieving sales. The risks associated with these types of payments have been criticised in other contexts. In particular, the April 2017 report on Retail Banking Remuneration Review by Stephen Sedgwick AO stated (at pp. 12–13):

> Conversely, nothing has emerged since publication of the Issues Paper that has changed my view that some practices of some banks entail an unacceptably high risk of incentivising poor selling practices, potentially leading to poor customer outcomes… One such practice is the linking of the size of a variable reward payment directly to the achievement of sales targets or similar measures such as cross sales or referrals. The effect of this practice is that sales success is rewarded irrespective of performance against other measures such as customer oriented measures. The risk is that staff or other observers interpret this as a signal that “only sales matter”, or “sales matter most”, even when staff must demonstrate certain minimum standards of behaviour towards customers to qualify for any incentive payment at all.

Note: The banks have agreed to implement the recommendation in the report that they should abandon variable reward payments and campaign-related incentives that are directly linked to sales or the achievement of sales targets.

252 ASIC's view is that a number of other factors contribute to inappropriate sales practices. These include the number of authorised representatives and their geographic dispersion, and the commercial pressures placed on car dealers, including by manufacturers.

253 As noted earlier, we do not consider that it is appropriate for the amount or rate at which commissions are payable to be reviewed as part of this process: see paragraph 10. We are therefore seeking to drive changes by requiring providers to exercise more control over the conduct of their authorised representatives.

254 We think that sales practices will be fairer and consumers would benefit if there were clear minimum requirements on supervision for insurers and product providers. We also consider that it is desirable to impose specific obligations to ensure a clear break with the emphasis on achieving sales targets, and to reinforce the need for providers and their representatives to move to a consumer-centric model. In the 2017 report on Retail Banking Remuneration Review Stephen Sedgwick AO also stated (at p. 13):

> This risk [that staff consider that "only sales matter", or "sales matter most"] is accentuated if the workplace culture is heavily sales oriented, which some banks concede is likely to be the case after many years in which sales performance has been highly valued and rewarded.

255 We consider that current supervision practices could be improved by requiring providers to properly identify and address the risks in this distribution channel, and to respond to information that may indicate failings in the system.

256 These requirements should include the development and use of sophisticated risk indicators to allow early identification of possible non-compliant or unfair sales practices through:

(a) choosing indicators that address the specific risks in their business models for the sale of add-on products;

(b) identifying the data necessary to support that identification;

(c) determining which data sources will provide that data in a way that is reliable and consistent; and

(d) monitoring and reviewing the indicators and the findings from their use to ensure they remain effective.

257 Appropriate risk indicators could include tailoring the level of supervision according to:

(a) *the amount and basis on which commissions are earned*—for example, a provider could have more robust supervision requirements if commission payments are solely sales-based (and conversely less rigorous requirements if different criteria are used); and

(b) *whether a representative has been identified as having a history of non-compliant or unfair sales practices*—for example, if a person has been found to fail to follow instructions about how to sell add-on products, or to mislead or pressure consumers to buy products in ways that are unfair, the level of supervision should be enhanced (and the provider should not simply rely on additional training without also testing whether that has changed the person's behaviour).

258 Examples of other requirements that could be introduced include:

(a) detailed reviews of penetration rates (as high or atypical penetration rates may be an indicator of unfair sales practices);

(b) post-sale interviews with a statistically robust sample of individual consumers or shadow shopping exercises (to ensure providers are aware of the consumer experience);

(c) requiring providers to undertake strict accreditation checks both before appointing authorised representatives, and afterwards on a continuing basis (noting that ASIC has identified examples of individuals who have continued to be authorised representatives even after being prosecuted for criminal offences); and

(d) requiring providers to have greater visibility about complaints (given that some consumers may lodge complains with the lender that also relate to the conduct of the individual in relation to the sale of add-on products).

259 We also consider that insurers should have procedures in place to more effectively deter their representatives from engaging in unfair conduct. This could include:

(a) removing or suspending their authorisations (notwithstanding the impact this may have on the level of sales for the provider); and

(b) actively identifying and compensating consumers where systemic misconduct has occurred, and seeking clawbacks of commissions paid in relation to those sales.

Your feedback

E2Q1 Given the limitations in monitoring conduct at the point of sale, what changes would be necessary to ensure providers are effectively supervising their representatives?

E2Q2 What risk indicators could be introduced to improve the capacity of providers to monitor their representatives?

E2Q3 What sanctions would be most effective in deterring representatives from engaging in unfair practices at the point of sale?

F Regulatory and financial impact

260 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

261 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

262 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

Note: See 'The consultation process', p. 4.

Appendix: Accessible version of Figure 1

263 This appendix is for people with visual or other impairments. It provides an accessible version of the sales sequences shown in Figure 1 in table format.

Table 12: Interaction of add-on products with car purchase and finance

Sales sequence	Advantages	Disadvantages
A: Car—Add-on products—Finance	Consumer can assess products offered based on risks associated with the particular car Consumer is less likely to experience decision fatigue for add-on products	Exact cost of products is not known (as interest rate/loan term has not been finalised) Consumer cannot assess impact of add-on products on loan amount and term
B: Car—Finance—Add-on products	Consumer can assess products offered based on risks associated with the particular car Exact cost of products is known (as interest rate/loan term has been finalised) Consumer can assess impact of add-on products on amount borrowed and loan term	Consumer and lender may need to adjust loan amount or term to allow for additional costs Consumer is likely to experience decision fatigue but this would be mitigated by deferral period
C: Add-on products—Car—Finance	Decision fatigue for add-on products would be minimised	Consumer cannot assess products offered based on risks associated with the particular car Exact cost of products is not known (as neither car purchase nor interest rate/loan term has been finalised) Consumer cannot assess impact of add-on products on loan amount and term Consumer is more likely to experience decision fatigue for car purchase and finance

Note: This table shows the sales sequences set out in Figure 1.

Key terms

Term	Meaning in this document
2013–15 financial years	The three-year period comprised of the 2013–14, 2014–15 and 2015–16 financial years
AADA	Australian Automotive Dealer Association
ACCC	Australian Competition and Consumer Commission
add-on insurance/ products	General insurance policies ‘added on’ to the sale of a primary product, most commonly with the purchase of a motor vehicle
add-on products	Add-on insurance and warranties regulated by the Corporations Act other than comprehensive or CTP insurance products)
ADI	Authorised Deposit-taking Institution
ASIC	Australian Securities and Investments Commission
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
BMW Finance	BMW Australia Finance Limited
CAANZ	Consumer Affairs Australia and New Zealand
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
caryard intermediaries	A range of entities who distribute add-on products, where the sale of these products is associated with the acquisition of a car by the consumer
CCI	Consumer credit insurance (see paragraph 17 for an explanation of this insurance in the context of our reviews)
claims ratio	The total premiums paid upfront by consumers for new policies compared to total claims paid out by insurers
comprehensive insurance	Comprehensive car insurance
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
CTP insurance	Compulsory third party insurance
FCA	Financial Conduct Authority (UK)

Term	Meaning in this document
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
ICA	Insurance Council of Australia
Insurance Contracts Act	*Insurance Contracts Act 1984*
life insurance/cover	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')
mechanical risk products	Mechanical breakdown insurance and third party warranties sold with new cars or with used cars where the vehicle is still covered by the manufacturer's warranty
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	Sch 1 of the National Credit Act
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
QBE	QBE Insurance (Australia) Ltd
REP 470 (for example)	An ASIC report (in this example numbered 470)
s916A (for example)	A section of the Corporations Act (in this example numbered 916A) unless otherwise specified
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 from blowouts, punctures or from road hazards
volume bonuses	Payments made calculated according to the volume of business placed or arranged with the insurer in a specified period

List of proposals and questions

Proposal	Your feedback
E1 We propose that the sale of add-on products by caryard intermediaries for a new or used car should be permitted only after a certain period of time has elapsed (the deferral period). During the deferral period: (a) providers would be restricted from offering, or entering into, a contract for an add-on product with a consumer; (b) caryard intermediaries would be restricted from: (i) arranging for a consumer to apply for an add-on product; or (ii) referring a consumer to a product provider in relation to an add-on product; and (c) consumers would be restricted from initiating the purchase of an add-on product directly with the provider, or opting-out of the deferral period. Table 10 sets out key issues in the design of any deferred sales model. Note: The proposed options in Table 10 are not intended to be definitive. We welcome further suggestions.	E1Q1 Do you consider that it is appropriate to apply a deferral period to the sale of add-on products by caryard intermediaries? E1Q2 To what extent would a deferral address the consumer harms identified in this market? E1Q3 How would the proposal affect businesses (e.g. insurers, car dealers, finance brokers, credit providers)? Would it have a different impact on small businesses? E1Q4 Would the model need to apply differently to the new and used cars markets? In what ways could the model differ to be effective across the two markets? E1Q5 What are the preconditions for a competitive online market? How can a deferred sales model contribute to this outcome? E1Q6 Could the objectives of a deferred sales model be achieved in a different way or could any complementary measures better ensure our objectives are achieved? E1Q7 If a deferred sales model was introduced, are there any existing related obligations on insurers, finance providers and car dealers that would no longer be appropriate and could be removed? E1Q8 What is the most effective way of testing whether consumer understanding has improved due to a deferred sales model? What metrics would provide the best way of measuring consumer comprehension? E1Q9 Should a consumer opt-out mechanism be included?
Commencement of the deferral period **E1.1** We do not propose in this paper a specific trigger event for the commencement of the deferral period and seek stakeholders' views on this. The period could commence when the consumer: (a) receives a consumer communication (with mandated content); (b) finalises the vehicle purchase and receives the consumer communication; or (c) takes delivery of the vehicle and receives the consumer communication.	E1.1Q1 Which of the proposed options in paragraph 193 for commencement of the deferral period would be preferable and why (please suggest other options if relevant)? E1.1Q2 Which sales sequence (see Figure 1) is most likely to meet our stated objectives and why? E1.1Q3 How could the point at which the deferral period commences be easily documented to be readily verified by all relevant parties? E1.1Q4 If the deferral period commenced at vehicle delivery, could short-term 'bridging' insurance be offered to cover the deferral period (only)? What does insurers' claims data demonstrate about the likelihood of a claim shortly after delivery?

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Duration of the deferral period **E1.2** We propose that the total duration of the deferral period for add-on products (except those discussed in proposal E1.4) could be a: (a) minimum of four days; and (b) maximum of 30 days.	E1.2Q1 What would be the appropriate duration of the deferral period within the range of 4–30 days and why? E1.2Q2 Should the duration of the deferral period be different for new and used cars? E1.2Q3 What is the average period of time between the sale of a new car or a used car and its delivery to the consumer? What is the shortest period of time and how common is it? E1.2Q4 What is the average period of time between when a consumer applies for finance and approval? What is the shortest period of time and how common is it?
Consumer communication **E1.3** We propose that the consumer communication should: (a) address the current limitations in consumers making informed decisions (as discussed in Section C); (b) include information about each type of add-on product being offered through the car dealership (e.g. in a standardised format) and how they interact with other elements of the transaction; (c) provide information to consumers that is accessible and addresses different levels of comprehension or financial literacy; and (d) make use of innovative techniques to deliver this information to the consumer.	E1.3Q1 Should providers be required to take active steps to ensure consumers read and understand information about their products before they can buy them? E1.3Q2 What forms of innovative disclosure could be used to better inform consumers about their insurance decision? E1.3Q3 What information should the consumer communication include? E1.3Q4 Should providers be required to inform consumers about the availability of other products that provide similar cover, but may be cheaper? E1.3Q5 If so, what information should the consumer communication include?
Mechanical breakdown insurance and warranties **E1.4** Where these products are sold with new cars or used cars that are still covered by the manufacturer's warranty, we consider that: (a) a different deferral period could apply; and (b) the consumer communication could be tailored to explain that cover will not commence for some time and set out the consequent risks in buying the product.	E1.4Q1 Should a separate deferred sales model be introduced for these products? If not, how could the particular risks associated with these products be addressed?
E2 We propose to introduce specific requirements for the supervision and monitoring of a provider's authorised representatives, based on the risks for consumers in this distribution channel.	E2Q1 Given the limitations in monitoring conduct at the point of sale, what changes would be necessary to ensure providers are effectively supervising their representatives? E2Q2 What risk indicators could be introduced to improve the capacity of providers to monitor their representatives? E2Q3 What sanctions would be most effective in deterring representatives from engaging in unfair practices at the point of sale?