14th September 2017

Mr Christian Mikula
ACT Regional Commissioner Senior Specialist – Deposit Takers, Credit and Insurers
Australian Securities and Investments Commission
Level 2, 2 Allsop Street
Canberra ACT 2600
By Email: add-on.consultation@asic.gov.au

Dear Mr Mikula,

**RE: The sale of add-on insurance and warranties through caryard intermediaries
ASIC Consultation Paper 294 (August 2017)**

We refer to the recent media release 17-280MR published 24th August 2017 and Consultation Paper 294 (August 2017) regarding "The sale of add-on insurance and warranties through caryard intermediaries".

Before we address ASIC's specific queries, AFS provides the following general feedback for ASIC's consideration in relation to add-on insurance and warranties.

Firstly, the sale and financing of add-on insurances and warranties has been an area of constant consternation for credit providers for many decades. Despite enhancements to the law via the introduction of the Uniform Credit Code and FSRA reforms, the legal framework that governs these products continues to fail consumers.

Furthermore, AFS believes that the reform proposals outlined in CP294 may fall short of achieving ASIC's objectives particularly in respect to fairer sales processes and product value due to inherent conflicts of interest driven by high commissions and underwriting profits.

We appreciate that ASIC will face enormous pressure from insurers, product licensees, finance brokers, car dealers and even 'conflicted' credit providers to water down progressive changes that improve consumer outcomes due to the highly profitable nature of these products and the ease by which these products can be readily 'packaged' or 'sold to' consumers.

We are also concerned that industry participants such as insurers and car dealers have indicated that they can 'work around' the current suite of proposed changes to ensure these contentious products continue to be 'sold to' consumers, hence retaining insurer, finance broker and car dealer super-normal profits to the detriment of consumers.

Therefore, we are of the firm opinion that other reforms must be considered to ensure enhanced consumer outcomes in the market. In particular, we request that the reforms **prohibit the financing of premiums for add-on products** through the related finance contract or lease as the financing of add-on insurances is the key driver to the broad distribution of these products.

We also believe any reform package should include capping the amount of commissions paid to car dealers for the sale of add-on products in line with the industry's proposed **voluntary cap of 20%** and prohibiting authorised representatives from issuing add-on products where the consumer cannot reasonably be expected to benefit from it.

We commend ASIC's work in the design of a robust outcome in respect to flex commissions and we trust that a similar outcome will be achieved in relation to add-on insurance and warranties.

Key terms

caryard intermediaries	AFS is aware of poor consumer outcomes in relation to add-on insurance in the private sale market that is largely serviced by finance brokers. We believe ASIC should ensure reforms are market-wide and competitively neutral and broaden this definition by removing 'caryard' and referring to the key term as '**intermediaries'** or **'insurance intermediaries'**.
car dealer	The current definition of 'car dealer' is quite narrow. Please note that where AFS makes reference to the key term "**car dealer**", we are also referring to suppliers who deal in marine goods, such as boats and jet-skis, caravans, and camper trailers where the sale of add-on insurance is just as wide spread as through car dealers and motorcycle dealers. Therefore we recommend that ASIC expand the definition of car dealer to cover dealers of leisure goods.
maintenance service contract	A clear distinction between '**mechanical breakdown insurance**' (subsection 136(2) of the NCCP Code) and non-underwritten dealer warranties or maintenance service contracts should be made. Where dealers are not authorised to issue products of insurance or financial risk management products, a dealer is still permitted to warrant the goods sold, provided they are not issuing a product of insurance. AFS believes ASIC should clarify that where a **maintenance service contact** is provided, the car dealer is not permitted to 'hold-out' that these dealer service contracts are an insurance product or to finance these non-underwritten products as products of insurance in contravention of the credit laws. Furthermore, third parties, such as finance brokers, should not issue this type of product on behalf of the dealer due to a high risk that the consumer may mistake a dealer service contract for a product of insurance, particularly if it has been incorrectly disclosed as mechanical breakdown insurance on a regulated credit contract.

We provide our response to ASIC's queries in the same sequence as raised in the Consultation Paper.

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?

Yes, but excluding comprehensive or compulsory third party insurance (CTP).

Add-on insurance and warranties are financial products that are generally sold to consumers using high pressure tactics and that often cast aspersions on not only the authorised representative issuing the product at the car dealership but also on the credit provider that in itself has been pressured to finance these high price/low value products.

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

The introduction of a suitable deferral period will assist the consumer to make an informed purchase decision independent from the actual purchase and delivery of their vehicle/leisure product.

AFS AUTOMOTIVE FINANCIAL SERVICES

AFS is of the firm opinion that these add-on insurance and warranties **should not be financed by the credit contract** that finances the goods being purchased due to the inherent conflicts of interest at point of sale.

We are concerned that industry participants such as insurers and car dealers have indicated that they can 'work around' ASIC's proposed deferral model to ensure these contentious products continue to be 'sold to' consumers, hence retaining insurer, finance broker and car dealer super-normal profits to the detriment of consumers.

As the financing of add-on insurances is the key driver to their success, prohibiting the ability to finance these products in conjunction with the goods being purchased is paramount.

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?

Insurers:

- The reforms would promote change away from an out-dated high pressure selling model pre-delivery to a more considered and informed post-delivery model.
- Assuming the sale of add-on insurance will occur post-delivery, the implementation of a Pay-As-You-Go payment method for premiums would supersede the outdated method of financing the entire premium upfront in the point of sale credit contract, enabling consumers to terminate their insurance at any time with ease.
- Potential development of a centralised call centre model, supported by enhanced online information and material that can be mandated by the regulators.
- Potential concentration of authorised representatives and the appointment of select authorised distributors to ensure enhanced supervision over arranging and issuing add-on insurances.
- If the proposed voluntary cap of 20% is adopted, premium prices will be substantially reduced resulting in a vastly improved value proposition.
- We believe the proposed reforms may prompt some insurers to withdraw these add-on products from the market due to the substantial compliance risks.

Car Dealers:

- (including boat dealers, motorcycle dealers, caravan dealers et al) Depending on the extent of the reforms, we envisage a lower frequency of sale of add-on insurances, lower premiums and resultant lower level of commissions.
- Should a prohibition of financing add-on insurance on related credit contracts be adopted, it would also eliminate the payment of commission on the financed insurance amount where currently the introducer of the business currently receives two lots of commission for the same product sold ie. one from the insurer & one from the financier for the elevated net amount financed.
- If the sale of add-on products is greatly reduced, we believe it would result in improved customer experience and expedited vehicle delivery process due to the elimination of lengthy disclosure and sale process required for add-on insurances.
- If car dealers are prohibited from financing the premium of these products on a credit contract, they may devise new methods of indirectly financing them through loading the sale price of the vehicle and wrapping the product(s) up in the dealer invoice so that they are camouflaged from the credit provider and regulator(s). Any prohibition of financing add-on insurance on the related finance contract, must also prohibit the car dealer from 'gaming' the system and loading the add-on insurance premium(s) into the price of the vehicle (except for new vehicles).

Finance Brokers:

- Lower frequency of sale of add-on insurances, lower premiums and resultant lower level of commissions.
- Larger aggregators may be appointed by insurers as insurance product distributors providing enhanced supervision for insurers obligations.
- Refer comments above on duplication of commission payment for the same product

Credit Providers:

- Potential voluntary prohibition of providing credit for add-on insurance and warranties which are considered low in value to both consumers and the credit provider.
- Reduction in net amount financed by consumer resulting in lower repayments and interest payable by the consumer.
- Reduction in commissions paid to finance brokers and car dealers due to lower net amount financed.
- Reduced regulatory risk as a consequence of new reforms.

We don't believe the proposal would have a different impact on small businesses but would be proportional.

Having said that, if a reduction or restriction on commissions were mandated, smaller car dealers may not have the ability to benefit from 'indirect' or 'secret' commissions generally paid to larger corporate authorised representatives. We believe such benefits range from cash payments in excess of $1M paid to a large car dealer group to switch supplier of add-on insurance products, to the purchase of vehicle hoists and other service equipment, payment of advertising costs to media houses etc. Such 'indirect' commissions are extremely difficult for regulators to monitor.

Obviously any voluntary or mandated cap of the amount of commissions paid to car dealers, finance brokers, auction houses, and credit providers for the sale of add-on products should be drafted to prevent insurers from 'gaming' the system. We believe the industry's proposed voluntary cap of 20% may have been considered by industry participants with intentions of 'gaming' the system and hence ASIC's strategy to work thoroughly through this complex area is applauded

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?

No.

The only way the model could differ is in the case of the new car market, the ability to extend the manufacturers warranty (which have the greatest consumer benefit) may be granted as an exclusion from the deferral period and also be allowed to be financed as part of the vehicle price. This may encourage insurers to work with manufacturers to deliver warranty products that provide far greater value to consumers than buying a warranty as an after-market product.

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

A deferred sales model would greatly reduce the sale of add-on insurances by car dealers and finance brokers, particularly if the products are banned from being financed at point of sale. <u>We see this as a must have precondition for a competitive online market.</u>

However, a deferred sales model would prompt insurers to look for improved delivery mechanisms that deliver a better consumer experience and outcomes, similar to that which has occurred in the online sale of comprehensive insurance and CTP.

It is feasible that the model would promote the proliferation of online insurance supermarkets, supported by centralised call centres with enhanced supervision by the product issuer. Consumers would have ready access to online disclosure information, be able to readily compare premium prices and make an informed purchase decision outside the high pressure sale environment of a car, boat, bike or caravan dealership, auction house or finance broker in the private-to-private market.

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?

Not likely. Again, banning the financing of add-on insurance at the point of sale is critical to achieving success of all stated objectives.

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?

No.

However, if the financing of add-on insurance at the point of sale is not permitted under the new model, then credit providers may be able to streamline their credit contracts by removing unnecessary references to the various add-on insurance products.

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?

A reduction in customer complaints through the EDR schemes is a tangible metric to track before and after the introduction of the new model.

Unless a product comprehension test is introduced prior to the sale of the various add-on insurances, it is otherwise difficult to gauge and monitor consumer comprehension.

E1Q9 Should a consumer opt-out mechanism be included?

No. This only promotes high-pressure selling tactics which is exactly what we are all trying to eliminate.

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)?

Option (c) - When the vehicle has been delivered to the consumer and the consumer communication has been provided.

The primary reason why this option is the preferred is that it removes the ability for car dealers to incorporate add-on insurances into the credit contract for the vehicle purchase. This enables the consumer to take time to evaluate the complexities of the various add-on insurances, the cost and benefits, and the most effective way to pay for these products.

To ensure that car dealers and insurers don’t devise a method of circumventing this option (such as delivering the vehicle pre-settlement of the credit contract, with the insurer providing the car dealer a new ‘guaranteed settlement’ insurance product to enable them to do so), ASIC should expand the definition of “**delivered**” to include circumstances where the vehicle is being financed that delivered also includes any related credit contract having been settled.

Alternatively, a new Option (d) could be introduced that builds onto Option (c) as follows:

Option (d) - When the vehicle has been delivered to the consumer, the consumer communication has been provided *and any related credit contract has settled*.

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

Sales sequence B, however, this is inadequate.

There should be a further option "Sales Sequence D" which is derived from Sales Sequence B but where the finance has 'settled'. This is AFS' preferred sales sequence.

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

Establishing a clearly defined deferral point is not an easy task due to the fluid nature of a vehicle sale and the various parties involved in the transaction(s). However, the **payment for the vehicle** is clearly the most tangible point that can be readily audited by the regulator via the use of bank statements.

The benefit of establishing the deferral point as the point where '**payment in full**' has been made is that in the event that the customer or lender has paid for the vehicle but not yet taken delivery, the car dealer can still proceed with the sale of the add-on insurance prior to delivery.

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?

As noted in E1.1Q1, the introduction of a deferral sales model may result in a new delivery sequence being developed by car dealers and insurers, where the insurer undertakes to insure any event where the lender does not settle a credit contract thus enabling a car dealer to 'pre-release' the vehicle to a consumer, satisfying ASIC current definition of 'delivery' but enabling the car dealer & insurer to readily incorporate add-on insurances into a related credit contract. Again, ASIC should expand the definition of "**delivered**" to include circumstances where the vehicle is being financed that delivered also includes any related credit contract having been settled.

On a product specific basis, the underwriting guidelines of the add-on insurance products could be enhanced to provide the 'bridging' cover within the product disclosure statements. For instance, comprehensive insurers could provide 30 days total loss cover for used vehicles for minimal additional cost or customer's should be encouraged to acquire an 'agreed value' policy which covers any potential gap. Please note that most insurers provide 'replacement car cover' for new to 2 year vehicles in any case.

In relation to consumer credit insurance, consideration could be given to extending the 'cooling-off period' to 30 days where the car dealer has arranged finance for the car (goods) and a customer looses their job that they would be entitled to return the vehicle (goods) back to the dealer without penalty.

In regards to the likelihood of a claim occurring shortly after delivery, AFS' experience with its borrowers is as follows:

- The highest incidence of claims occurs with comprehensive insurance due to general motor vehicle accidents. Having said that the incidence of a total loss occurring shortly after delivery is small.
- The next highest incidence occurs with warranty insurance on used cars. However, most insurance claims occur post the expiry of the statutory warranty that last for three months or 5,000 kilometres after purchase, whichever occurs first, so there is little to no requirement for 'bridging' cover in respect to warranty cover. Where a statutory warranty is not provided, then a dealer guarantee under Australian Consumer Law requires motor dealers to repair or make good, at their own expense, any defective vehicles they sell. To 'make good' means the vehicle must be repaired or remediated so that it is in a reasonable condition having regard to its age.
- The incidence of gap or CCI claims occurring shortly after delivery is negligible in our experience.

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?

In the used car market many dealers are now promoting a 7 day exchange policy where a customer may not be satisfied with the vehicle they have purchased, enabling the consumer to select a replacement car.

Therefore a deferral period should not commence until a reasonable time after the delivery of the vehicle.

Having said that, further consideration needs to be given to the fact that most States require car dealers to cover certain aspects of the goods they are selling under a statutory warranty. Where an after market warranty has been sold, car dealers will often defer rectification of the issue at their cost to the insurer or third party provided warranty. Unfortunately this can result in further consumer stress regarding their newly acquired vehicle.

As most critical issues will (or should) be resolved by the car dealer in the initial period after delivery, we believe a deferral period between **14 days and 30 days** is fair and reasonable.

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

No.

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?

In the used car market, sale and delivery timeframes are expedited, compared to the new car market, as vehicles are generally registered and displayed on a drive-away basis. It is quite common for same day sale & delivery to occur during weekdays as finance companies are readily able to verify required information and approve a loan application within the same day. For sales that occur on the weekends, most deliveries will occur on the Monday or Tuesday after the loan has been approved.

In the new car market, restricted supply of stock and the fact that almost all vehicles are unregistered at the time of sale means that delivery to the consumer will often be a week after the sale, and much longer if the vehicle is not in stock.

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?

Our observation of general turnaround times between application and approval in the car finance industry where the application is made at a car dealership, or via a finance broker, is around **2 – 3 hours**.

However, a number of large institutions promote auto-approvals where verification of the information is digitised or is done prior to the credit day, providing an instant answer for the car dealer (**less than 1 minute**). This is designed to provide efficient service, particularly on weekends, and is the shortest period of time. We believe that some bank owned finance companies are achieving ratios of circa 50% auto approvals through car dealers.

At AFS, we generally provide a 'same day' answer where a full application and all required supporting information has been supplied before midday. Where applications are submitted in the afternoon, we generally provide a 'next day' answer. Timeframes are subject to the requirement to make inquiries and take steps to verify the consumer's requirements, objectives and financial situation in relation to the credit contract.

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?

Yes. To ensure a minimum standard of compliance, it is preferable that the information required to be disclosed and understood is delivered electronically and confirmation of receipt and understanding also acknowledged electronically. This may also include some form of comprehension yard stick/test.

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

ASIC could develop a MoneySmart Add-on Insurance app similar to the Cars app that provides generic market knowledge about these complex products.

At the conclusion of each product review, ASIC could issue to the consumer's email address a unique reference number that could be mandatory to key into the insurers insurance policy origination system thereby ensuring consumers are informed with a minimum information set that details risks, costs and probabilities associated with each product.

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

Information should detail standard disclosures, such as it is not mandatory to take out any form of add-on insurance, associated risks, costs and probabilities of certain events occurring and details of product benefits and exclusions.

Importantly, the most prominent providers of the same type of insurance product should be listed, with links to the relevant online information for each provider/product, so that consumers are empowered with the necessary information to compare various product offerings in the marketplace.

We also believe insurers should be required to publish uniform pricing online for each add-on products and the various cover types. '**Standardised Pricing**' for each product issued is critical. We are concerned that many car dealers & intermediaries negotiate independent pricing to maximise the combination of upfront commission and volume bonuses. In other words, a consumer may pay one premium to one car dealer and a higher inflated premium to the next because the later car dealer has negotiated a higher upfront commission or volume bonus.

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?

Yes.

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

We believe providers should be required to inform consumers about the availability of other products that provide similar cover, including the provider's name, generic product name, and a link to the relevant online information for each provider/product, so that consumers are empowered with the necessary information to compare various product offerings in the marketplace. We envisage that any online product information board would also include premium pricing and commissions.

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?

In general, AFS believes that implementing a separate deferred sales model introduces an unnecessary additional layer of complexity.

Having said that, there is an argument that a separate deferred sales model could apply to the new car market, which would enable car dealers to extend the manufacturers warranty (which have the greatest consumer benefit). This may encourage insurers to work with manufacturers to deliver warranty products that provide far greater value to consumers than buying an after-market warranty product.

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?

This is an extremely complex area given the geographic dispersion of individual authorised representatives, paper-based disclosure, the complex nature of the products and the high rewards at stake.

Many of the insurer's have watered down the on-going training requirements for authorised representatives arguing that the products are general in nature and can be sold on a 'no advice' basis. However, we suggest that many authorised representatives shift their selling techniques to a 'general advice', or even 'personal advice', basis without the requisite RG146 (Tier 2) training and further ongoing training requirements. We recommend ASIC consider mandating that these add-on insurance and warranties require a minimum training level of RG146 (Tier 2) – General Advice, and that each authorised representative must undertake an annual refresher course or minimum hours of continuous professional development each year. This would ensure that providers are monitoring their authorised representatives on an annual basis.

Insurers and providers also rely on authorised representatives being classed as 'employees' so that they are NOT required to separately record each individual authorised representative on the professional registers but merely the details of the corporate authorised representative. We believe legislation should be changed so that it becomes a requirement for individual (natural persons) authorised representatives to be recorded in the professional registers to heighten the level of accountability, similar to that in the credit industry.
ASIC, and all licensees that the individual is authorised to represent, would then have clear visibility of the individuals activity, including details of any suspension, cessation, or remedial action.

We believe improvements could be made regarding the sharing of information between licensees, so that if an authorised representative is noted as ceased, a reason be given and this information shared with all active licensees, in order that they can determine whether any tailored monitoring or supervision activities are required.

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

Risk indicators could be introduced to improve the capacity of providers to monitor their representatives are:

- Mandatory breach reporting
- Mandatory consumer complaints reporting
- Mandatory commission reporting at the corporate authorised representative level

These should all be recorded and disclosed on the professional registers so that insurers, corporate authorised representatives and individual authorised representatives are motivated to avoid behaviour that may be detrimental to consumer outcomes.

Mandatory commission reporting would also assist alleviate a culture of high commissions that are central to the inherent unfair sales practices within the car dealer market.

We also recommend that, where an insurance product has been financed, the credit provider be granted online access to lodge a negative report on the professional register to improve the efficiency and transparency of poor consumer experiences. This is because the credit provider is often the party that first fields these complaints but does not have a direct relationship with product providers to efficiently lodge this on the consumer's behalf. Having an ability to lodge a complaint on behalf of the debtor may improve outcomes for consumers.

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

As per E2Q2 above, mandatory reporting on the professional registers would be a transparent and effective way to deter representatives from engaging in unfair practices at the point of sale.

This could be supported by clearly identifying breakdowns in the issuing of the product, where applicable, and details of any remedial action such as a refund of the premium or clawback of commissions.

Enforcing this with a minimum performance criteria would assist dampen unfair practices dramatically. We suggest a criteria such as three (3) negative reports within any consecutive three (3) year period results in instant suspension, pending review by the provider or a regulator. Again enforcing monitoring and supervision upon the provider.

Please do not hesitate to contact us about the information provided.

Yours faithfully,

Brad Dale
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