Reforms to the sale of add-on insurance products

Submission by the Australian Securities and Investments Commission

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Executive summary

1 The Australian Securities and Investments Commission (ASIC) supports the introduction of an industry-wide deferred sales model for both add-on insurance products and insurance-like products, as set out in the Treasury proposal paper *Reforms to the sale of add-on insurance products* issued on 9 September 2019 (Treasury reform paper).

2 The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) reviewed this market and considered that the case for introducing a deferred sales model for the sale of add-on insurance products had been clearly established. Recommendation 4.3 of the Royal Commission is that an industry-wide deferred sales model should be introduced as soon as reasonably practicable.

3 We support linking the deferred sales model to the circumstances in which the add-on insurance product is sold, as the Treasury reform paper proposes. This acknowledges that the harm being addressed by the proposal arises from the connecting of the sale of the insurance product to the sale of the primary product.

4 Examples of the poor outcomes that can arise for consumers include:

(a) *Price discrimination*—This occurs where the insurer charges different consumer segments significantly different amounts for the same goods (see the example in Box 1 in the Treasury paper, which describes how the same policy was offered for sale at $577 as a standalone product and for $1,448 as an add-on product).

(b) *Unfair sales practices*—ASIC's investigations into add-on insurance products have found that intermediaries could structure the sales process to be fatiguing for consumers, 'hijack' consumer attention, distort consumers' perceptions of cost and cover, and rush decisions on grounds other than the value of the products.

(c) *A culture that fails to prioritise the consumer's interests*—Swann Insurance gave evidence to the Royal Commission that Swann 'viewed its customer, in effect, as being the dealer', rather than the consumer who purchased the insurance policy.

Note: See Royal Commission, Round 6 hearing, 18 September 2018, Benjamin Bessell, transcript at P-6098.

5 In light of these findings we agree with the conclusion of the Royal Commission 'that the problems evident in the motor vehicle add-on and CCI add-on contexts extend across the add-on insurance market'.

Note: See Royal Commission, *Final report*, February 2019, vol 1, p. 290.

6 We therefore endorse the approach in the Treasury reform paper, of including add-on products in Tier 2 by default, as the most effective way of immediately addressing consumer harm and delivering improvements, including better value products (as premiums for add-on products become more competitive), improvements to cover (as products are designed to better meet the needs of consumers), and fairer sales processes.

7 The alternative approach, of including products in Tier 3 by default, would significantly increase the risk of ongoing harm to consumers and so fail to achieve the Royal Commission's policy objective of *preventing* harm in the add-on insurance market.

ASIC's work on add-on insurance

8 ASIC has undertaken significant work in reviewing the sale of:

(a) a number of different add-on products by caryard intermediaries; and

(b) consumer credit insurance (CCI) policies by lenders.

9 We have released four detailed reports as a result of these reviews:

(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);

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

(d) Report 622 *Consumer credit insurance: Poor value products and harmful sales practices* (REP 622).

10 The key findings in these reports support the case for Government intervention and are summarised in Table 1.

11 The extent of detriment to consumers from the sale of add-on products is also demonstrated by the dollar value of the refunds that ASIC has secured as part of its investigations:

(a) In response to ASIC's concerns in REP 470, REP 471 and REP 492, as at June 2019, there are 11 insurers, one underwriting agency and one warranty provider that have agreed to provide refunds of approximately $130 million to over 245,000 consumers.

Note: See Media Release (19-146MR) *ASIC announces further add-on insurance refunds, bringing total to over $130 million* (19 June 2019).

(b) Our review of lenders' practices in selling CCI is expected to result in lenders paying remediation of over $100 million to more than 300,000 consumers.

Table 1: Key findings in the add-on insurance market

Report	Focus of the 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 due to the way in which 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 indicated any intention to purchase these products). • Many consumers had a very poor recollection of which policies they had purchased, how much each policy cost and what it covered.
REP 471	This report analysed quantitative data from five insurers selling life insurance under 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 show the effect 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.

Report	Focus of the review	Key findings
REP 622	This report reviewed the sale of CCI by 11 lenders in the period 2011 to 2018	• For CCI sold with credit cards, consumers were paid only 11 cents in claims for every dollar they paid in premiums (and the more cover types in the policy, the lower its claims ratio). • For all CCI sold, this increased to only 19 cents in claims paid. • CCI sales practices cause consumer harm, including through: CCI being sold to consumers who were ineligible to claim or unlikely to benefit from or need cover; and sales staff who used pressure selling and other unfair sales practices.

A Policy design issues

Key points

This section sets out ASIC's views on the proposed deferred sales model, including recommendations for changes to ensure the model works as intended.

12 This section discusses the following issues in relation to Treasury's proposed deferred sales model:

(a) the definition of add-on insurance products;

(b) the commencement point and duration of the deferral period;

(c) the proposal for a three-tiered model and the criteria for exemptions for Tier 3 products;

(d) the proposal for a shortening of the deferral period if a consumer initiates the completion of sale of an add-on product; and

(e) the responsibilities proposed for ASIC in implementing the model.

13 In general, ASIC supports the model proposed by Treasury, and considers it has the potential to significantly improve consumer outcomes. Our comments on these issues are made with a view to ensuring the model operates as effectively and efficiently as possible.

14 In particular we support the approach in which add-on products are included in Tier 2 by default. Given the adverse nature of the findings in Table 1 in relation to both the motor vehicle insurance add-on market and the CCI add-on market, we consider that Government can have no confidence that the same practices do not prevail in other markets. The proposed model therefore strikes an appropriate balance between promptly addressing current consumer harm and placing the onus on insurers to demonstrate a positive case for exemptions.

Definition of 'add-on insurance products'

15 In the absence of an existing statutory definition of 'add-on insurance products', the approach taken in the Treasury reform paper is to define the products covered by this term by reference to the relationship between the insurance and the 'primary product'. It proposes that the deferred sales model will apply to 'insurance products that are offered or sold *at the same time* as when a consumer purchases the primary product or acquires finance for which the insurance covers associated risks'.

16 We agree with the approach taken by Treasury, as it seeks to address the harms arising from a sales process in which consumers are reliant on the limited information provided by one supplier and cannot 'shop around' to find the best deal.

17 We consider that a clear and broad definition of 'add-on insurance products' is integral to the effectiveness of the Government's deferred sales model. It is preferable to a narrow definition, given that ASIC will be given a specific exemptions power. A narrow definition may also create a risk of avoidance where *de facto* add-on insurance products are artificially structured to avoid the narrow definition.

18 We therefore consider that the phrase 'at the same time', as used in Treasury's proposed definition, will need to be defined in a way that covers all parts of the sales process, including the following situations:

(a) *In-person sales where the primary transaction has already been completed, but the consumer is still physically present on the retailer's premises*— The phrase 'same time' needs to include conduct after the sale of the primary product has been finalised.

(b) *Online sales where the retailer arranges for the consumer to be automatically redirected from its website to the insurer's website*— The deferred sales model should apply even though the sale is made directly with the insurer.

(c) *Sales where the initial payment by the consumer is deferred*— Under some models the consumer may be provided with free cover for the first month. These transactions should be subject to the deferred sales model where the arrangements for payment are made at the same time as the sale of the primary product.

19 We support the treatment of credit as a primary product. We consider it is important that the definition of 'add-on insurance products' clearly includes any insurance product where payment under the policy would reduce the consumer's liability under a credit contract. We consider that these products are inherently complex, given that the amount paid can reduce or vary with the balance of the loan. These products are also typically financed through a disbursement under the credit contract, which is a factor inhibiting consumer engagement and encouraging passive sales.

Commencement and duration of deferral period

20 The Treasury reform paper proposes that the deferral period commences based on the following sequence of two events:

(a) the consumer makes a financial commitment to purchase the primary product or arrange finance; and

(b) the retailer provides the prescribed information about the add-on insurance product.

21 Examples of the type of conduct that may constitute a financial commitment include:

(a) paying a deposit; or

(b) making an application for finance.

22 We support the 'trigger event' proposed in the Treasury reform paper, with the exception that we consider the 'trigger event' for CCI should be the approval of a loan application by the lender.

23 In REP 622, in order to reduce the risk of consumer harm, we set out our expectation that lenders should incorporate a four-day deferred sales model for all CCI products across all channels, with the deferral period starting on the day after the consumer is informed that their loan is approved. We identified loan approval as the 'trigger event' for the following reasons:

(a) It minimises the risk of pressure selling and other unfair sales tactics identified during our review (including sales staff falsely representing that buying CCI was a condition of getting credit).

(b) It mitigates the risk that consumers felt that they needed to buy CCI to be approved for the loan.

(c) It provides an appropriate break after loan approval for the consumer to consider other insurance options (e.g. buying comprehensive life cover rather than life cover under a CCI policy that would only discharge a single liability and where the amount payable would therefore reduce over time).

24 We support Treasury's proposal of four days as an appropriate deferral period, rather than a shorter period. It may be argued that the effect of this is that some consumers would be denied access to add-on products, and so create a risk that they will be uninsured. Implicit in this argument is an assumption that add-on products would only ever be sold through a retailer.

25 We do not accept this assumption: if there is significant demand for add-on products from consumers who need cover in a shorter period of time than the four-day deferral period, we expect that product providers will develop alternative distribution methods (if they do not already exist), such as selling these products online.

26 We also suggest that the retailer should be required to record or document, so as to be able to clearly demonstrate to ASIC on request, when the prescribed information was provided to the consumer (e.g. through digital signatures, emails or SMS tracking).

Consumer-initiated completion of sale

27 Treasury proposes to give consumers the flexibility to shorten the deferral period by allowing a consumer to initiate the completion of sale of an add-on product the day after the deferral period commences. The rationale for this is that the consumer's act of initiating contact with the add-on distributor indicates engagement with the sales process and a deliberate purchasing decision.

28 While we accept this rationale, we are concerned that this approach may create a risk of misuse and unfair sales tactics inconsistent with the Government's intentions in introducing a deferred sales model. In particular, it is not clear how it could be definitively established that any contact was initiated by the consumer, or whether, for example, the consumer was responding to a phone call or other prompt from the retailer.

29 This risk can be managed through legislative design to ensure that any early conclusion of sale is properly consumer-initiated. This could be achieved by complementary obligations, such as expressly prohibiting the retailer or the insurer from making follow-up contact with the consumer for the purpose of discussing add-on insurance products for the duration of the deferral period.

Tiered model and classification of add-on products

30 The Treasury paper proposes a three-tiered deferred sales model:

(a) Tier 1 includes the most harmful products (products 'causing significant consumer detriment'). ASIC would introduce tailored obligations for these products through a product intervention order (under the powers introduced by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*).

(b) Tier 2 includes all add-on insurance products not included in either Tier 1 or Tier 3. A legislated deferred sales model would apply to products in Tier 2.

(c) Tier 3 comprises products that are exempt from the deferred sales requirements. ASIC would determine whether a case for exemption exists, tested against criteria set out in the Act.

31 We support this tiered model, given that it enables ASIC to respond flexibly to the diversity of products in the add-on insurance market with their varying levels of value and different distribution channels.

32 We note that the use of ASIC's product intervention powers for Tier 1 products simply acknowledges the existing legal position, rather than adding complexity or introducing new requirements.

33 The product intervention powers allow ASIC to intervene proactively where a financial product has resulted, will result or is likely to result in significant consumer detriment. A breach of the law is not required for ASIC to exercise the powers: they allow us to address business models that are legal—but causing consumer detriment.

34 Concurrently with this submission we are consulting on the use of our product intervention powers in relation to the sale of add-on products by caryard intermediaries: this provides a 'live' example of how the proposed approach would complement and interact with ASIC's existing powers.

35 However, to address the risk of insurers having to meet inconsistent obligations, the drafting of the Bill will need to make clear that the deferred sales model for Tier 2 products will not apply where it is 'turned off' or modified by ASIC through a legislative instrument made under our product intervention powers.

36 Treasury proposes the following criteria for Tier 3 exemptions:

(a) historically good value for money;

(b) strong competition;

(c) high risk of underinsurance; and

(d) well understood by consumers.

37 We support these criteria, particularly the use of value as a criterion for testing the need to intervene in the sales process. Our work on the sale of add-on products has found poor results for consumers in terms of amounts returned in claims relative to premiums (low claims ratios, as set out in Table 1). Conversely, high claims ratios are likely to be an indicator of a market that is operating effectively and competitively.

38 However, we note that these criteria will likely mean that any new add-on products will be Tier 2 products by default, as they will not have any experience or track record to justify being exempt.

39 We also suggest the following additional criteria to those proposed by Treasury, noting the matters raised above:

(a) *Significant differences in prices and consumer outcomes between the add-on distribution channel and direct sales*—We suggest that price discrimination is a strong indicator of an uncompetitive market and of insurers taking advantage of consumers making passive purchasing decisions without 'shopping around'.

(b) *Period of cover and any associated change in benefits over time (e.g. decrease in value)*—Some products, such as CCI on credit cards, and pet insurance, can be offered on a 'guaranteed renewal' basis, and so be sold with the expectation that the consumer will make payments for extended periods, without any clear end date. The risk of poor outcomes is arguably greater in these circumstances as the consumer may 'set and forget' their cover, and the products may be designed so that the cover offered becomes more restrictive over time. For example, in the case of pet insurance, some policies provide reduced benefits as the pet ages, through greater excess payments, higher premiums and added exclusions.

40 We note that Treasury's approach will create a need for continued monitoring to ensure that products that are exempted by ASIC continue to operate or deliver consumer benefits.

ASIC's implementation responsibilities

41 The implementation of Treasury's proposed deferred sales model will result in ASIC having responsibilities to:

(a) prescribe information to be provided by insurers on commencement of the deferral period for Tier 2 products;

(b) declare add-on insurance products that will be Tier 1 products, after complying with the relevant legislative procedural requirements for making a product intervention order;

(c) declare add-on insurance products that will be exempt as Tier 3 products; and

(d) declare risk management products issued by holders of an Australian financial service (AFS) licence that will be subject to the deferred sales model.

42 We make the following observations on these responsibilities, and the consequent need for an adequate transitional period.

43 In relation to the prescribed information in paragraph 41(a), our view is that ASIC would use the transitional period to develop this, preferably through consumer testing and research.

44 Our preference is that the prescribed information would be delivered in a way that maximises consumer engagement (e.g. through the consumer being able to access personalised information through an online portal). The power proposed to be given to ASIC should therefore be flexible enough to accommodate this, rather than being limited to paper-based disclosure.

45 The transitional period will need to allow sufficient time for insurers to apply to ASIC for their products to be assessed as Tier 3 products, and for ASIC to decide on those applications.

46 Based on the proposal in the Treasury reform paper, we expect this application process will require insurers to produce both quantitative and qualitative information. We would therefore potentially seek to streamline

this process through a standard template that addresses the criteria as ultimately mandated in the legislation. Our preference would be to exempt products as a class, rather than exempting each insurer's products individually; the legislation should be flexible enough to accommodate this. We consider that this will simplify the application process and reduce the time needed for ASIC to make decisions in response to requests for exemptions, given the objective of reducing consumer harm as quickly as possible.

47 However, we suggest that the power should allow ASIC to exempt particular insurers given the risk of some outlier insurers 'free riding' on the better value products of other insurers.

48 Finally, we support the proposal in the Treasury paper to provide ASIC with the power to regulate risk management products such as warranties where they are similar to—though legally different from—add-on insurance products. This would help to ensure competitive neutrality. We expect that our work will initially focus on risk management products where they provide cover similar to add-on insurance products, and where there is a consequent risk that insurers and consumers would be disadvantaged if the providers of these products were able to sell them without a deferral period (e.g. because they are high cost and low value).

Key terms

Term	Meaning in this document
add-on insurance products (or add-on products)	Defined consistently with the Treasury reform paper
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee (or licensee)	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
car dealer	A motor vehicle dealer who sells directly to consumers, including the sale of both cars and motorcycles
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
claims ratio	The value of premiums paid by consumers, compared to the value returned to consumers in claims paid
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
life insurance (or term life 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
product providers	Includes both AFS licensees and non-AFS licensees who provide add-on products
REP 470 (for example)	An ASIC report (in this example numbered 470)
retailer	The provider of a primary product
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Term	Meaning in this document
s912A (for example)	A section of the Corporations Act (in this example numbered 912A), unless otherwise specified
Treasury reform paper	The Australian Government's consultation paper on implementing the Royal Commission's Recommendation 4.3 on a broader deferred sales model, *Reforms to the sale of add-on insurance products* (9 September 2019)