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Reforms to the sale of add-on insurance products
Submissions in respect to Treasury proposal paper dated 9 September 2019

Domestic & General Insurance plc (Australian Branch)

1 Introduction

1.1 These submissions are made by Domestic & General Insurance Plc (**DGI**), and are provided to Treasury further to the joint submissions made by DGI, along with The Warranty Group Australasia Pty Ltd trading as Assurant and ICF Protection Plus Pty Ltd trading as Brightside Cover.

About Domestic & General

1.2 Domestic & General Insurance Plc (**DGI**) is a UK-domiciled general insurance company specialising in insurance products for domestic appliances and personal devices. DGI's Australian branch is authorised by APRA to carry on insurance business in Australia and DGI holds an Australian Financial Services Licence.

1.3 DGI is part of the Domestic & General group, which offers warranty and insurance products to 16 million customers across 15 countries around the world. As well as being authorised in Australia, DGI is authorised as a general insurer by the UK's Prudential Regulation Authority (**PRA**) and is regulated by the Financial Conduct Authority (**FCA**). A related group insurance carrier, Domestic & General Insurance Europe AG, is domiciled in Germany and is authorised to carry on insurance business by the German Federal Financial Supervisory Authority (**BaFin**).

Domestic & General's products

1.4 DGI underwrites extended warranty and accidental damage insurance products principally in partnership with retailers and manufacturers of domestic goods and electronic devices. Where those retailers or manufacturers distribute non-insurance extended warranty products, DGI or related group companies may also underwrite their liability and administer those products on their behalf. In most cases, DGI's retail or manufacturing partners will sell the insurance products in-store after the customer has acquired one or more domestic appliances or electronic devices.

1.5 DGI is a specialist insurer operating exclusively in the extended warranty market. In considering the legislative framework to be adopted, Treasury should have regard to the consequences of the reforms to business (of all sizes) as well as to consumers. While other insurers operating in the Australian market may have comparatively small add-on insurance business as a proportion of their overall premium income and may therefore be able to absorb any adverse financial effects of the reform, the position for Domestic & General is markedly different. Were a deferred sales model to be applied to our products, the implications for our business would be significant.

1.6 Domestic & General employs 59 people in Australia and operates an extensive repair network across the country providing repair jobs to approximately 2,500 authorised repairers.

2 Submissions on the deferred sales model

Domestic & General supports the Government's reform agenda

2.1 Domestic & General supports the Government's regulatory reform agenda for financial services and products in Australia. As an organisation with a substantial retail client base, Domestic & General has always been committed to the highest standards of service delivery and customer care.

2.2 Domestic & General also supports the adoption of a deferred sales model for add-on insurance products. However, for reasons explained below, it considers that the deferred sales model should only be imposed in respect of particular products where there is strong evidence of consumer detriment being caused by the proximity of the sale of the primary good with the sale of the add-on insurance product. The application of the deferred sales model as the default position (subject to case by case exemption process) would be unduly restrictive on legitimate commercial activities in the absence of evidence of consumer detriment and is likely to lead to a decline in the availability of add-insurance products, an increase in their cost and a corresponding rise in underinsurance.

2.3 Accordingly, Domestic & General supports the adoption of the deferred sales model for add-on insurance products on the basis that all add-on products, save for those expressly identified in the legislation or regulations, are exempt from the deferred sales model until ASIC determines that the manner in which the product is sold is causing detriment to consumers and that the deferred sales model is the appropriate mechanism to apply to address that detriment. In practice, this would reverse the current Treasury proposal to apply the deferred sales model to all add-on insurance products and provide for ASIC to determine exemptions on a case-by-case basis. We submit that such a reversal is entirely appropriate to ensure a proper balance is struck between the legitimate commercial interests of insurers and the need to enhance consumer protection where that protection is required.

2.4 Alternatively, if the Government is minded to pursue the proposal in the terms of its consultation paper, then for reasons set out in the joint submission referred to above, we submit that extended warranty insurance and non-insurance products should be classified as Tier 3 and be exempt from the imposition of a deferred sales model.

3 The rationale and effectiveness of a deferred sales model

As a business operating globally and subject to insurance and financial services regulation in a number of different jurisdictions, we consider it appropriate to provide the following context to Treasury before responding to the particular feedback sought in the consultation paper.

Rationale for the deferred sales model and the UK experience

3.1 The purpose of a deferred sales model is to impose a temporal separation between the sale of a primary product, and the sale of a related retail insurance product. As Treasury will appreciate, the concept arose in the UK and has its genesis in consumer behavioural economics, in which studies concluded that consumers do not always make informed decisions about products they purchase, depending on the circumstances in which that purchase occurs. In the context of add-on insurance products, the extrapolation of those studies by the UK regulator led to the conclusion that where a consumer has been engaged in the purchase of a significant primary product, they will be less engaged with the secondary add-on insurance purchase, and may therefore not make good purchasing decisions.

3.2 This analysis undertaken by the UK regulator arose in very particular contexts; namely, in connection with the sale of payment protection insurance (**PPI**) through financial institutions, and Guaranteed Asset Protection (**GAP**) insurance through caryard intermediaries. In those specific circumstances, the UK regulator formed the view that the environment of the sale was resulting in consumers acquiring products which did not meet their needs.

3.3 Given the differences between these two products and the differing concerns about them and the way they were sold, the deferred sales model has been applied differently to each. Further, UK legislators and regulators have not thought it necessary or appropriate to extend the deferred sales model to other forms of add-on insurance products. No other jurisdiction in the world has done so either. In seeking to implement a solution covering all add-on insurance products, the Government should therefore be mindful that other international regulators may have found the exception to be the rule; and that the solution is not readily suitable or applicable to different types of products sold through different distribution arrangements, albeit that the products are all 'add-on' products.

3.4 The Government should also be aware that the UK regulator has recently reported that the deferred sales model in respect of GAP insurance may have been of limited effectiveness. In July 2018, the FCA issued a paper setting out its evaluation of the effectiveness of the imposition of a deferred sales model on GAP insurance, which included the following conclusions:

(1) prior to intervention, the FCA had expected the proportion of GAP insurance purchased on a standalone basis to increase significantly. However, while it expected sales of add-on GAP insurance to decrease (which it did), and the sale of standalone GAP to increase as consumers elected to shop around during the deferred sales period, both the decline in sales of add-on GAP insurance and the increase in sales of standalone GAP insurance were much less than anticipated;

(2) the decline in sales of add-on GAP did not equate to an increase in the purchase of standalone GAP, suggesting that consumers elected not to purchase the insurance at all, as opposed to the FCA's expectation that they would shop around to acquire the product from the open market on a standalone basis. The FCA acknowledges that the intervention would therefore have had a negative impact on those customers who might have purchased the product initially, but were less inclined to after the deferral period, because they valued convenience, not having to search for a standalone policy and being able to purchase an insurance policy face-to-face rather than by email or over the phone. This is an implicit acknowledgement that the reform may have led to a rise in underinsurance; and

(3) the FCA anticipated a fall in the price of add-on GAP insurance as demand for the product declined, however there was actually a modest *increase* in price. While it expected no change in price to standalone GAP insurance, prices actually fell significantly. The FCA concludes that, rather than increase competition between the add-on GAP market and the standalone GAP market, its intervention may have heightened market segmentation.

3.5 The FCA concluded that although there has been modest benefit obtained through the intervention by reason of a reduction in the total sales of add-on GAP insurance, *"…the impact on the standalone's share of total sales and on add-on prices has been much less pronounced than we expected. Our findings are consistent with recent academic literature* *on demand-side interventions. The literature indicates that although well-designed demand-side remedies can be effective, their impacts tend to be modest…"*.[1]

Rationale in Australia for general application of the deferred sales model

3.6 It is acknowledged that Commissioner Hayne adopted verbatim the recommendation of the Productivity Commission in recommending that the deferred sales model be applied to all add-on insurance products, subject to a process of case-by-case exemption. The Productivity Commission (and Commissioner Hayne) recommended that a working group be established by Treasury to consider how a deferred sales model could be applied across all add-on insurance products. In making that recommendation, the Productivity Commissioner raised concern with the historic slowness in gathering evidence to support regulatory intervention which was resulting in regulators playing an ineffective game of "whack-a-mole" in respect to insurers and their retail partners.

3.7 It is important context to appreciate that the Productivity Commission was assessing the add-on insurance markets through the lens of competition, not specifically consumer outcomes. The Productivity Commission noted that *"The Commission considers that — in principle — deferred sales models enhance consumers' ability to impose competitive pressure on insurers and product retailers. They allow consumers to more carefully consider the merits and appropriateness of the add-on product at hand, and to shop around for alternatives from outside of the product retailer distribution channel.*" The evaluation of the effectiveness of the deferred sales model in the UK market referred to above reveals that the deferred sales model may not achieve the end of increasing competition. UK consumers did not on the whole shop around. Rather, the decline in add-on GAP insurance sales suggested that consumers simply elected not to purchase the insurance at all. This creates a risk of underinsurance which neither the Royal Commission nor the Productivity Commission appear to have had sufficient regard to.

3.8 Further, there was no evidence before either the Productivity Commission or the Royal Commission that the same consumer detriment identified in the consumer credit insurance (CCI) and caryard insurances was prevalent across other add-on insurance markets. Only limited further examples were given (travel insurance and vehicle extended warranty products). Both the Productivity Commission and Commissioner Hayne therefore proceeded on an assumption that the sale of add-on insurance products would in all but limited circumstances, give rise to the same issues. While we appreciate the concern raised by the Productivity Commission that it takes time to gather evidence to support the regulatory intervention, that difficulty should not be a rationale for intervening in markets where no consumer detriment has been established.

4 Our submissions

4.1 The preferred approach, in our submission, is for Treasury to recommend a mechanic which will allow for the deferred sales model to be imposed in connection with particular add-on insurance products (or, alternatively, to particular issuers or distributors, or in connection with particular distribution channels) where significant consumer detriment is identified and the cause of that detriment could reasonably be attributed to the concurrent sale of a primary product and an add-on insurance product. A deferred sales model in that circumstances would be a reasonable remedy to apply, and the application of that remedy would be consistent with the principles underpinning the recent design and distribution obligations and product intervention power legislation. Such reform might in fact be more readily achieved through amendments to that legislation.

4.2 Otherwise, and in response to Treasury's request for feedback as to why a particular insurance product should reside in a particular tier, we provide the following response.

[1] Evaluation Paper 18/1: An evaluation of our guaranteed asset protection insurance intervention; Financial Conduct Authority (UK), July 2018, page 4.

4.3 When assessing whether an add-on product should be subject to the deferred sales model (Tier 2), or in considering an application for exemption under Treasury's current proposed model (Tier 3), we note the following in respect to possible criteria and matters for consideration:

(1) ***product value***

Determining whether a product has value to a consumer requires an analysis of a range of metrics, including (but not limited to) claims ratios. It must also be acknowledged that consumers may prescribe value to products because they are convenient or offer peace of mind, and that such factors are not readily capable of being reduced to the type of quantitative evidence that Treasury refers to.

For Domestic & General's products, we consider that industry recognition and metrics such as claims acceptance rates and Net Promotor Score (NPS), as well as the loss ratio for our products, demonstrate that our products offer real value and should therefore be classified as Tier 3. We note that:

- The claims ratio of our products is well above the ratios of the CCI and car yard insurances reviewed by ASIC and referred to in the proposal paper, and we consider them to be within an acceptable range for general insurance products. We would be pleased to provide details of relevant ratios on request;
- Our holistic commitment to excellence was recently recognised when D&G was awarded the Australian Business Award for Service Excellence for the ninth consecutive year (2011-2019);
- Our claims acceptance rate is above 99%. This confirms that the vast majority of our customers are aware of their policy coverage the value that our products provide, and obtain the benefit of the product when they need it; and
- Our Net Promotor Score (NPS) has historically averaged +49 and has recently been as high as +57

(2) ***risk of underinsurance:*** it should be expected that the imposition of a deferred sales model will lead to a decline in the take up of add-on insurance products. That necessarily means an increase in underinsurance. It should not be assumed that a consumer deciding against the purchase of an add-on product after the deferred sales period has ended has decided that the product is of no value to them without evidence to support that conclusion. Evidence of declining sales should therefore not be a proxy to offset arguments of rising underinsurance risk;

(3) ***product complexity:*** as evidenced by UK inquiries into PPI and GAP insurance, and its use of behavioural economics, the complexity of products sold as add-on insurance products can lead to consumers making poor choices. There is no evidence to suggest that consumers make similarly poor choices in connection with simple and well understood retail insurance products. In fact, that is one reason why it has been proposed that comprehensive car insurance should be exempt. Similarly other simple and well understood retail products, such as extended warranty products and accidental damage insurance, should be exempt. We have designed our products and terms and conditions with simplicity in mind. They are very easy to understand, are clear in what is covered and limited and clear exclusions. Terms and conditions have been drafted to be concise and easy to understand. There is no risk of consumers failing to understand the products, or becoming disengaged in the sales process as a result of product complexity Further, we conduct oversight of the sales process which includes mystery shopping of sales both in store and over the phone to ensure the correct process is adhered to;

(4) ***absence of a significant primary product:*** a key component of the circumstances where the UK regulator determined that a deferred sales model should apply, and where ASIC has identified poor consumer outcomes with add-on insurance products in Australia, is where there the add-on insurance product is sold in conjunction with a primary product that has some significance to the consumer. There is no evidence to support that disengagement with primary products of lesser value, such as relatively modestly priced retail whitegoods, domestic appliances or personal electronic devices. Only add-on products sold in conjunction with primary products of some significant value should therefore be considered for the deferred sales model, and other add-on products (such as extended warranty products) should be exempt; and

(5) ***effect on consumer choice:*** a deferred sales model will not be practicable in all circumstances and may in fact counterproductively lead to a decline in valuable insurance cover available to consumers. For extended warranty providers, the ability to underwrite domestic appliances and electronic devices from the point they leave the store is an important underwriting factor, as the condition of the goods is known at that time. Once the goods leave the store, underwriters can no longer determine the condition of the goods, and the extent to which damage relates to an insured event or caused by some other factor impacting the goods following purchase. This may result in extended warranties not being offered in connection with some products (particularly electronic devices), leading to less consumer choice and further underinsurance. Alternatively, it may significantly increase the cost of the products, again leading to consumer detriment.

4.4 In light of our submission that our products should be classified as Tier 3 and not subject to the deferred sales model, we do not intend to address the second question raised in the proposal paper, save to note that our products are generally sold in retail stores after customers have purchased a household appliance or electronic device. As such, most customers will commit to and/or complete the purchase of the primary good at that time.

5 Contact

5.1 We would be pleased to elaborate on these submissions further. Please contact the writer on 0418 985 265 at your convenience.

Yours faithfully

Miles Parkin
Country Manager – Australia and New Zealand

Domestic & General