30 September 2019

The Treasury of the Commonwealth of Australia
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Submitted via email: AddOnInsurance@treasury.gov.au

Submission: ***Proposal Paper: Reforms to the sale of add on-insurance products***

Eric Insurance welcomes the opportunity to make a submission on the *Treasury Proposal Paper: Reforms to the sale of add on insurance product* (the Proposals Paper), of 9 September 2019.

Eric Insurance is an Australian owned general insurer operating primarily in the motor vehicle insurance and add on insurance (AOI) market.

Our submission is structured as follows:

1. General commentary on the role of a deferred sales model (DSM) in the AOI market.
2. Specific commentary in response to each consultation issue raised by Treasury in its Proposals Paper.
3. Closing remarks.

1. The role of a deferred sales model

1.1. General Comments

Eric Insurance generally supports the introduction of a deferred sales model (DSM) for the sale of AOI.

However, we question whether a deferred sales model (DSM) on its own will resolve the challenges associated with mis-selling of insurance products, particularly those that have occurred historically in the motor vehicle sector. This has been a consistent theme in our submissions on *CP 294 The sale of add-on insurance and warranties through caryard intermediaries* and *REP 492 A market that is failing consumers: The sale of add-on insurance through car dealer.* We have also suggested this in our submissions to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, and in our conversations with regulators and policy makers since 2016 when issues associated with the AOI sector were first identified by ASIC.

1.2. The role of a DSM in creating a working market for AOI products

Eric Insurance supports, and is committed to, a multi-faceted approach to dealing with historical issues in the AOI sector.

Eric Insurance proposes that there are several issues which contribute to a properly functioning AOI sector, which go beyond the operation of a DSM. Without properly designed and issued products training and oversight for sellers of AOI products and fair and consistent pricing and remuneration structures, the inclusion of a DSM will be unable to drive prevention of the issues that lead ASIC and others to investigate the industry in 2016.

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To that end, we consider that the DSM is not a panacea solution to the issues that the AOI sector has experienced historically. Rather, we consider that a multitude of changes are required, some regulatory, and some by insurers themselves. We note the following, which we have been actively advocating for and/or integrating into our business over the last 24 months:

- AOI products which are appropriately designed. This includes demonstrated value to end consumers and clear, simple and transparent disclosures around product exclusions and benefits. Ideally, this is coupled with further financial education and understanding about AOI products generally. Since 2016, Eric Insurance has been actively engaged in the review and enhancement of its products to ensure that features and benefits are clearly explained, and that they meet regulatory expectations by allowing customers to compare them to other products in the market. We consider that further product enhancement across the AOI sector will be achieved through the operation of ASIC's new Product Design and Distribution Obligations (PDDO). To be truly effective, these obligations need to extend to unregulated products that have similarities to AOI products.
- Fair and transparent pricing of AOI products which allow for appropriate, but not excessive, remuneration of third-party distributors. To that end, Eric Insurance has imposed a 20% transactional commission cap on the sale of AOI products in motor vehicle dealerships. We consider that the implementation and maintenance of a legal and regulatory framework which applies to all players in the AOI sector (not just those entities who hold insurance licences and are APRA / ASIC regulated) will further support this. This will lead to an 'even playing field' and prevent regulatory arbitrage, whilst ensuring that all consumers have access to consumer protections associated with relevant financial services laws.
- The introduction and enforcement of clear and transparent sales practices supported by proper accreditation, training and supervision of third-party distributors. Eric Insurance has been actively engaged in the roll out of its sales system, Genesis, which ensures that products are sold to target market consumers who are eligible for the product. We consider that the design and implementation of Genesis, coupled with proper compliance, audit and oversight of third-party distributors, will form the cornerstone of remediating the issues that have been seen in the AOI sector in the past. We are also committed to improving customer financial literacy in respect to AOI. To this end our digital portals that are part of the Genesis system provides the platform for this.

1.3. Experience in other jurisdictions

As we have noted in our previous submissions on this issue, the successful introduction of a DSM in the United Kingdom can offer relevant learnings for the Australian market. Eric Insurance has been actively working towards the implementation of a DSM within our Genesis system.

The UK DSM aims to ensure the consumer is fully informed of the features, benefits and financial impacts of a decision to purchase financial products. Similar features could be adopted in Australia, including:

- creation of customer portals at the dealership level upon a vehicle purchase which automatically loads product details for later consideration by the consumer;
- a prohibition on contact by the sales agent for a *deferral period of 4 days from the date that consumers first contact the sales agent,* and

- finalisation of the transaction(s) through the customer portal where information can be accurately recorded (for example, any relevant documentation and /or disclosures).

We note that in the Proposals Paper, Treasury has also had regards to the UK DSM experience, stating:

> In 2018 the FCA released an evaluation of its deferred sales model for GAP insurance. The evaluation found that the model had effectively reduced sales of GAP insurance through car dealerships and showed a marginal increase in standalone GAP sales. The evidence suggested that **in the main** '*consumers decide, on reflection, not to go ahead with the purchase* (emphasis added). [1]

We challenge this statement. Having closely followed the adoption of the DSM model, and using it as a blueprint to design our internal sales systems to accommodate to a DSM, we note that the FCA found that '*the evidence suggests that **some** consumers decide, on reflection, not to go ahead with the purchase*'[2] *(*emphasis added*)*. We note a shift in the point of sale of GAP policies in the UK from the Dealership to online channels and submit that this is evidence of the consumer making informed decisions and confirming the appetite for the product.

This is a subtle but important difference, in our view – to imply that a majority of customers did not proceed with the GAP purchase is potentially misleading, noting that only some customers elected not to proceed, and in light of the following observations from the FCA's report:

- The FCA had expected sales to drop in Dealerships by 32.5% based on their intervention, however GAP insurance sales had only reduced by 16%-23%. This suggests that even with regulatory interventions related to the sale of GAP insurance, customers still identified value in the product and decided to purchase it (notwithstanding that there was no real reduction on GAP insurance premiums which may have affected consumer's decision to purchase). This challenges the notion that customers only purchase GAP insurance when it is 'forced' upon them.
- The FCA acknowledged that GAP insurance is a suitable purchase for consumers who value the product. This is further borne out by the finding that up to 66% of customers who purchased GAP insurance had purchased it previously, suggesting that customers see value in the product and are recurrent purchasers of the product. The FCA also notes that around 50% of GAP consumers decided to purchase GAP insurance ***before*** a decision to purchase a car was made, again, challenging the notion that the product is only purchased as a result of poor selling practices.
- The FCA has stated that following the change in sales practices, consumers are more aware of the product and engage more with the purchasing process than they did before

The Proposals Paper goes on to note:

> …neither the UK nor any other jurisdictions comparable to Australia have an industry-wide deferred sales model for add-on insurance products.

It appears that a close adoption of the UK DSM model has been dismissed as an option for the Proposals Paper. Eric Insurance considers that there are learnings from this experience –

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[1] Treasury Proposals Paper: Reforms to the sale of add-on insurance products, 9 September 2019. https://treasury.gov.au/consultation/c2019-t408984

[2] Financial Conduct Authority: Evaluation Paper 18/1: An evaluation of our guaranteed asset protection insurance July 2018 https://www.fca.org.uk/publication/corporate/gap-insurance-intervention-evaluation-paper.pdf

particularly noting that the UK DSM has been in place for several years, and has been subject to empirical, independent testing to assess consumer impacts.

1.4. The need for consistent regulatory policy

Eric Insurance notes the potential for contradictory regulatory policy outcomes with the introduction of a DSM through multiple regulatory instruments. We note simultaneous discussion of a DSM both within this Proposals Paper consultation process, and other through regulatory instruments such as the General Insurance Code of Practice (the Code). We are aware that the Code is currently being re-drafted to create a DSM only for the sale of Consumer Credit Insurance (CCI).

This appears fundamentally at odds the stated policy objective 'to create an 'industry-wide deferred sales model for add-on insurance products,' given that one particular product has now been carved out for additional compliance obligations in a Code of Practice whilst the majority of products are regulated by legislation. This double up creates a confusing and unnecessary regulatory regime with potentially conflicting obligations created for insurers through the law and the Code and begs the question which is the appropriate vehicle for implementation of a DSM. Depending on the specific design aspects of both DSMs, it also places insurers in the curious position of being able to only comply with the law ***or*** the Code to the extent that there are inconsistencies between these instruments.

2. Specific responses to questions in Treasury's Proposal Paper (the Proposal Paper).

Section 1.2 – Tier Design
Treasury has sought comment on the Tier Design set out in its Proposals Paper.

Eric Insurance supports the proposed Tier design described at Table 1 / Figure 1. It would be useful for Treasury to provide additional practical examples of what existing products it considers to sit in each Tier, and to specify whether the distribution method of a product affects it's Tier rating (for example, would CCI policy be classified in a different tier if it is sold through the insurer's website, as opposed to a third party intermediary).

Another practical question for consideration is how AOI products may 'shift' from one tier to another (for example, from Tier 2 to Tier 3 in the case of products which may have historically presented poor value for consumers but where, over time, quantitative evidence can be produced which indicates strong consumer understanding and product value).

Section 1.4 – Trigger Event
Treasury has sought comment on the Trigger event described in section 1.4.

<u>Specific comments on our current business processes for the sale of AOI</u>

It is worth noting at the outset that:

- Eric Insurance has been proactively working towards integrating a DSM into its existing business process since 2016, when issues with the AOI sector were first raised by ASIC. This has been through the introduction of our sales system, Genesis. In addition to the initiatives described at 1.1 above, the Genesis program is indicative of Eric Insurance's commitment to proactively improving the AOI sector, rather than awaiting legislative or regulatory change to dictate improved consumer outcomes.
- Prior to the Financial Services Royal Commission Final Report, Eric Insurance had been in ongoing discussions with other regulatory bodies about our work and the Genesis program, to ensure that this met regulatory concerns around the previous issues of mis-selling experienced in the AOI sector.

- Our Genesis system is based on UK experience described above, and has involved significant financial and resource investment, as well as regulatory engagement. Implementing this system has involved a broader program of change management, training and education to the motor vehicle sector.
- The customer touchpoints in Genesis have been designed in consideration of compliance outcomes (for example, being able to time and date stamp the delivery of product information to customers), and rigorous assessment when and how customers make decisions in relation to AOI products as they relate to motor vehicles. On this point, we have concluded that the purchase of AOI products is inextricably linked to the decision to purchase a motor vehicle, and to the decision to take finance for that motor vehicle. For example:
    - a decision to finance a vehicle may only be made by some consumers because they are able to purchase a CCI policy for protection in the event of unemployment.
    - a decision to purchase or lease a vehicle may only be made by some consumers because they are able to purchase a GAP policy to cover the difference between their lease amount and the total loss payout of their car under their motor vehicle comprehensive policy.
- With the above in mind, Genesis has been designed to provide clear, transparent and readily available product information to customers, so that they are aware of the benefits of these AOI products and can make a decision on how to manage their risk, in the same way that customers may or may not elect to purchase comprehensive motor vehicle insurance.
- For those who do not wish to consider the purchase of AOI products, we have implemented strict opt out options for customers who do not wish to discuss finance and insurance as part of their purchase of a car.

<u>Specific comments on the proposed DSM overview</u>

Eric Insurance also generally supports the proposed DSM overview described at Figure 2, offering the following comments:

- The provision of prescribed information on the AOI product should be applied consistently across the industry, through a consistent format that allows customers to easily compare information from other providers. We broadly agree with the required information described on page 13, with the exception of product claims ratios.
- We also support the deferral period of 4 days, noting that we have already commenced work on preparing for a DSM through our sales process which commences from the time that the customer is furnished with information about AOI products, and consent is sought from the customer to continue discussions about those products.
- We recommend that clear guidelines are established about how a customer can 'accept or decline' the offer to purchase AOI products as described in Figure 2.
- Whilst we agree that the trigger event should be predicated on the provision of AOI information, we assert that the second trigger – '*consumer makes a financial commitment to purchase the primary good/service and/or arranges finance'* (emphasis added) is not the correct point for the commencement of the deferral period. Our logic for this is set out below.
- We note that that the DSM does not appear to have been considered alongside all mechanisms via which AOI products could be sold. This includes, the sale of AOI products in non-dealership environments, such as the salary packaging industry.

Eric Insurance does not support the commencement of the deferral period being from 'when the customer has made a financial commitment to purchase primary product.' We set out our reasoning below:

The purchase of the AOI product and primary product can be inextricably linked

- As we have noted above, the sale of AOI products is often inextricably linked to the 'primary' product. It would appear odd if a customer wishes to consider the benefits and pricing of AOI products as part of their 'primary' purchase, that they cannot do so under the proposal model.

The central protections for mis-selling should be the provision of information and clear opt in / opt out procedures

- We believe that the key factor in triggering the deferral period should be the provision of consistent and transparent information regarding the AOI product. This should include a clear opt out if they do not wish to receive the information or discuss the products (and we note that our systems are already designed to capture this). This allows the customer three distinct choices:
    - to decide not to continue any further discussions or explorations of the AOI products,
    - to decide to consider the AOI products outside the primary purchase, for example, through online research or through another provider, or
    - to consider the purchase of AOI products in conjunction with the purchase of the primary product.

The sale of products related to motor vehicles is not the same as CCI purchased through banks

- Unlike the sale of CCI through banks, an AOI policy is not necessarily funded by the product issuer. A situation, for example, where a consumer agrees to a CCI product for a credit card and the policy premium is added to the customer's credit card account is unlikely to occur with the sale of other AOI products through other distributors.
- For motor vehicle AOI product sales, premiums are funded:
    - through the finance contract which includes the finance for the primary purchase, being the motor vehicle,
    - through premium funding or instalment payments, set up by the insurer, including pay by the month premium funding, or
    - through cash, credit card or another one-off payment method up front.
- Delaying the trigger for the deferral period may result in the customer being unable to finance the insurance premium (as the finance contract has been settled and cannot be reopened later to add additional costs / insurance premiums). This will eliminate the possibility of financing the insurance premium and effectively rail-road consumers into either a cash payment or an instalment plan.
- Delaying the trigger for the deferral period may also result in the customer being potentially underinsured until the deferral period runs out.

The term "financial commitment" is open to wide interpretation

Firstly, the term 'financial commitment' can be construed many ways in the sale or lease of a motor vehicle. This could include, amongst other things, the customer:

- indicating verbally that they wish to purchase a vehicle,
- signing a purchase order for a vehicle,

- making a financial commitment to a deposit,
- taking steps to arrange finance either through the dealership or through a financial institution,
- having finance approved.

This leaves ambiguity within the DSM and creates some subjectivity for the insurer or its agent to interpret when such a commitment has been made by the consumer.

If the term 'financial commitment' is construed too narrowly (for example, at the time the finance is approved), Eric Insurance considers that this can create unintended consequences for a consumer's ability to purchase their policy as noted above.

Proposed trigger event

In light of the above, we proposed the following is a better 'trigger' for the commencement of the deferral period. If the policy intent is to ensure that the customer is not pressured or coerced into the sale of an AOI product, we suggest that a better trigger for the commencement of the deferral period would be:

- the customer has been furnished with information about the insurance product as suggested in Figure 2,
- the selling agent or insurers has a ***reasonable expectation*** that a primary purchase will be made, and
- the customer has been given a clear option to 'opt out' of further discussions about AOI products if they wish, based on the provision of AOI information.

The Proposals Paper specifically seeks feedback on how this trigger would correspond to current business practices and seeks information on the number and frequency of customer touchpoints in the sales process and/or at what point in the process financial commitments are typically made by consumers. In support of Eric Insurance's proposal above, we provide the following overview of our preferred sales process and Genesis selling system:

1. Customer touch point one: At the point the customer wishes to engage in the purchase of a specific vehicle they are issued a verbal Statement called an Initial Disclosure Statement. This statement makes the customer aware that as well as motor vehicles the dealer provides other products such as finance and insurance. At this point the customer is emailed a link to a personal portal (micro site) which contains all product information, PDS', FSG's, a one-page key facts document and info videos describing each product.
2. Customer touch point two: Once the vehicle is purchased the Business manager will conduct a series of questions to determine what products the customer will be eligible for based on their ownership and usage. These products are then displayed and discussed using customer interaction with customer facing screens. Premiums are then made clear to the customer and the differing ways in which they can purchase.
3. Customer touch point three: once the customer has indicated their potential interest, or not, the system issues a Statement of Customer Option & interest (SCOI) this document clearly identifies all questions asked and all the related answers. It then identifies the products which were eligible, those that were not and those that the customer showed interest in. All products have the potential related premium attached. This document is provided on screen, is automatically emailed to the customer and is also deposited in the customers own portal which was issued earlier.

4. Post the intended deferral period when the customer wishes to finalise/purchase the products, further customer info is added and then policies and schedules are issued. At this time an email is generated, and copies of all schedules are then deposited in the customers portal for future reference.

3. Closing remarks

Eric Insurance would welcome further discussion on the points contained in this submission or the DSM model more generally.

We also highlight that with the withdrawal of some of the larger Insurers from this market we have a significant presence in this sector.

As discussed in this submission we have been preparing for Regulatory change and do believe we have re-engineered our business to provide a better experience and better information for our customers.

We believe Treasury would benefit from a demonstration of our Genesis sales practices, to see the process from a customer's perspective, and help determine the make up and practical application of a DSM.

If you are so inclined, please contact me on mtilbrook@ericinsurance.com.au and we will arrange a demonstration.

We thank the Treasury for the opportunity to comment on the Proposal Paper.

Yours sincerely

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