

# Using the product intervention power: add-on motor vehicle financial risk products

Submission in response to ASIC's consultation

Australian Financial Complaints Authority

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## Introduction

The Australian Financial Complaints Authority (AFCA) is the independent external dispute resolution (EDR) scheme for the financial sector.

AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. It does this not only by providing fair dispute resolution services, but also by working with financial firms to improve their processes and industry standards of service, thereby minimising disputes.

In addition to providing solutions for financial disputes, AFCA has responsibilities<sup>1</sup> to identify, resolve and report on systemic issues and to notify the Australian Securities and Investments Commission (ASIC), and other regulators, of serious contraventions of the law. More broadly, AFCA plays a key role in restoring trust in the financial services sector.

AFCA welcomes the opportunity to provide a submission<sup>2</sup> in response to ASIC's proposed use of its product intervention powers to address significant consumer detriment from the sale of add-on motor vehicle financial risk products (the add-on products).

### Key points

In response to ASIC's consultation paper<sup>3</sup>, the key points in our submission are:

- AFCA strongly welcomes and supports ASIC's proposal to make a product intervention order by legislative instrument that provides critical protections to consumers in relation to the way the add-on products are sold. These protections include a four-day period (deferral period) for consumers to consider whether to buy the add-on product and restricting product issuers or intermediaries from contacting consumers during the deferral period.
- Similar to detriment caused by consumer credit insurance, AFCA has seen instances where add-on products were sold to consumers who:
  - > were ineligible for the cover (and only informed of this at the point of claim)
  - > received little to no benefit from the add-on products
  - > were unaware they were sold the products or about the products' purpose.
- We also believe that all consumers purchasing add-on and warranty products should have access to fair, independent external dispute resolution for complaints

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<sup>1</sup> Refer to Part C, Reporting Requirements, of [ASIC Regulatory Guide 267: Oversight of the Australian Financial Complaints Authority](#).

<sup>2</sup> This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

<sup>3</sup> [ASIC Consultation Paper](#), *Using the product intervention power: Add-on Motor Vehicle Financial Risk Products*

about these products or their sale. Therefore, we believe all product issuers should be required to hold AFCA membership and be responsible for intermediaries' conduct, if the intermediary is an authorised representative.

### **AFCA's related submission – Reforms to the sale of add-on insurance products**

ASIC confirms that its proposed product intervention order complements the proposed industry-wide deferral sales model for add-on insurance, to be implemented as part of the Government's response to the Financial Services Royal Commission (recommendation 4.3).

In response to the Government's consultation in September 2019 about its proposed *reforms to the sale of add-on insurance products*<sup>4</sup>, AFCA provided a submission on 9 October 2019<sup>5</sup>. In our submission AFCA's Chief Executive Officer and Chief Ombudsman, Mr David Locke confirmed that AFCA welcomed and supported the proposed reforms. Whilst AFCA considered that the unsolicited sale of financial products should be prohibited, AFCA affirmed its support for measures to implement an industry-wide deferral sales model for add-on insurance products.

In AFCA's experience, the sale of add-on insurance products, particularly when they are sold at the same time that a primary product is acquired, increases the opportunity for a financial firm or their associates to take unfair advantage of, or exert undue influence over a consumer. In our October 2019 submission, AFCA highlighted that this significantly increases the likelihood of a consumer being sold an insurance product that doesn't meet their needs or offers little to no value for them.

## **1 Overview**

ASIC is consulting on its proposal to exercise its product intervention power to address significant consumer detriment caused by the sale of add-on insurance and warranty products sold with motor vehicles.

### **What is the significant detriment in this market?**

We understand that ASIC's proposed product intervention follows on from its consultation paper 294 (CP 294) *The sale of add-on insurance and warranties through caryard intermediaries*<sup>6</sup>. Amongst other things, CP 294 provided a summary of key findings from ASIC's reviews of add-on insurance. We note that the key findings included:

- Many consumers were actively sold and sometimes pressured to buy add-on insurance products both through explicit sales techniques and how the sales process was structured, even though consumers had not requested insurance.

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<sup>4</sup> [The Australian Government, the Treasury, \*Reforms to the sale of add-on insurance products\*](#).

<sup>5</sup> AFCA letter to Treasury - Reforms to the sale of add-on insurance products (9 October 2019)

<sup>6</sup> [The sale of add-on insurance and warranties through caryard intermediaries](#)

- Many consumers had very poor recollection of which policies they had purchased, how much each policy cost and what it covered.
- 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.
- 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.

### Clear consumer information

In response to ASIC's consultation paper, the Legal Aid Commission of NSW (Legal Aid NSW) said that the deferral sales model is only one component in improving consumer outcomes in the add-on insurance industry. Another key component is improving consumer understanding of, and engagement with, their decisions about add-on insurance. To achieve this, Legal Aid NSW highlighted that interactive and meaningful communication with consumers about the cost, coverage and value of add-on insurance is essential.<sup>7</sup>

AFCA agrees with Legal Aid NSW. It is critical that consumers are provided with clear information to understand the type of add-on product they are presented with, including whether the product may provide benefit, and in what circumstances.

### Online consumer roadmap

ASIC confirms that as part of the deferral sales model, an online portal (online consumer roadmap) will be made available, by which the client can choose to:

- apply for or acquire a product
- decline to apply for or acquire a product
- request further information about a product,

where those choices are presented to the client in a way that does not highlight one choice over another.

ASIC's product intervention order outlines the information that must be disclosed or made available through the online consumer roadmap, prior to the client being permitted to use the online portal. We agree with the four compulsory disclosures ASIC has included. Given, however, the issues identified with add-on products, it is

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<sup>7</sup> [Legal Aid Commission of NSW submission October 2017](#)

critical that comparable and complete information about the costs, risks and benefits of the products are provided as part of the online consumer roadmap.

We believe that at a minimum, this information should include:

- the total premiums for an add-on contract, including for different cover levels within a particular product
- the significant features and benefits, significant and unusual exclusions or limitations, and cross-references to the relevant policy document provisions
- the duration of the policy
- Commission disclosure
- the product claims ratio (with information to consumers to explain that this may be an indicator about the value of the policy)
- notice that the product is optional and not compulsory
- the potential for duplicate cover and an explanation (i.e. Gap vs agreed value/new car replacement policies, LPI vs IP policies the consumer may have)
- whether the add-on product is sold by other distributors

The combination of information being provided to consumers in a clear and concise way that allows for the comparison of products, and the deferral sales model itself, will provide consumers with opportunity to review their options prior to purchase, in the same way other products are considered.

## 2 Product intervention order – proposed changes

- Q1 Please summarise your views on any of the changes made to the revised draft product intervention order, including whether the changes would be more or less effective in addressing the significant consumer detriment previously identified by ASIC, including in CP 324. Please explain the reasons for your position.

### General agreement

AFCA has considered the proposed changes to the product intervention order, since ASIC's initial consultation in October 2019. We generally agree that these changes provide greater clarity about the specific prohibitions implemented by the order.

Our feedback on these changes is provided with a view to ensuring the product intervention order operates as effectively and efficiently as possible.

### Inability to access external dispute resolution

AFCA in principle supports ASIC's proposal that for each warranty product that intermediaries are permitted to make available through the online portal, and for which the product issuer is not a member of AFCA, it must provide:

*a prominent statement that the client has no right to make a complaint to AFCA about the warranty product.*

However, AFCA considers that part of the protections should ensure consumers of these products have access to free and independent EDR.

This means that the product issuers should at least be an AFCA member. For intermediaries involved in the sale and/or distribution of the product, they should also be AFCA members if an AFCA member is not responsible for their conduct.

Otherwise, it creates a gap in the extent of protections consumers will have. This will enhance confusion and mistrust as it will be unclear why some product issuers and/or intermediaries are subject to AFCA and some are not.

### Identification of issues and industry standards

AFCA's responsibilities include identifying, resolving and reporting systemic issues and notifying ASIC and other regulators of serious contraventions of the law.

Therefore, if a consumer is unable to access our service, the ability for AFCA to identify broader systemic conduct and to work with organisations to address these issues is reduced.

### Intermediaries

AFCA strongly believes that all entities who offer or facilitate the sale of add-on or extended warranty products to consumers should be held to appropriate standards. We believe that consumers should have the right to expect that intermediaries will not make available to them a product or option of cover through the 'online consumer roadmap', that the intermediary believes falls within an 'unsuitable class'.

We therefore strongly advocate against the removal of section (2)(a) and (2)(b) titled 'The Intermediary'. AFCA can see no benefit to consumers or improvements to industry standards for this previously included section, to be removed.

## 3 Further changes

Q2 Do you consider that any further changes should be made to the revised draft order before ASIC proceeds to a final decision on whether to exercise the product intervention power?

### After the deferral period

AFCA notes that product issuers and intermediaries are not permitted to contact consumers about the add-on products, during the deferral period. We believe that instruction about conduct after that period would be useful.

We are concerned that if a consumer elects not to purchase a product within the deferral period, they may be contacted again after this period and pressure sales conduct similar to what is being restricted, may occur. We would support the inclusion of information about appropriate conduct after the initial deferral period, to ensure consumer detriment is removed, not deferred.

We believe that the added protections may include that product issuers or intermediaries are not permitted to follow up consumers after the deferral period. Any contact should be initiated by the consumer.

### External Dispute Resolution (EDR)

As outlined above, all consumers who purchase the add-on products should have access to EDR, to raise any issues about the products they were sold or about the sale itself. It would be an unsound consumer outcome if consumers' access to EDR was restricted due to the product issuer not being an AFCA member and the intermediary not being a member, and an AFCA member is not responsible for their conduct.

- Q3 Do you consider there is a significant risk of avoidance of the revised draft order as a result of any changes made by ASIC? If so, should ASIC introduce additional measures to address that risk?

As outlined above, we believe further information should be included in the order, about appropriate conduct after the deferral period ends.

### Intermediaries

We believe that if the online consumer roadmap definition is not more prescriptive about what product information must be provided prior to sale, the potential risk of avoidance is that intermediaries may continue to use pressure sales tactics to encourage purchase of the products.

We again highlight that if there is no accountability on intermediaries identifying an unsuitable class, there is a risk that consumers will be sold products unsuitable to their needs, especially if an intermediary engages in pressure sales tactics when selling the primary product.

Q4 Do you consider that the consequences of the COVID-19 pandemic have had, or are likely to have, any effect on the significant consumer detriment identified by ASIC in CP 324? Please provide evidence in support of your response.

### COVID-19 implications

ASIC has previously reported on the low value that the add-on products have provided. Given these findings and the unprecedented circumstances due to COVID-19, AFCA believes that it is essential to ensure all consumers entering these types of products have access to free and independent EDR, to raise any issues about these products.

In relation to specific detriment, consumers of these products may not be able to comply with warranty conditions (i.e. if they are required to service their vehicle every six months), even though:

- the vehicle has barely travelled any kilometres
- the vehicle unlikely needs a service
- a consumer has limited funds.

Q5 Please provide any information on likely compliance savings or costs, the likely effect on competition and other impacts, costs and benefits.

ASIC's product intervention looks to remove significant consumer harm identified through the sale of add-on motor vehicle products. We believe that ASIC's intervention will have direct benefit to the community and will drive up standards across the industry.

AFCA understands that ASIC's product intervention forms part of a broader introduction of obligations. This will assist to ensure products are designed and distributed to consumers to meet genuine needs and any significant detriment, identified through poor claim ratios, complaints etc. are directly identified and addressed.