

Consultation Paper 324

Product Intervention: The sale of add-on
financial products through caryard
intermediaries

Legal Aid NSW submission to ASIC

22 November 2019

About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 24 offices and 221 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with LawAccess NSW, community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal services. Our community partnerships include 29 Women's Domestic Violence Court Advocacy Services.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact most on disadvantaged communities, such as credit, debt, housing, employment, social security and access to essential social services. This submission draws on the casework experience of our civil lawyers in providing these services.

Legal Aid NSW welcomes the opportunity to make a submission ASIC's Consultation Paper 324. Should you require any further information, please contact:

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Introduction

Legal Aid NSW welcomes the opportunity to provide a submission to ASIC's Consultation Paper 324 – Product Intervention: The sale of add-on financial products through caryard intermediaries (**the Consultation Paper**). We note that Legal Aid NSW previously provided a submission in response to ASIC's 2017 Consultation Paper 294: *The sale of add-on insurance and warranties through caryard intermediaries* (**2017 submission**), which is attached for reference.

Our clients experience significant harm as a result of being sold add-on insurance and warranties by caryard intermediaries. We strongly support ASIC's proposal to introduce a deferred sales model, along with the complementary obligations.

However, we are concerned that the proposed deferral period of four days is too short to enable the consumer to properly consider all of the financial products being offered. We suggest that a period of 30 days would be more appropriate. We are also concerned about the potential for the additional obligations placed on add-on insurance products to be applied inconsistently across industry or avoided by providers.

We suggest that 'knock-out' questions and classes of consumers for whom products are unsuitable should be consistent for all providers, and should be determined through consultation between industry and consumer advocates. We also suggest a range of anti-avoidance strategies. We provide further detail on these recommendations below.

Proposed Intervention: All add-on products

C7Q1 – Do you consider that there is significant consumer detriment from the sale of add-on financial products by caryard intermediaries? Please provide evidence in support of your response.

Yes, Legal Aid NSW considers that significant consumer detriment is caused by the sale of add-on financial products by caryard intermediaries.

These products and sales tactics often have the most detrimental impact on consumers experiencing vulnerability. This includes consumers from low socio-economic backgrounds, newly arrived migrants or refugees, Aboriginal and Torres Strait Islander people, people with low literacy skills, people who are solely reliant on Centrelink benefits and young people with limited life experience and understanding of financial products.

The detriment from the sale of add-on financial products relates to:

- consumers being unaware of the cost, cover or value provided by add-on products
- high-pressure sales tactics used in the sale of add-on products, and an imbalance of bargaining power

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- buyer and decision fatigue occurring at the caryard, with consumers reporting that they will often be held for lengthy periods of time to discuss add-on products
 - the poor design of the add-on products which frequently do not meet the needs of consumers or the target market, and do not provide a tangible benefit at reasonable value. Consumers very often pay for cover that they do not need, are already covered for under another policy, or would be ineligible to make a claim under
 - many of the add-on products are poor value, which ultimately results in low claim payouts relative to premiums, or exclusions leading to no payouts at all.

Case study

Abdul is a newly arrived refugee to Australia and in receipt of the Newstart Allowance.

Abdul purchased a car on finance from a caryard, and was sold an extended warranty at the point of sale for \$1200 (plus interest). Abdul was not advised that the terms of the extended warranty contract provided that it was only effective for the first three months from the date of the purchase of the car.

After four months, the car began to have significant issues. Abdul was advised by the caryard that it was no longer under warranty, as the term had expired after three months.

Abdul was unable to afford the repairs required with his Newstart Allowance, and has not been able to use the vehicle.

Had Abdul understood the limited cover provided on the extended warranty, he would not have agreed to purchase the extended warranty.

C7Q2 – If you consider there is significant consumer detriment, do you think that it should be addressed by the proposal in this section, or by some other intervention or action by ASIC? For example, could product providers be given incentives to offer better products if some or all of the proposed obligations only applied to low-value products? Please give the reasons why you think a particular approach will be more effective.

Legal Aid NSW supports ASIC's proposal to use the product intervention power to address the significant harm caused by the sale of add-on financial products, as outlined in the Consultation Paper.

We consider that ASIC's main proposal to introduce a deferred sales model for a period of at least 18 months, is an appropriate and necessary intervention and a welcome step to alleviate the significant detriment to consumers caused by add-on sales through caryard intermediaries.

We also support ASIC's proposed complementary obligations, to require providers to develop criteria to restrict sales so that consumers are not offered products unlikely to provide them with a significant benefit. We support obligations that prohibit unfair sales

tactics that either represent that consumers may have to make payments from their own resources if they do not buy the add-on products, or that require consumers to justify why they are not purchasing the add-on products.

We note that the proposals would complement the Design and Distribution obligations, which will come into effect in 2021, and which will require insurers to ensure that appropriate products are offered and sold to the appropriate and intended target market. Together, these reforms will likely provide a tangible benefit to consumers at a reasonable cost to industry.

We support ASIC's proposed obligations applying to the sale of all add-on financial products by caryard intermediaries, except for compulsory third party insurance (CTP) and manufacturers warranties provided with new cars. We note that this approach is consistent with the recommendation of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.¹ As noted in the Consultation Paper, this was also broadly supported by submissions to ASIC's 2017 *Consultation Paper 294: The sale of add-on insurance and warranties through caryard intermediaries*.

We are concerned that the alternative option—to provide an incentive to product providers to offer better products by applying the proposed obligations only to 'low value' products—will risk leaving consumers exposed to significant harm. Factors that contribute to consumer detriment through the sale of add-on financial products by caryard intermediaries may still continue to exist for products that are not regarded as 'low value'. This includes the use of unfair and high-pressure sales tactics, commission-based sales, consumer decision fatigue, lack of competition, complexity within products and arising from multiple products, and the use of no or general advice sales models.

We are also concerned about how a 'low value' product will be defined. From our case work experience, a product might be considered 'high value' to one consumer, but 'low value' to another. For example, a reasonably priced tyre and wheel rim insurance policy may be of high value to a consumer who regularly drives in rural areas on unsealed roads, who does not have comprehensive insurance, and where the payout would exceed the insurance premiums paid. However, this insurance policy would be of 'low value' to a consumer who already has cover for tyre and wheel rim issues under their comprehensive insurance policy.

We suggest that ASIC could reconsider alternative options after evaluating the effectiveness and impact of the current proposals after 18 months of operation.

C7Q3 – Please summarise your views on the proposal for a deferred sales model in this section (e.g. whether it should apply across all channels where intermediaries regularly arrange finance for cars). Please explain the reasons for your position.

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (February 2019), Vol. 1, 31, 288.

Legal Aid NSW strongly supports ASIC's proposal for a deferred sales model. We consider that it should apply across all channels where intermediaries regularly arrange finance for cars, including the three main categories of car dealers, finance brokers, and entities arranging leases as part of salary packaging services.

A deferral period would allow consumers relief from high pressure sales tactics and decision fatigue. The deferred sales model is appropriate because it would provide consumers with additional time to:

- consider their insurance options, and compare products if necessary
- seek advice about the suitability of the add-on financial product/s, and
- work out the affordability of the product, and how much extra it will cost to have the add-on financial product/s.

However, we consider that a longer deferral period would be more beneficial, and we support a period of 30 days, rather than the four days proposed in the Consultation Paper. As outlined in our 2017 submission, this would allow the consumer an appropriate amount of time to consider the value of the product to them, seek advice and research other alternatives. If the consumer had purchased the vehicle during this time, they may also have made at least one payment to their lender. This would allow the consumer to have a better understanding of their financial position following the purchase, and to assess if they are able to afford an increased payment to take out an insurance product.

We support the use of a consumer roadmap, which will provide consumers with individualised information about the products available to them and the cost of those products. The roadmap will require consumers to engage with the disclosure material, increasing the likelihood that consumers will understand the information and make informed decisions.

We refer to our comments about innovative product disclosure in our 2017 submission (in response to E1.3Q2 on page 11) and note our suggestions that:

- plain language principles and infographics should be used
- the roadmap should have a function to read the information to consumers, which would benefit consumers with low literacy or those who are visually impaired
- the platform could require consumers to confirm their understanding of a product before expressing interest—for example, a test which poses a series of questions about the product, including what it is, how it operates and its cost
- the roadmap should be available in multiple languages
- some consumers will not be able to engage with technological disclosure and a paper-based version of the roadmap should still be available.

C7Q4 – Please summarise your views on the additional obligations in this section (e.g. whether ‘knock-out’ questions should be introduced). Please explain the reasons for your position.

Legal Aid NSW supports ASIC’s proposed additional obligations set out in the Consultation Paper. We support the view that add-on products that offer no benefits to consumers should not be sold, and that the sale of products that offer minimal benefits should be reduced. We agree that sales processes should be fairer, more interactive and assist consumers to make better decisions.

We consider that ‘knock-out’ questions could be an effective filter to add-on products that offer little or no benefits to consumers. However, the Consultation Paper does not elaborate on examples of the types of ‘knock-out’ questions that might be asked. It envisages the obligation being on insurers and warranty providers to develop ‘knock-out’ questions for their own products, which could be refined over time based on analysis of sales and claims data and other information.

We are concerned that this approach might lead to an inconsistent application of this obligation by insurers and intermediaries, and to an elevated risk of avoidance. Legal Aid NSW suggests that the ‘knock-out’ questions should be developed in consultation between insurers/warranty providers and consumer advocates, while aiming to comply with the future design and distribution obligations. Following such consultation, a regulatory guide by ASIC would be a useful reference resource for industry and consumer advocates.

We further suggest that in order to avoid unfair sale tactics and pressure, the ‘knock-out’ questions should be in writing and require a written response (whether on paper or on a device). A ‘knock-out’ questionnaire should include a notice to the consumer that they are not required to take out add-on insurance products in order to purchase or lease the vehicle.

To ensure that consumers understand the questions and their purpose, the ‘knock-out’ questions should employ plain language principles and infographics for consumers with low literacy and be offered in multiple languages to assist consumers who have limited English skills.

Case study

Mr. Smith is a middle-aged Aboriginal man living in a rural part of Northern NSW. Mr. Smith is in and out of work and currently receives Newstart Allowance.

In 2016, Mr. Smith purchased a car on finance. Upon his purchase, the caryard intermediary also sold him consumer credit insurance (**CCI**) and guaranteed asset protection insurance (**GAP**) on behalf of the insurer.

The CCI premium was \$4834.75 and the GAP insurance premium was \$1435. the insurer received 20% commission for the sale of CCI and 50% commission for the sale of GAP insurance.

Upon the sale, the salesperson told Mr. Smith that he had to buy the add-on products as part of the loan. The salesperson rushed through the sales process and did not give Mr. Smith an opportunity to properly read the paperwork, or to ask questions before he signed the contract. The salesperson did not explain that the premiums would exceed \$6,000, and that interest would accrue on the premiums over the term of the loan.

When Mr. Smith left the caryard, he realised that he would have to pay \$65,000 on a car worth \$34,000. Mr. Smith already had Total and Permanent Disablement and Temporary Salary Continuance cover through his superannuation. The CCI policy was less beneficial and substantially more expensive than the policies connected to Mr. Smith's superannuation.

Had there been a deferral period to the sale of the add-on products commencing upon delivery of the car, Mr. Smith would have had the opportunity to calculate the overall amount payable on the loan, review his existing insurance policies, work out the true cost of the add-on products versus the actual cover provided, and seek legal advice if necessary. Mr. Smith told Legal Aid NSW that had he known this information, he would not have purchased the policies.

Had 'knock-out' questions been used at the time Mr Smith was entering the agreement for add-on products, it would also have been apparent to him that he would not benefit from the CCI or Gap Insurance products.

C7Q5 – How would the proposal and obligations set out in this section affect business?
No comment.

C7Q6 – Please provide an estimate of the impact of implementing the proposed model, or any changes or variations to this model set out in your response.

Legal Aid NSW is not in a position to comment about the impact of implementing the proposed model. However, we broadly consider that any costs incurred by insurers are likely to be outweighed by the benefits to consumers.

C7Q7 – Do you consider there is a significant risk of avoidance of the proposed obligations? If so, should ASIC introduce additional measures to address that risk?

Legal Aid NSW considers that there is a risk of avoidance of the proposed obligations, and ASIC should introduce additional measures to address this risk.

The proposed obligations aim to:

- identify which products should not be offered to consumers (through 'knock-out' questions)
- provide better information to consumers (through the roadmap), and

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- address the risk of pressure selling and unfair tactics at the point of sale (through the deferral sales model).

Legal Aid NSW is concerned that intermediaries might try to work around the proposed obligations to maximise their commission-based sales, while disregarding the potential detriment to consumers.

There is a risk of avoidance of the proposed obligations in the following situations:

- where ‘knock-out’ questions are inconsistent across various product issuers and their intermediaries, allowing for different levels of filtering, and
- where product issuers and intermediaries, who maintain a commission-based system, have the sole discretion to identify ‘unsuitable classes’ of consumers.

The Draft Instrument states that an intermediary must:

- (a) *identify* unsuitable classes ‘of retail clients for whom the intermediary *reasonably believes* would not benefit from acquiring the add-on insurance product or extended warranty product or option of cover within the product...’, and
- (b) ‘must not make available the product or option of cover through the online consumer roadmap to a retail client that the intermediary *reasonably believes falls within the unsuitable class...*’ (emphasis added).²

This obligation relies primarily on the subjective view of different intermediaries, who might in some cases, have a conflict of interest, considering the current product-based commission system. In this regard, we note recommendation 4.4 of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, that ASIC should impose a cap on the amount of commission that may be paid to vehicle dealers in relation to the sale of add-on insurance products.³

Legal Aid NSW suggests the following additional measures to reduce the risk of avoidance:

- ‘Knock-out’ questions should not be developed individually by insurers and warranty providers, and classes of unsuitable consumers should not be determined by individual intermediaries at each point of sale. Rather, these determinations should be developed in consultation with consumer advocates and where possible, be consistent across the industry.
- *Insurers and warranty providers should be required to implement software that accurately records the start time of the deferral period*

Legal Aid NSW suggests that ASIC should determine a date by which insurers should be required to have installed technology that accurately records the start

² *Draft ASIC Corporations (Product Intervention – Add-on Insurance and Extended Warranties) Instrument 2019*, cl 6(2).

³ *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, Final Report (February 2019), Vol. 1, 31.

time of the deferral period. The Consultation Paper refers to technology currently available in the United Kingdom that could be adapted for this purpose.

- *Protocols should be developed regarding consumer-initiated contact during the deferral period*

The Draft Instrument requires the intermediary to refrain from initiating ‘any contact with the retail client about an add-on insurance product or extended warranty product during the deferral period’ (cl 7(2)). However, the Draft Instrument’s phrasing does not prevent the intermediary from initiating contact about other issues (for example the car, the loan etc.). If such contact occurs, there is a risk that one of the parties might extend the discussion to add-on products.

We note and support the prohibitions under clause 8 of the Draft Instrument, which might assist in deterring intermediaries from using unfair sale tactics during the deferral period, or afterwards.

We suggest that the Draft Instrument also make it clear that if the consumer initiates contact with the intermediary regarding an add-on insurance product or extended warranty product during the deferral period, the intermediary should refer the consumer to the roadmap and should not provide any other information and/or an opinion.

- *There should be sanctions for non-compliance*

Legal Aid NSW supports the implementation of sanctions to deter misconduct and encourage compliance with the Draft Instrument.

We refer to our 2017 Submission, which supported the monitoring role proposed by ASIC, and we repeat our suggestion that with adequate funding, ASIC could consider the following sanctions:

- fines for both insurers and intermediaries for repeated instances of avoiding their obligations under the Draft Instrument
- removal or suspension of authorisations and licences to sell insurance products
- clawbacks of commissions paid where obligations were avoided or not complied with, and
- active identification and compensation of consumers who have purchased unsuitable products as a result of intermediaries avoiding their obligations.

Information about the imposition of sanctions and the number of sanctions per entity per year should be published and made available to the public. Legal Aid NSW further submits that industry bodies should agree on a standardised compliance supervision protocol to ensure consistent behaviour across providers of insurance products. Apart from the element of reporting to ASIC, this could also include a provision for post-sale

interviews with individual consumers as a means of assessing the effectiveness of the obligations placed on intermediaries at the point of sale and during the deferral period.

Proposed Intervention: Mechanical Risk Products

E3Q1 – Do you consider that there is significant consumer detriment from the sale of add-on mechanical risk products in the circumstances described by ASIC? Please provide evidence in support of your response.

In our experience, the sale of add-on mechanical risk products, including products like mechanical breakdown insurance, third-party warranties and dealer warranties, results in significant consumer detriment. Consumers experiencing disadvantage, including people with low literacy, older people and people with limited English language skills, are particularly vulnerable to experiencing harm from the sale of add-on mechanical risk products.

The sale of these products is often the result of high-pressure sales tactics by car-yard staff who receive substantial commissions on sale.

Mechanical risk products themselves often represent little if any value to consumers, particularly in circumstances where the products only commence after a manufacturer's warranty ends. Policies often contain substantial restrictions and exclusions, as well as onerous obligations on the part of the consumer. For example, one policy held by a Legal Aid NSW client included a clause that said that if a claim is made on a policy and that claim is refused, then the customer is liable to pay for any inspection fee associated with the claim. In some cases, the amount that can be claimed under a policy is less than the premiums paid by the consumer.

Policies also often require consumers to service their car at a specific garage as a pre-condition for making a claim. This is a particularly onerous and unreasonable requirement for consumers living in regional and remote areas. Claims have been refused on the basis that consumers did not have their cars serviced in the precise manner specified in the policy.

These policy features are rarely disclosed to consumers, and consumers are afforded little time to review documents before signing up.

Case study

Daniel purchased a second-hand vehicle from a caryard. At the point of sale, Daniel was told that he should purchase mechanical breakdown insurance to protect him in case the car breaks down. Daniel initially said that he didn't want it, but the sales person told him that he would regret it if his car broke down, so he agreed to purchase the insurance for \$1400.

Daniel was not told that the mechanical breakdown insurance he purchased would not come into effect for seven years. Three years later, Daniel sold the car, at which point the car was still under the manufacturer's warranty. Daniel has lost money on

paying the premium for this product before he was even entitled to make a claim under it.

E3Q2 – If you consider there is significant consumer detriment, do you think it should be addressed by the proposal in this section, or by some other intervention or action by ASIC? Please give reasons why you think a particular approach will be more effective?

Legal Aid NSW generally supports ASIC's proposed intervention in the manner outlined in section E of the Consultation Paper.

Where mechanical breakdown insurance products represent little or no value to consumers, they should not be offered to consumers at all. Legal Aid NSW's casework shows that consumers often pay significant premiums for insurance products where the maximum claim limit is close to or less than the premium.

We support ASIC's proposal to prohibit the sale of mechanical risk products on new cars, where the manufacturer's warranty still has more than 12 months' cover.

We also support ASIC's proposal to apply the obligations detailed in section C of the Consultation Paper to mechanical risk products. However, we consider that a four day deferral period is too short. We recommend that the deferral period be 30 days, as outlined in our response to C7Q3 above.

We support ASIC's proposal that consumers should be entitled to a refund where they cancel the product. We agree with ASIC's proposal as to how a refund regime should operate.

We also support ASIC's proposal to restrict the requirements that providers can impose on consumers to service their vehicle. We agree that this restriction should prevent policies from requiring consumers to have their vehicles serviced at a specific garage, and that a policy cannot include a term requiring a consumer to have their car serviced more frequently than is required by the manufacturer.

E3Q3 – How would the proposal in this paper affect businesses (e.g. insurers, car dealers, finance brokers, credit providers)?

No comment.

E3Q4 – What would be the advantages and disadvantages of car dealers no longer being able to rely on the exemption for incidental financial products (as a result of the proposal in paragraph E1(a))?

Legal Aid NSW notes that an unintended consequence of there being a significant break between the sale of a vehicle and the sale of a dealer warranty is that dealers may not be able to rely on the licensing exemption under section 763E of the

Corporations Act 2001 (Cth) (the Corporations Act) that would otherwise allow dealers to sell dealer warranties without an Australian Financial Services Licence.

However, we consider that the advantages of applying ASIC's proposed deferred sales model, and the benefit it will bring to consumers, is likely to outweigh any disadvantage that might arise from dealers no longer being able to rely on the licensing exemption under the Corporations Act.

Given that dealer warranties have historically represented poor value for consumers, it is unlikely that consumers will be any worse off if dealers are unable to sell dealer warranties. However, if a product represents good value for consumers, one disadvantage that may arise from dealers no longer being able to rely on the exemption is that a good product may not be available.

We consider that it is a matter for industry as to how it approaches the possibility that dealers may no longer be covered by the 763E exemption.

E3Q5 – If you are able to do so, please provide an estimate of the impact of implementing the proposed model, or any changes or variations to this model set out in your response.

Legal Aid NSW is not in a position to comment about the impact of implementing the proposed model.