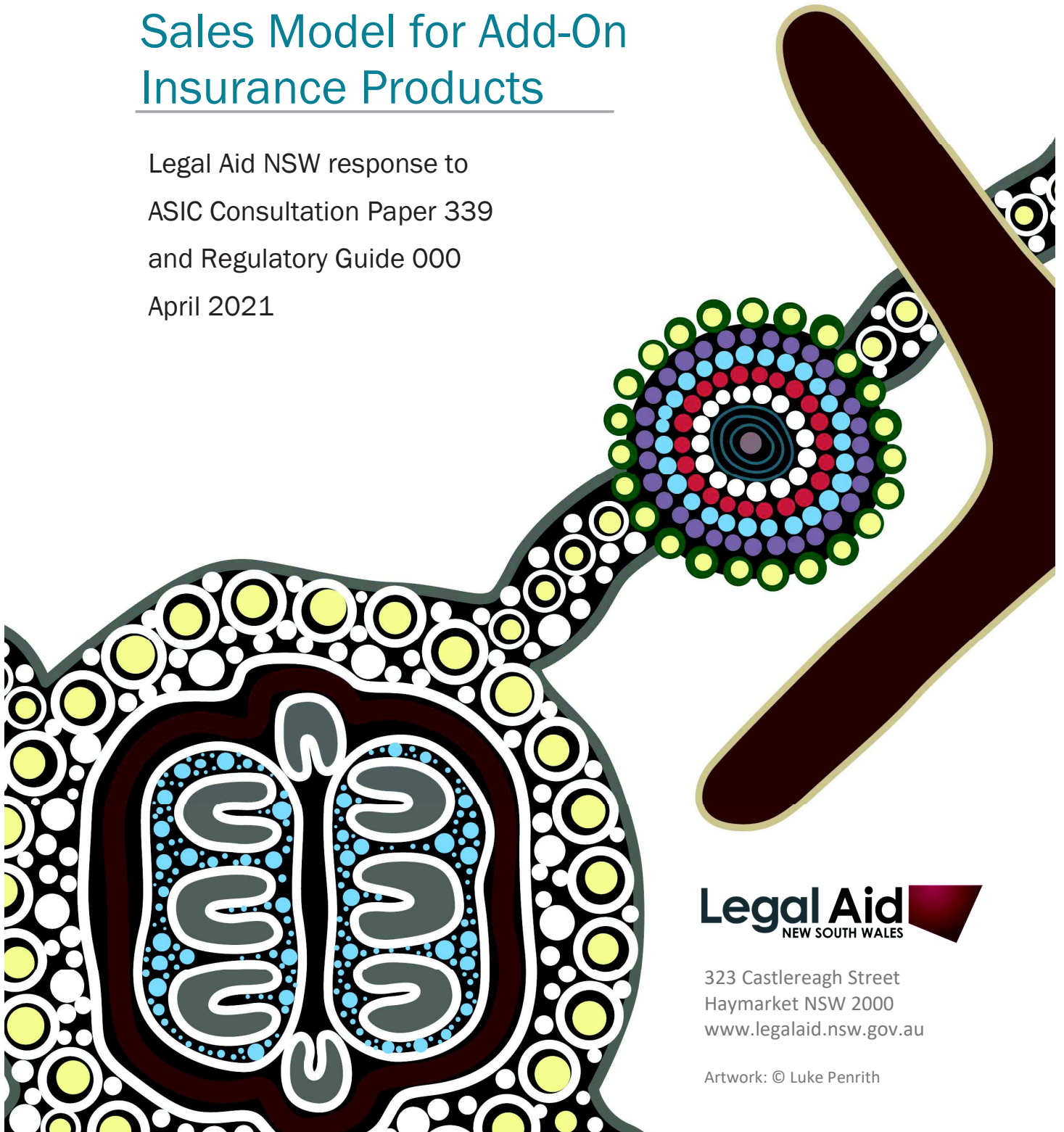


Implementing the Royal Commission recommendations: Deferred Sales Model for Add-On Insurance Products

Legal Aid NSW response to
ASIC Consultation Paper 339
and Regulatory Guide 000
April 2021



Legal Aid
NEW SOUTH WALES

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Acknowledgement	3
1. About Legal Aid NSW	4
2. Executive Summary	5
Recommendations:.....	6
Recommendation 1.....	6
Recommendation 2.....	6
Recommendation 3.....	6
Recommendation 4.....	6
Recommendation 5.....	6
Recommendation 6.....	6
3. Regulatory Guide on the deferred sales model for add-on insurance .	7
3.1 Use of examples	7
Recommendation 1.....	7
3.2 Language of the Regulatory Guide.....	8
Recommendation 2.....	8
3.3 Guidance on customer-initiated contact	8
3.4 Guidance on customer right of return and refund	8
Recommendation 3.....	9
3.5 Guidance on exemptions	9
3.6 Ensuring compliance with the deferred sales model for add-on insurance	10
Recommendation 4.....	10
4. Customer Information	11
4.1 Content	11
Recommendation 5.....	11
Recommendation 6.....	12
4.2 Mode of delivery.....	12
4.3 Time of delivery.....	12

Acknowledgement

We acknowledge the traditional owners of the land we live and work on within New South Wales. We recognise continuing connection to land, water and community.

We pay our respects to Elders both past and present and extend that respect to all Aboriginal and Torres Strait Islander people.

Legal Aid NSW is committed to working in partnership with community and providing culturally competent services to Aboriginal and Torres Strait Islander people.

1. 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 25 offices and 243 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged. We offer telephone advice through our free legal helpline LawAccess NSW.

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 community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal services. Our community partnerships include 27 Women's Domestic Violence Court Advocacy Services, and health services with a range of Health Justice Partnerships.

The Legal Aid NSW Family Law Division provides services in Commonwealth family law and state child protection law.

Specialist services focus on the provision of Family Dispute Resolution Services, family violence services and the early triaging of clients with legal problems through the Family Law Early Intervention Unit.

The Civil Law Division provides advice, minor assistance, duty and casework services from the Central Sydney office and 20 regional offices. It focuses on legal problems that impact on the everyday lives of disadvantaged clients and communities in areas such as housing, social security, financial hardship, consumer protection, employment, immigration, mental health, discrimination and fines. The Civil Law practice includes dedicated services for Aboriginal communities, children, refugees, prisoners and older people experiencing elder abuse.

The Criminal Law Division assists people charged with criminal offences appearing before the Local Court, Children's Court, District Court, Supreme Court, Court of Criminal Appeal and the High Court. The Criminal Law Division also provides advice and representation in specialist jurisdictions including the State Parole Authority and Drug Court.

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2. Executive Summary

Legal Aid NSW welcomes the opportunity to provide a submission to ASIC's Consultation Paper 339 – Implementing the Royal Commission recommendations: The deferred sales model for add-on insurance (**Consultation Paper**), and the ASIC Regulatory Guide 000: The deferred sales model for add-on insurance (**Regulatory Guide**). We note that Legal Aid NSW previously provided a submission in response to ASIC's 2019 Consultation Paper 324 – *Product Intervention: The sale of add-on financial products through caryard intermediaries* and 2017 Consultation Paper 294 – *The sale of add-on insurance and warranties through caryard intermediaries*. These are attached for reference.

Legal Aid NSW has raised serious concerns about the sale of add-in insurance products in our previous submissions.¹ Our casework experience, which mostly centres on the sale of add-on insurance in the context of caryard sales, shows that the add-on insurance market often represents poor value for consumers, and that provision of incentivised commission payments creates a high risk of unfair sales and adverse outcomes.² Our clients experience significant harm as a result of being sold add-on insurance and warranties by caryard intermediaries. Accordingly, we have advocated for the prohibition on the sale of add-on insurance by motor vehicle dealers. In the alternative, we support the establishment of a deferred sales model with a 30-day deferral period for purchases of add-on motor vehicle insurance.³

While the provisions regarding the sale of add-on insurance in the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* do not go as far as we would have preferred, we welcome the introduction of the deferred sales model and the four-day deferral period. We recognise that these changes signal an important step in protecting consumers from low-value products in a high-pressure sales environment.

Legal Aid NSW recognises that the deferred sales model is complex and accordingly we support clear guidance by way of the Regulatory Guide. Overall, we are satisfied with the form and content of the Regulatory Guide and the sample Customer Information notice.

¹ Legal Aid NSW submission to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, Round 6 Hearing (September, 2018); Legal Aid NSW submission in response to Financial Services Royal Commission Interim Report, (October 2018); Legal Aid NSW Submission No 15 to Australian Securities and Investments Commission, *Consultation Paper 294 – The sale of add-on insurance and warranties through caryard intermediaries*, (October 2017).

² Legal Aid NSW submission to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, Round 6 Hearing (September 2018).

³ Legal Aid NSW, Submission to Australian Securities and Investments Commission, *Consultation Paper 324 – Product Intervention: The sale of add-on financial products through caryard intermediaries*, (November 2019).

We have made a number of suggestions to clarify the content of the Regulatory Guide to ensure both industry and consumers understand their rights and obligations under the model, to facilitate better compliance and safeguard consumers from high pressure sales tactics of low value insurance products.

Recommendations:

Recommendation 1

Provide additional examples in the Regulatory Guide to demonstrate different stages of the deferred sales model and clarify acceptable and prohibited conduct during each phase.

Recommendation 2

ASIC should use plain English throughout the Regulatory Guide.

Recommendation 3

Clarify the scope of consumer refunds and remedies available after the six-week period following the sale of add-on insurance in breach of protections.

Recommendation 4

In addition to providing regulatory guidance, ASIC should employ a range of strategies to ensure compliance with the deferred sales model and Regulatory Guide.

Recommendation 5

Consider changing the phrase “Customer Information” throughout the Regulatory Guide to less ambiguous wording that is more aligned with the notice’s purpose, to clarify a customer’s right to say no to being sold insurance.

Recommendation 6

Apply the Australian Government logo to both hardcopy and electronic customer information statements and consider prescribing the form of the document for electronic distribution.

3. Regulatory Guide on the deferred sales model for add-on insurance

Legal Aid NSW recognises that the deferred sales model is complex, particularly when it comes to identifying the triggers for the commencement of each phase of the model and what constitutes permissible conduct during each of those phases. Legal Aid NSW therefore supports prescriptive guidance in the form of the Regulatory Guide to assist both industry and consumers in understanding their rights and obligations, aid consistency and ensure overall compliance in such a technical area.

3.1 Use of examples

We note that the Regulatory Guide is detailed and comprehensive. The use of the infographic⁴ is helpful at demonstrating different phases of the model, although we have found it easier to understand the infographic *after* reading the guidance that follows. Equally, the use of examples aids an understanding of how the model works in practice. We agree that without examples, it can be confusing for both consumers and industry which modes of communication are permissible in which phase of the deferred sales model and when specific phases are triggered.

What would also be useful in our view, is if the scenario in Example 1 of the Regulatory Guide⁵ was expanded to cover each of the phases of the model, thereby giving both industry and consumers a complete example of how the model works in practice. Additional acceptable and non-acceptable examples of permissible modes of communication in different phases could also be added as an appendix to the Regulatory Guide for further guidance.

Further, while the Regulatory Guide notes the intersection of anti-hawking laws with the deferral period, we suggest demonstrating this by way of an example, so that those less familiar with hawking prohibitions understand how the two regimes operate side by side.⁶

Recommendation 1

Provide additional examples in the Regulatory Guide to demonstrate different stages of the deferred sales model and clarify acceptable and prohibited conduct during each phase.

⁴ Australian Security and Investments Commission ASIC *Consultation Paper 339 Implementing the Royal Commission recommendations: The deferred sales model for add-on insurance* (March 2021); Australian Security and Investments Commission ASIC *Regulatory Guide 000 The deferred sales model for add-on insurance* (March 2021), 15.

⁵ Australian Security and Investments Commission ASIC *Regulatory Guide 000 The deferred sales model for add-on insurance* (March 2021), 18.

⁶ Ibid [RG 000.48]-[RG 000.53].

3.2 Language of the Regulatory Guide

We note that for those familiar with the language of the legislation, the content of the Regulatory Guide is clear. However, for those less familiar, or for consumers trying to understand their rights of redress, the language can still appear overly complex and legalistic at times. Accordingly, we recommend greater use of plain English throughout the Regulatory Guide. Additional examples would also assist consumers to gain a better understanding of the more complex aspects of the model.

We are also of the view that the use of the phrase “Customer Information” may be confusing to consumers. Rather than conveying information which needed to be provided to consumers, it suggests information which consumers needed to provide to businesses in the course of their purchase, or alternatively, how customer information is treated by providers (akin to privacy policies). We make further comments and suggestions on this matter below under “Customer Information”.

Recommendation 2

ASIC should use plain English throughout the Regulatory Guide.

3.3 Guidance on customer-initiated contact

Legal Aid NSW supports prohibitions on the sale of add-on insurance products during the deferral period even following customer-initiated contact,⁷ and agrees that the onus should be on the provider to demonstrate that any offer, request or invitation relates only to the purpose for which the customer-initiated contact.

3.4 Guidance on customer right of return and refund

The Regulatory Guide explains the customer’s rights of return and refund where an add-on insurance product was sold to them in breach of the prohibition on selling.⁸ It further provides that no customer should be made to pay a penalty when they access their right to a refund.⁹

However, the Regulatory Guide is silent on whether customers who purchase add-on insurance on finance and thereby incur interest on premiums are entitled to a refund on the interest accrued on those premiums as well. Legal Aid NSW submits that if the principle behind the customer’s right of return and refund is to ensure that the customer is not required to pay a penalty (or otherwise be worse off) when they exercise their

⁷ Ibid [RG 000.81].

⁸ *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) Schedule 3, ss 12DQ and 12DT

⁹ Ibid s 12DT.

rights, then the Regulatory Guide should clearly set out that any interest accrued in connection with purchasing the add-on insurance policy is refundable as well.

Legal Aid NSW is also concerned that the Regulatory Guide is unclear on what remedy, if any, is available to customers after the six-week period following the sale of add-on insurance in breach of the provisions. In our experience, it can take years for customers to become aware of add-on insurance products. Their remedies, if any, in those situations should be clearly stated in the Guide.

Case Study: Ms Wheeler¹⁰

Ms Wheeler* is a young Aboriginal and Torres Strait Islander woman who at the age of 19 years old was coerced by her then partner to purchase a car on finance for his benefit. Due to her personal circumstances it took a number of years to seek assistance in relation to this debt. She only then discovered that her finance arrangement included the purchase of two separate add on insurance products. Despite raising complaints with the insurers, the remedy was limited to a refund of premiums, although Ms Wheeler had paid years of interest on the premiums borrowed.

Recommendation 3

Clarify the scope of consumer refunds and remedies available after the six-week period following the sale of add-on insurance in breach of protections.

3.5 Guidance on exemptions

Legal Aid NSW reiterates and supports ASIC's interpretation of its power that exemptions should only be made in limited circumstances. For this reason, we support the rigorous process around exemption acceptance set out in the Regulatory Guide.¹¹ We agree that where insufficient evidence is provided in support of an exemption, the application should be refused.

¹⁰ All case studies and client stories have been deidentified in this submission.

¹¹ Australian Security and Investments Commission ASIC *Regulatory Guide 000 The deferred sales model for add-on insurance* (March 2021), [RG 000.124].

3.6 Ensuring compliance with the deferred sales model for add-on insurance

Alongside the Regulatory Guide, Legal Aid NSW supports rigorous ASIC oversight of the deferred sales model, deploying “secret shopper” spot checks and auditing records and training modules provided by insurers to ensure compliance with model. Further, crucial to the ultimate effectiveness of the model is thorough evaluation of the Regulatory Guide, which should include benchmarking before and after intervention to assess the effectiveness of regulatory guidance and determine whether any changes are required.¹²

Recommendation 4

In addition to providing regulatory Guidance, ASIC should employ a range of strategies to ensure compliance with the deferred sales model and Regulatory Guide.

¹² See UK model: Financial Conduct Authority, *Evaluation Paper 18/1: An evaluation of our guaranteed asset protection insurance intervention* (July 2018).

4. Customer Information

4.1 Content

As mentioned above, Legal Aid NSW submits that the use of the phrase “Customer Information” in the Regulatory Guide is potentially confusing and suggests information which customers need to give to providers of add-on insurance products, rather than the other way around.¹³ We suggest using an alternative phrase which more explicitly relates to the opt out purpose of the notice, to clarify that customers have a right to say no to being sold insurance. Finally, once the Sample Customer Information statement is settled, it should be attached to the Regulatory Guide. We note that at present the sample notice is only attached to the Consultation Paper.

Recommendation 5

Consider changing the phrase “Customer Information” throughout the Regulatory Guide to less ambiguous wording that is more aligned with the notice’s purpose, to clarify a customer’s right to say no to being sold insurance.

In our view, the language of any customer facing documents should be clear and written in plain language. To that end we are satisfied with the wording of the Customer Information document and welcome the fact that it was user tested. We note that many of our clients who purchased add-on insurance were Aboriginal and Torres Strait Islander and we recommend user testing the Regulatory Guide with Aboriginal and Torres Strait Islander communities, if this has not already occurred.

We agree that there is no need to include the official name of the Customer Information statement on the document itself, however, should that be changed, we prefer renaming the statement to a less ambiguous phrase as discussed above.

Apart from being written in plain and clear language, the statement should be available in different languages and read aloud versions for people with visual impairment.

Finally, it is not clear why the Australian Government logo is only applied to the hardcopy and not the electronic version. To give the document significance and authenticity, and differentiate it from other advertising material, we support the Australian Government logo appearing on both hardcopy and electronic versions of the statement. We also suggest that ASIC consider including its own logo on both versions of the statement.

¹³ Appendix 1 of the Regulatory Guide, ‘Customer Information’ relates to the ASIC-prescribed information that must be provided to a customer to start the deferral period.

Recommendation 6

Apply the Australian Government logo to both hardcopy and electronic customer information statements and consider prescribing the form of the document for electronic distribution

4.2 Mode of delivery

Legal Aid NSW accepts that providing the customer information statement electronically by default assists with respect to record keeping and avoids any delays or possible loss of information through post. We also accept that many customers may prefer to receive information electronically and may feel more comfortable opting out of being contacted about insurance electronically rather than in person, particularly where they wish to do so immediately.

However, for consistency, our preference is for electronic information to also be provided in a prescribed form clearly bearing the Australian Government logo. Alternatively, we agree with mandating key features of electronic provision as per consultation paper.

We note that there is a risk that if the information is provided to customers via email they may not read it. However, we agree that this risk may be somewhat mitigated by specifying that the information must appear in the body of the email rather than only as an attachment.

Finally, use of customer email addresses or other electronic contact details provided for the purposes of receiving the customer information for marketing or other purposes without customers' permission should be expressly prohibited.

4.3 Time of delivery

Legal Aid NSW supports providing customer information at the time of committing to acquire a product and no earlier, and further agrees with customer information being provided each time for repeat purchases.



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Consultation Paper 324

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

Legal Aid NSW submission to ASIC

November 019

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

-
- 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

-
- 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.

The sale of add-on insurance and warranties through caryard intermediaries

Legal Aid NSW submission to ASIC
October 2017

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Legal Aid 
NEW SOUTH WALES

Table of Contents

Introduction	1
Deferred sales model	2
<i>Testing consumer comprehension</i> 5	
<i>A market study</i> 5	
<i>Other approaches</i> 6	
<i>Commencement of the deferral period</i> 7	
<i>Duration of the deferral period</i> 10	
<i>Consumer communication</i> 10	
<i>Mechanical breakdown insurance and warranties</i> 12	
Supervision obligations for product providers	14

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) to provide legal assistance, with a particular focus on the needs of people who are socially and economically disadvantaged.

Legal Aid NSW provides information, community legal education, advice, minor assistance and representation, through a large in-house legal practice and private practitioners. Legal Aid NSW also funds a number of services provided by non-government organisations, including 32 community legal centres and 29 Women's Domestic Violence Court Advocacy Services.

Legal Aid NSW welcomes the opportunity to provide a submission to ASIC's Consultation Paper 294, *The sale of add-on insurance and warranties throughout caryard intermediaries*.

Legal Aid NSW's Civil Law Division focuses on legal problems that impact most on disadvantaged communities, such as credit, debt, insurance, employment, social security and access to essential social services. The Civil Law practice provides legal services to people through the Central Sydney office and 13

regional offices. Currently, we have over 150 civil lawyers who provide advice across all areas of civil law, and specialist teams that assist with insurance issues affecting particularly disadvantaged clients.

This submission draws on the casework experience of our civil lawyers in providing these services.

Our submission addresses the questions in the Consultation Paper, following the numbering set out in the Paper. The names of individuals and companies in the case studies have all been changed.

Should you require any further information or wish to discuss this submission, our contact officer is:

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Introduction

Legal Aid NSW welcomes ASIC's consultation on the sale of add-on insurance and warranties through caryard intermediaries.

Legal Aid NSW strongly supports the proposal to establish a deferred sales model for add-on insurance products and warranties. A deferred sales model is vital to reduce the significant consumer harm occurring through the sale of add-on insurance by caryard intermediaries.

A deferred sale model would prohibit the sale of add-on insurance products until the expiration of a defined period after the sale of a car. Add-on insurance products include:

- consumer credit insurance (CCI), covering a borrower's capacity to make repayments under a car loan
- loan termination insurance, where the consumer returns the vehicle
- guaranteed asset protection (GAP) insurance, covering the difference between what a consumer owes on their car loan and an amount received under their comprehensive insurance policy, if the car is a total loss
- tyre and rim insurance, and
- mechanical breakdown insurance (which often only commences after the manufacturer's warranty has expired).

The deferral period should start after delivery of the car and it should be thirty days long. This would allow the consumer time to compare and consider their options, absent the decision fatigue induced by the car purchase experience. It is also likely that the consumer will have made at least one payment towards any car loan during the thirty day period, meaning that the consumer is better equipped to assess their financial situation, particularly their ability to finance extra insurance, after the car purchase.

The deferred 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, interactive and meaningful communication with the consumer about the cost, coverage and value of add-on insurance is essential.

Deferred sales model

E1Q1 Do you consider that it is appropriate to apply a deferral period to the sale of add-on products by caryard intermediaries?

E1Q2 To what extent would a deferral address the consumer harms identified in this market?

Yes. Legal Aid NSW considers that a deferral period should apply to the sale of add-on products by caryard intermediaries.

ASIC's Reports 470, 471 and 492¹ describe key failings in the add-on insurance market, including that add-on insurance products represent poor value for consumers, and that the payment of high commissions creates a risk of unfair sales and adverse outcomes. This reflects our casework experience. These failings disproportionately affect our clients who are the most vulnerable in the community, often with complex needs or mental health issues.

Case study: Mr Smith

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 through Star Automotive. Upon his purchase, the caryard intermediary also sold him CCI and GAP insurance on behalf of the insurer, Star Insurance.

The CCI premium was \$4834.75 and the GAP insurance premium was \$1435. Star Automotive received 20 per cent commission for the sale of CCI and 50 per cent commission for the sale of GAP insurance.

During 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 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 he would have to pay \$65,000 on a car worth \$34,000. Mr Smith already had Total and Permanent Disability 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.

¹ ASIC (2016) *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470); ASIC (2016) *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471); ASIC (2016) *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492).

Had there been a deferral period for 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 instructs that had he known this information he would not have purchased the policies.

As the case study shows, a deferral period would allow consumers, like Mr Smith, relief from the high-pressure sales tactics often found in caryard sales and the decision fatigue that results. It would provide consumers with the time necessary to consider their insurance options, seek advice, and understand the affordability and value of the product. With this information, the consumer is better placed to decide if the add-on insurance product is suitable for them and worth purchasing.

E1Q4 Would the model need to apply differently to the new and used car markets? In what ways could the model differ to be effective across the two markets?

No. The model should not apply differently to the new and used car markets.

We cannot identify any differences in the sale of add-on insurance between the two markets which would justify a different model. A consistent model has the benefits of reducing consumer and industry confusion, and reducing costs to industry and the regulator in enforcing compliance.

E1Q5 What are the preconditions for a competitive online market? How can a deferred sales model contribute to this outcome?

Comparable and complete information about the costs, risks and benefits of products are needed to ensure a competitive online market. A deferred sales model would provide consumers with the opportunity to investigate these options prior to purchase, in the same way that many consumers will research their car purchase.

E1Q6 – Could the objectives of a deferred sales model be achieved in a different way or could any complementary measures better ensure our objectives are achieved?

As noted at E1Q1 and E2Q2, the current sales process for add-on products is not designed to empower consumers or to assist them to make informed decisions. If the proposed deferral model is introduced it should be complemented by a strategy to improve consumer understanding about add-on insurance products.

While the deferred sales model may work to insert a pause into the sales process for add-on products, this pause does not provide full protection to consumers. Consumers will inevitably be approached at some point to purchase the add-on products. It is at this point that the consumer should be educated and aware of the products on offer so they may make an informed choice.

Consumer engagement, education and awareness must be delivered through strong and effective consumer communication. Effective communication should go beyond merely referring consumers to a link for more information or handing them a booklet to read. In our view, this approach is too passive and is a likely reason for the limited impact of the UK deferred sales model.²

Our responses to E1.3Q1, E1.3Q4 and E1.3Q5 provide further detail about how robust consumer communication might be achieved.

E1Q7 If a deferred sales model was introduced, are there any existing related obligations on insurers, finance providers and car dealers that would no longer be appropriate and could be removed?

No. We do not consider that there are any existing obligations on insurers, finance providers and car dealers that could be removed should the deferred sales model be introduced. In our view, additional obligations should be placed on insurers and distributors of insurance products in conjunction with the deferred sales process.

We note the comments in our submission to Treasury's Design and Distribution Obligations and Product Intervention Power proposals paper³ that there should be design and distribution obligations for issuers and distributors of financial products, specifically insurance products.

² See p39-40 of the Consultation Paper, noting that the UK reforms have had little impact on the volume of sales.

³ Legal Aid NSW submission to the Treasury, *Design and Distribution Obligations and Product Intervention Power*, March 2017

At a minimum, we consider that the design and distribution obligations should require insurers to design products that meet the needs of a clearly identified target market, and that provide a tangible benefit for these consumers at reasonable value. Insurers and distributors should also ensure that their products do not reach consumers for whom they are ill-suited and offer little benefit. A target claims ratio that sets a benchmark for the number of claims that are approved each year could be developed for each product so that there is quantitative evidence that consumers in the target market do in fact benefit from the product.

Insurers should have processes in place for monitoring their compliance with these obligations, including

- monitoring the number of complaints
- collecting data relating to claims outcomes
- assessing whether an insurance product is reaching its target market, and
- assessing whether the product continues to offer a benefit to consumers.

Testing consumer comprehension

E1Q8 What is the most effective way of testing whether consumer understanding has improved due to a deferred sales model? What metrics would provide the best way of measuring consumer comprehension?

As noted at our response to E1Q6, improving consumer understanding of add-on insurance products is essential. Legal Aid NSW supports consumer testing to measure the success of the reforms, and to shape future reforms.

A market study

One option is to conduct a market study of consumers. This could be conducted at the point where the consumer signs up to the add-on insurance product. The study could test the consumer's knowledge of the product at point of sale using questions such as: what is the product you have purchased; what are the main features of the product; what are the main exclusions of the product; and how much is your premium? Where the consumer does not pass the test, there could be an obligation to provide further information.

A market study could also be conducted after a longer period of time, such as a year. The second study could ask similar questions to the first study, and also ask: what is the value of the product to you; have you claimed on the product; and do you want to continue paying for the product? The results from the market studies could be compared against the consumer evidence provided to ASIC during the preparation of Reports 470, 471 and 492 to show how consumer understanding has changed.

Consumer testing should have the following characteristics:

-
- Testing should be done by an independent body, such as ASIC, or a research body, such as a university.
 - Testing should focus on a representative group of consumers with a variety of demographic indicators, including vulnerable consumers.
 - Testing should be done at various times, including just after the product has been bought and again after a period of time has passed.
 - Testing should generate data on the value of the car bought, whether it was a new or used car, the nature of the add-on insurance, and whether the customer made any claims in relation to it.
 - Testing should ask the consumer to explain the key features of the product purchased and compare this to the contract documents.
 - Testing should ask questions such as why the consumers bought the product, or why they did not, whether they would have bought the product in hindsight, whether the product was useful, whether they asked for independent financial or legal advice, whether they thought it was good value at first and whether their view changed.
 - If it becomes clear at the end of the testing that the consumer did not understand the product, the test should provide the consumer with referrals information should the consumer wish to challenge the sale of the product.
 - Testing should generate data on various dealers and if possible, this information should be published. These published figures would exert appropriate competitive pressure for dealers to act more ethically and ensure that their customers understand the products they are sold.

Other approaches

We note that some recent research points to the limitations of disclosure in ensuring consumer comprehension.⁴ In our view, it is important for ASIC to adopt innovative approaches, in conjunction with disclosure, to enhance consumer understanding.

As the ASIC Consultation Paper notes at paragraph 221, the use of websites and apps could facilitate the development of an online distribution channel, with its potential benefits for competition. A website and/or app could function as an online marketplace for all purchases of add-on insurance. The marketplace could enable users to compare different products and encourage competition between insurers. It could also incorporate interactive tools for better understanding, including an online test for the consumer prior to purchasing the product to make sure they understand the product's key features. However, we note that some vulnerable consumers with low computer literacy or limited

⁴ See for example: Insurance Council of Australia *Consumer research on general insurance product disclosures* (2017)

access to smartphones and tablets may not be able to access a website or app. Alternative measures should be put in place to ensure accessibility for all consumers.

Another approach to improving consumer comprehension is ‘performance based regulation’ as suggested by Professor Lauren Willis.⁵ This type of regulation creates performance standards for consumer comprehension or suitable consumer product use. Providers of financial products are motivated to ensure that customers understand products and purchase appropriate products, in order to comply with regulation. Such an approach can align the interests of industry with the goals of regulators.

E1Q9 Should a consumer opt-out mechanism be included?

No. Legal Aid NSW strongly opposes a consumer opt-out mechanism. We share the concerns expressed in the Consultation Paper at paragraphs 191–192 about introducing an opt-out mechanism.

As noted at our responses to E1Q1 and E1Q2, a mandated deferred sales model would provide all consumers with relief from high-pressure sales environments to assess the cost, suitability and value of add-on products and make an informed decision about purchasing those products. Including an opt-out mechanism in these reforms would create a risk of caryard intermediaries engaging in unfair practices to avoid the deferral period. Further, it could be difficult for consumers to prove that caryard intermediaries have engaged in such unfair practices.

Legal Aid NSW notes that the UK deferred sales model for GAP insurance includes an opt-in arrangement to reduce the deferral period from 4 days to 1 day after GAP insurance product information has been provided to the consumer. We consider this element of the UK model to be a weak point that may have contributed to the limited success of reforms in the UK.⁶

Commencement of the deferral period

E1.1Q1 Which of the proposed options in paragraph 193 for commencement of the deferral period would be preferable and why (please suggest other options if relevant)?

⁵ See for example: Willis, LE ‘Performance Based Consumer Law’ (2015) 82 *University of Chicago Law Review* 1309

⁶ See pages 39-40 of the Consultation Paper.

The deferral period should start after the vehicle has been delivered to the consumer and the consumer communication has been provided (Option C). Legal Aid NSW recommends that intermediaries should be prevented from making the consumer communication (and triggering the deferral period) until at least one day after the consumer has taken possession of the vehicle. Our preference is for the deferral period to operate as follows:

Delivery of car → Consumer communication provided at least 24 hours later → Deferral period commences after consumer communication provided.

One of the most common scenarios that arises in our add-on insurance casework is consumers confusing optional add-on products with comprehensive insurance required under the loan. Mandating that consumers have possession of the vehicle before the consumer communication takes place would help to disconnect the purchase of add-on products from the purchase of comprehensive insurance and vehicle finance approval. This would help make clear to consumers that the add-on products are optional. Delivery also provides the most easily documented, readily verifiable commencement point for the deferral period. More detail can be found at our response to E1Q1.3.

If the deferral period commences as we propose, consumers could use this period to assess the cost, suitability and value of add-on products and make an informed purchasing decision outside the high-pressure sales environment.

<p><i>E1.1Q2 Which sales sequence is most likely to meet our stated objectives and why?</i></p>

Sales sequence B, where the consumer is asked to select the add-on products they want to buy after they have chosen the vehicle and finance is approved, is most likely to mitigate consumer harm from the inappropriate sale of add-on insurance and warranties.

Provided ASIC adopts Legal Aid NSW's proposal in E1.1Q1 that the deferral period not commence until after the vehicle is delivered, sales sequence B would benefit consumers in the following ways:

- consumers can assess add-on products based on risks associated with the particular car
- consumers know the exact cost of add-on products (because interest rate and loan term are finalised)
- consumers can assess the impact of add-on products on the loan amount borrowed and loan term and can compare the total loan cost with and without add-on products, and
- consumers are less likely to experience decision fatigue relating to vehicle selection, finance, compulsory third party and comprehensive insurance.

One disadvantage of sales sequence B relates to the timing of vehicle finance. If the consumer proposes to finance the add-on product under a related loan contract, the consumer and lender will have to adjust the loan amount or term to fund the add-on products. However, we note that if the deferral period applies after vehicle delivery, this disruption will apply to all proposed sales sequences. We do not think that this disadvantage outweighs the benefits of sales sequence B. Further, we consider that it may be overcome by establishing clear communication channels between the lender, intermediary and consumer.

In our view, the consumer protection advantages of sales sequence B are necessary to counteract the systematic problems with add-on insurance sales, and outweigh any potential inconvenience.

E1.1Q3 How could the point at which the deferral period commences be easily documented to be readily verified by all relevant parties?

Legal Aid NSW considers that vehicle delivery is the most easily documented and readily verifiable point in the sales process. Delivery follows loan approval, which is already extensively documented. The caryard also documents car delivery and it is the point in the sales process that consumers are most likely to remember in detail.

The caryard intermediary should bear the onus of establishing that they have complied with and accurately documented the start of the deferral period.

E1.1Q4 If the deferral period commenced at vehicle delivery, could short-term 'bridging' insurance be offered to cover the deferral period? What does insurers' claims data demonstrate about the likelihood of a claim shortly after delivery?

Short-term bridging insurance should not be offered to cover the deferral period. Although we acknowledge there is some risk associated with this cover not being offered, we consider this risk small when compared with the additional cost and consumer harm that may result from bridging insurance.

It is likely that the sale of bridging insurance would occur in similar poor conditions to the current sale of add-on insurance. It may give rise to high-pressure sales of a low value product at a time when consumers feel decision fatigue and may not be equipped to understand the terms and conditions of the product. For these reasons, we consider that bridging insurance is unnecessary and may continue the consumer harms that the proposed reforms are trying to remedy.

Duration of the deferral period

E1.2Q1 What would be the appropriate duration of the deferral period within the range of 4-30 days and why?
E1.2Q2 Should the duration of the deferral period be different for new and used cars?

Legal Aid NSW considers that the appropriate duration of the deferral period is 30 days from the date the consumer communication is provided, at least one day after car delivery. Our response at E1.1Q1 provides further detail as to how this could operate.

A 30-day deferral period means it is likely that the consumer will have made at least one payment to their lender. This will allow the consumer to have a better understanding of their financial position following the purchase, and assess if they are able to afford an increased payment to take out an insurance product.

A 30-day deferral period would also allow the consumer the necessary time after a pressured sales experience to consider the value of the product to them, seek advice and research other alternatives.

We do not consider that the duration of the deferral period should be different for new and used cars. We refer to our response at E1Q4 for further detail.

Consumer communication

E1.3Q1 Should providers be required to take active steps to ensure consumers read and understand information about their products before they can buy them?

Yes. Providers should be required to take active steps to ensure that consumers understand information about add-on products before they can buy them. In our view, a crucial part of the success of the deferred sales model is increased consumer engagement with and understanding of add-on insurance.

Legal Aid NSW's client base includes some of the most vulnerable consumers, including those who have low literacy levels, come from culturally and linguistically diverse backgrounds, are elderly or have disabilities. Any efforts to ensure consumers read the relevant information must be tailored to the most disadvantaged consumer.

Our responses to E1.3Q2 – E1.3Q5 provide further detail about how these obligations on providers might operate in practice.

E1.3Q2 What forms of innovative disclosure could be used to better inform consumers about their insurance decision?

Legal Aid NSW supports the use of innovative disclosure to ensure that all consumers, especially vulnerable consumers, understand the relevant information and to encourage consumer engagement with the decision-making process. Any disclosure communication should be developed in consultation with consumer advocates.

We suggest that plain language principles and infographics could be employed to better inform consumers about their insurance decision. As a good example of this in practice, we note the Consumer Financial Protection Bureau's recent redraft of a credit card agreement. The agreement is a simple, easy to read document which provides relevant information about the product's terms and conditions.⁷

Legal Aid NSW would also support the use of an online 'app', as suggested in paragraph 219 of the Consultation Paper, to engage consumers with the information gathering and decision-making process. If consumers are required to engage with disclosure material, they are more likely to understand the information and make informed decisions about whether the product is appropriate for them.

The platform could require the consumer to confirm their understanding of a product before signing up.⁸ This could be a test, which poses a series of questions about the product, including what it is, how it operates and its cost.

The platform could have a function to read the information to consumers and show a video displaying the information pictorially. This would be of particular benefit to consumers with low literacy or consumers who are visually impaired. Ideally, the platform would also have the ability to provide information in multiple languages to assist consumers who have limited English skills.

The platform could present information about add-on products in a standardised way so that consumers may easily compare products. This could be in a table format, which clearly sets out information about coverage, costs and the likelihood of events occurring in separate categories.

We note that some consumers will not be able to engage with a technological disclosure model and so paper-based disclosure should still be available.

The disclosure process could also prompt a consumer to use a Moneysmart calculator to calculate the cost and value of the add-on insurance product. This may be a useful and engaging way to prompt consumers to consider the utility and affordability of the product prior to purchasing.

⁷ Consumer Financial Protection Bureau, *Know Before You Owe: Credit Cards*
<https://www.consumerfinance.gov/data-research/credit-card-data/know-you-owe-credit-cards/>

⁸ See ASIC Consultation Paper 294 at [222]

E1.3Q3 What information should the consumer communication include?
E1.3Q4 Should providers be required to inform consumers about the availability of other products that provide similar cover, but may be cheaper?
E1.3Q5 If so, what information should the consumer communication include?

Employing the disclosure techniques discussed at E1.3Q2, the consumer communication should include:

- notice to the consumer that they are not required to take out add-on insurance products in order to purchase or lease the vehicle
- information about the key terms and conditions of the product, including what events the product covers
- information about the recent claims ratio for the product
- information about the commissions that the intermediary receives from the insurer
- the total cost of the product, including a worked example of what the consumer would pay with and without the add-on insurance
- links to Moneysmart calculators so consumers can calculate the costs of products
- information about referrals to financial counselors and legal advice, including Legal Aid NSW and community legal centres
- a comparison with other add-on products in terms of the cost, coverage and claims ratio, and
- if the product is essentially a warranty against defects, a clear statement about the trader's obligations and the consumer's rights under the Australia Consumer Law and any relevant state based motor dealer legislation.

Mechanical breakdown insurance and warranties

E1.4Q1 Should a separate deferred sales model be introduced for these products? If not, how could the particular risks associated with these products be addressed?

No. We do not consider that a separate deferred sales model should operate in respect of mechanical breakdown insurance and warranties.

Legal Aid NSW is concerned about the particular risks to consumers purchasing these products. In particular, because cover under these products often commences only after the manufacturer's warranty ends, they typically represent little, if any, value to

consumers, as the case study below shows. Our submissions to the Australian Consumer Law Review also provide further detail about our concerns with mechanical breakdown insurance and warranties.⁹

Case study: Daniel

Daniel purchased a second hand vehicle from a car dealership. 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 did not 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 at a significant cost.

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

In circumstances where products represent very little or nil value to consumers, or do not provide a sufficiently tangible benefit to consumers, we do not think that these products should be offered to consumers at all.

However, if these kinds of products are to be sold to consumers, Legal Aid NSW considers that the same deferred sales model should apply to these products as to other add-on insurance products.

Applying the same deferred sales model will allow for a uniform and consistent approach, ensuring that consumers and providers are not required to navigate varying sales processes when buying and selling these products.

Consumer communication for mechanical breakdown insurance should ensure that consumers understand:

- the date at which cover under a policy will commence
- the specific events the insurance will cover
- the risks associated with buying the product
- that the vehicle is subject to consumer guarantees under the Australian Consumer Law
- any other guarantees or warranties that apply to the vehicle that may affect the value of any mechanical breakdown insurance being offered, and

⁹ Legal Aid NSW submission to Consumer Affairs Australia and New Zealand (December 2016), 'Australian Consumer Law Review – Interim Report'; Legal Aid NSW submission to Consumer Affairs Australia and New Zealand (May 2016), 'Australian Consumer Law Review'

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- any terms of cover that restrict the capacity of consumers to assess the future value of the product.

Supervision obligations for product providers

E2Q1 Given the limitations in monitoring conduct at the point of sale, what changes would be necessary to ensure providers are effectively supervising their representatives?

E2Q2 What risk indicators could be introduced to improve the capacity of providers to monitor their representatives?

The current level of supervision and monitoring by providers of their authorised representatives is inadequate and ought to be improved alongside the introduction of a deferred sales model.

Legal Aid NSW frequently advises vulnerable consumers who have been subject to unfair sales tactics when purchasing a car. Current arrangements do not adequately protect consumers at the point of sale, especially where sales are substantially driven by the receipt of commissions.

We strongly recommend that product based commissions should be removed altogether. Paying representatives based on sales encourages salespeople to act in their own interests, rather in the consumer's interests. As was clear in ASIC's Reports 470, 471 and 492, this has led to very poor consumer outcomes. We refer to our comments in our submission to the Australian Bankers' Association's *Independent Review of Product Sales Commissions and Product Based Payments* for further detail.¹⁰

However, if product based commissions are not prohibited, Legal Aid NSW considers that clear minimum requirements on supervision for insurers and product providers should be established. Providers should be required to effectively supervise sales representatives and quickly identify and compensate consumers who have been subject to unfair conduct. Legal Aid NSW expects providers to not only design and implement policies and procedures, but to actively ensure compliance by their representatives.

To achieve this, Legal Aid NSW supports the development and use of sophisticated risk indicators to ensure effective supervision of representatives. We broadly agree with the risk indicators identified at paragraph 257 of the Consultation Paper. In particular, we consider that where a sales representative falls within the categories below, they should be subject to more robust supervision and monitoring by providers:

- where commissions received are solely sales based

¹⁰ Legal Aid NSW submission to the Australian Bankers' Association *Independent Review of Product Sales Commissions and Product Based Payments* September 2016

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- where a representative earns a high amount of commissions
 - where a representative sells a high volume of add-on insurance
 - where a representative has a history of misconduct, and
 - where a representative is inexperienced in sales.

Legal Aid NSW further submits that representatives should be subject to increased supervision and monitoring based on consumer demographics. Where a particular caryard disproportionately sells add-on insurance products to disadvantaged groups, representatives should be subject to increased monitoring and supervision. This would require some data collection to be undertaken, or alternatively, a focus on caryards located in areas of significant socioeconomic disadvantage.

Industry should agree on a standardised supervision protocol to ensure consistent behaviour across providers of insurance products. This should include an element of oversight by and reporting to a third party, such as ASIC. It should also include a requirement for providers to undertake accreditation checks before appointing representatives, and on a continuing basis. We would also support a requirement for insurers to conduct post-sale interviews with a statistically robust sample of consumers, as suggested in the Consultation Paper at paragraph 258.

E2Q3 What sanctions would be most effective in deterring representatives from engaging in unfair practices at the point of sale?

Legal Aid NSW supports the implementation of sanctions to deter misconduct. It is important that these sanctions are widely understood by representatives, and used regularly if appropriate. An independent third party, such as ASIC, may have a role in monitoring misconduct and imposing sanctions. If ASIC takes on this role, it should be adequately funded to do so.

Sanctions could include:

- pecuniary penalties for breaches of the Australian Consumer Law, such as where unfair practices amount to unconscionable conduct or false or misleading conduct
- the removal or suspension of authorisations and licences to sell insurance products
- clawbacks of commissions paid where unfair practices at point of sale have occurred, and
- active identification and compensation of consumers who have been subject to unfair treatment by intermediaries at point of sale.

Information leading to the imposition of sanctions, and the number of sanctions per entity per year, should be published and made available to the public.