INSURANCE COUNCIL OF AUSTRALIA

2 October 2019

Mr Tim Wong
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Dear Mr Wong

REFORMS TO THE SALE OF ADD-ON INSURANCE PRODUCTS: TREASURY PROPOSAL PAPER

The Insurance Council of Australia[1] (Insurance Council) appreciates the opportunity to provide comments on Treasury's proposal paper of 9 September 2019 on "Reforms to the sale of add-on insurance products" (Proposal Paper). As we noted in our submission of 6 September 2019 on the Royal Commission Implementation Roadmap, the general insurance industry supports the implementation of the Royal Commission's Recommendation 4.3 of a deferred sales model (DSM) for add-on insurance products.[2] The Insurance Council is grateful for the additional time provided to complete its submission.

We appreciate that, as a general rule, the Government intends to consult on the implementation of all recommendations of the Royal Commission through exposure draft legislation. We understand the Proposal Paper was released as an exceptional case because:

- there are no jurisdictions comparable to Australia which have an industry-wide DSM for add-on insurance products. (We note that the UK's Financial Conduct Authority did not recommend this approach in its comprehensive report on add-on insurance released in March 2014.[3]);
- the add-on insurance market as defined in the Proposals Paper relates to a diverse and complex range of insurance products sold through a range of distribution channels; and
- the stakeholders likely to be affected extend well beyond the financial services sector, including front line intermediaries across other segments of the economy.

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent about 95 per cent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2019 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of $48.4 billion a year and has total assets of $128.4 billion. The industry employs about 60,000 people and on average pays out about $151.4 million in claims each working day.
Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance)

[2] Insurance Council (2019), "Royal Commission implementation roadmap", Submission of 6 September 2019.

[3] UK Financial Conduct Authority, "Market Study 14/1; General Insurance add-ons: Provisional findings of market study and proposed remedies", March 2014.

Given these complexities, the Insurance Council urges the Government to consider carefully the issues raised by stakeholders in order to avoid unintended consequences such as increased levels of non-insurance and consumer inconvenience. In line with the welcome additional step of consulting through the Proposal Paper, the Insurance Council suggests that it would also be appropriate for the Government to undertake a Regulatory Impact Statement to ensure the DSM strikes the intended regulatory balance.

The proposed three tier approach

Given the vulnerable situations in which consumers may find themselves when considering whether to buy insurance in addition to a primary product or service, the Insurance Council can appreciate the logic of the three tier DSM regime set out in the Proposal Paper:

- Tier One: to be prescribed by ASIC using its Product Intervention Powers (PIP) in order to address add-on insurance products with the most egregious consumer outcomes;

- Tier Two: a four day deferral period to be applied generally to add-on insurance products, with importantly the ability of the consumer to initiate conclusion of the sale on the day after the deferral period has commenced.

- Tier Three: for products exempted either by primary legislation or after being included by ASIC subject to any conditions it may specify. The primary legislation exemption will apply for products such as comprehensive car insurance that are accepted as being good value and have minimal likelihood of consumer detriment. The Insurance Council notes that a Tier Three exemption will need to apply also to mandatory insurance such as Compulsory Third Party (CTP) insurance.

As noted in the Paper, there is currently no statutory definition of “add-on insurance”. The term is primarily given meaning by considering both the linkage between the insurance product and a “primary” product, and also the sales context in which the “add-on” product is sold. As explained in the Paper, in terms of scope the DSM is intended to:

> *“…apply to those insurance products that are offered or sold at the same time as when a consumer purchases the primary product or acquires finance for which the insurance covers associated risks.”*

The primary product can be a consumer finance product, a contractual right that may be lost (covered by travel insurance), or a tangible thing such as a pet. Consequently, under the proposed approach a wide number and variety of insurance products will be included in Tier Two. The list of products classed as add-on by the General Insurance Code Governance Committee (CGC) (Attachment) illustrates this point. However, even this lengthy list is not conclusive. For example, it does not include the common practice of insurance available upon becoming a member of a sporting club or professional organisation.

In this situation, putting CCI and insurance sold through motor vehicle dealerships to one side, it is difficult without further quantitative study to conclude that it would be appropriate to apply a DSM under Tier Two to any of the remaining add-on insurances on the CGC list. The Insurance Council is unaware of concerns raised in relation to these products about high pressure selling leading to poor consumer outcomes. (It is a separate issue to be addressed by the recent Product Design and Distribution Obligations (PDDO) whether the product is suitable for a particular class of consumer.)

Examples are:

- travel insurance;
- accidental damage cover for mobile electronic devices;
- cargo insurance;
- home building and home contents insurance;
- jewellery insurance;
- third party fire and theft and third party property damage motor vehicle insurance;
- pet insurance;
- pleasure craft insurance;
- motor home/caravan insurance;
- motor bike insurance;
- rental bond insurance;
- ticket event/ticket cancellation insurance;
- transit insurance; and
- transport package insurance

A thorough analysis needs to be undertaken of individual products so that the Government is fully cognisant of the consumer detriment which may result from the requirement of even a shortened deferral of one day being imposed on products subject to Tier Two. In this regard, the Insurance Council notes that the UK Financial Conduct Authority's 2014 report on add-on insurance contains a good analysis of the factors which justify the application of a DSM.[4]

In relation to home building and home contents insurance (generically home insurance), our position is that these insurances distributed or issued by a financial institution when a mortgage is being issued at the same time should not be captured as "add on insurance". This is on the basis that insurance is a separate and unrelated purchase to the home loan, and while financial institutions will generally require buildings insurance to be purchased before a home loan is finalised, consumers are aware that home insurance can be purchased directly and from other insurers. We are not aware of any circumstance where home insurance sold by financial institutions have been characterised as an "add-on" insurance.

[4] UK Financial Conduct Authority, "Market Study 14/1; General Insurance add-ons: Provisional findings of market study and proposed remedies", March 2014.

In addition, complimentary insurance products and those provided on a temporary basis (e.g. interim cover, bridging insurance) offered to the consumer at no extra charge should not be treated as Tier Two. Requiring consumers to be subject to the DSM for these products could result in consumers missing out on cover in circumstances where pressure-selling issues are irrelevant.

Assessment of Tier Two status
Given the range of beneficial insurance products potentially caught by the Tier Two DSM model where a DSM is unlikely to improve consumer outcomes, it is crucial that there be a realistic and meaningful process for inclusion in Tier Three. Many of these products would be suitable for exclusion from the application of a DSM through primary legislation and the Insurance Council looks forward to working through with Treasury the factual evidence to justify exemption. The Insurance Council appreciates the statements in the Proposal Paper which show that the Government is aware of the need for transition period before commencement of the DSM regime which will allow for a well-considered exemption process.

The Proposal Paper proposes the following criteria for Tier Three add-on insurance products:

- historically good value for money;
- strong competition;
- high risk of underinsurance; and
- the product is well understood by consumers.

The Insurance Council would also suggest:

- the consequences for consumers of non-insurance. This can range from limited impact to catastrophic, with examples of the latter being driving with no third party property damage insurance or international travel with no medical expenses insurance.
- the extent to which the product is available on a stand-alone basis, as well known, widely available alternative sales channels reduce the likelihood of poor consumer choices;
- the existence of a regulated cap on commissions, as this removes much of the incentive for high pressure selling;
- the value in a digital age to the consumer of a quick, convenient purchase;
- whether the insurance comprehensively covers the entire primary product or service, rather than just having a mere ancillary relation to it (e.g. tyre and rim insurance);
- in order not to impede innovation, particular consideration be given to exempting new insurance products without a track record of having “historically good value for money” or good consumer familiarity, but likely to meet this criteria given time; and
- the regulatory situation in comparable foreign jurisdictions.

In order for applications for exempt status to be considered thoroughly, the Insurance Council submits that draft legislation for the DSM should be developed in close connection with that for related Royal Commission recommendations regarding the anti-hawking rules (Recommendation 4.1) and the cap on commissions for motor vehicle dealers (Recommendation 4.4). This will enable applications for exemptions to be assessed in full awareness of the regulatory environment. It would be useful for the explanatory materials for the DSM legislation to confirm the linkages between these regulatory initiatives.

We note that it will also be necessary when ASIC is issuing its Regulatory Guidance for consideration by given to the impact of requirements in the GI Code of Practice and other self-regulatory initiatives.

A possible alternative approach

In view of the numerous applications for Tier Three status which ASIC will need to decide, the Insurance Council is concerned that the proposed transitional arrangements necessary for an adequate assessment of exemptions would place a large regulatory burden on ASIC and the industry; raising serious questions about practical feasibility within an acceptable timeframe. Specifically:

- At least 12 months will be needed for ASIC to provide detailed regulatory guidance on how the DSM would operate in relation to the wide variety of add-on products, and the criteria for Tier 3 exemptions.[5]

- Another 12 months would be needed for ASIC to process the numerous applications for Tier 3 exemptions.

- ASIC is already burdened with a large workload to implement the recommendations of the Royal Commission, as well as engaging in other functions including litigation and remediation.

- Once the regulatory guidance and the applications have been finalised, the industry would need a period of time to make system and process changes.

From discussions with Treasury, the Insurance Council recognises that the proposed approach outlined in the Proposal Paper represents a hard policy decision by the Government and that it is not open for debate. However, in view of the high number of products involved and the strong likelihood that exempt status will be granted because of a lack of consumer detriment, the Insurance Council respectfully suggests that serious consideration be given to altering the approach to Tiers Two and Three. Tier Three could be the default treatment for all add-on insurance not deemed appropriate for Tier One treatment. ASIC could then use its PIP to require products of proven risks of serious consumer detriment to be sold with the DSM model under Tier Two.

The resulting approach would be in keeping with the key general principle of good Government policy that regulation is only used to the extent necessary to address a problem. Also, it is more in keeping with the Government commitment to encourage innovation across the Australian economy. The Proposal Paper approach will require all insurance products developed to complement new good or services to be sold with a Tier Two DSM in all add-on situations unless an exemption has been provided. This outcome appears unnecessarily rigid.

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[5] General Insurance Code Governance Committee (2018), "Who is selling insurance? 2014 General Insurance Code of Practice Own Motion Inquiry", Report of June 2018.

The Insurance Council's suggested alternative would also be consistent with the intent of Recommendation 4.3 which endorsed the Productivity Commission's recommended approach of establishing a Treasury led working group to develop an industry-wide deferred sales model, including to determine "which add-on insurance markets should in the first instance be subject to a deferred sales model".[6]

Scope of the DSM regime

We submit that a legislated DSM should only apply to add-on insurance products sold to 'retail clients' and not 'wholesale clients' (as defined in the *Corporations Act 2001* (Cth) (Act)). This would achieve the policy objectives of the DSM and be consistent with the approach generally taken under the Act that the focus of regulatory action is in relation to products where there are direct interactions with retail customers.

Given the close link between DSM and hawking, Treasury should also seriously consider whether DSM should be confined to telephone calls and face-to-face meetings, given that online sales do not typically involve pressure-selling. We note that Commissioner Hayne said "The purpose of this reform is said to be to reduce 'the risk that a consumer will feel pressured to purchase the CCI product, or purchases a CCI product that does not meet their needs'."[7]

As we understand the Government's intention is not to capture insurance products sold in bundles, we submit that an insurance product cannot be the primary product to avoid the DSM being applied to additional insurance products.

Personal advice

The Insurance Council suggests that add-on products sold as a result of personal advice should not be in scope, given that this business model minimises the possibility of high pressure sales.

If you have any questions or comments in relation to our submission please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on telephone: 02 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely

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Executive Director and CEO

[6] Productivity Commission (2018), "Competition in the Australian Financial System", Final Report of 2 August 2018, page 431.

[7] Financial Services Royal Commission, Final Report, Volume 1, page 290.

ATTACHMENT

Table 1 – Add-on insurance products listed in General Insurance Code Governance Committee (2018), "Who is selling insurance? 2015 General Insurance Code of Practice Own Motion Inquiry"

Accidental damage cover for mobile electronic devices	Covers accidental damage to mobile electronic devices such as mobile phones and tablets.
Cargo insurance	Covers cargo as it is transported from one location to another location.
Consumer credit insurance (CCI)	Sold with credit cards, personal loans, home loans and car loans, CCI insures the debtor's capacity to make repayments under the credit contract if they become sick, injured or disabled; lose their employment or die.
Home contents insurance	Covers cost of repairing or replacing household property such as jewellery, furniture and electrical appliances and devices.
Guaranteed asset protection insurance (GAP)	Sold with assets, GAP insurance covers the difference between what a consumer owes on a loan and any amount received under a separate insurance policy if the asset is a total loss.
Jewellery insurance	Covers cost of repairing or replacing jewellery.
Loan termination insurance	Sold with assets, loan termination insurance covers the difference between what a consumer owes on a loan and the value of the asset if they are unable to make a repayment and the asset is sold.
Mechanical breakdown insurance	Also known as an 'extended warranty', mechanical breakdown insurance covers the repair or replacement of specific parts where unexpected mechanical failure occurs. It typically applies after a manufacturer's or dealer's warranty has expired.
Motorcycle insurance	Three types of cover: damage to an insured's motorcycle (comprehensive) and other people's property; damage to other people's property (third party property); same as third party property with fire and theft cover for the insured's motorcycle.
Motor vehicle – cover for vehicles under a finance contract (CCI insurance)	Covers a borrower's shortfall under a finance contract when they and the financial institution agree to return the vehicle and terminate the finance contract (for instance due to illness or bankruptcy) or relieves the borrower of

	repayment obligations if certain defined events occur (for instance due to involuntary unemployment).
Motor vehicle – excess insurance	Covers an insured's excess payment on a claim under a separate motor vehicle insurance policy.
Motor vehicle – GAP insurance	When a vehicle is deemed a total loss, covers shortfall between the original purchase price of the vehicle and the total loss payment under a separate motor vehicle insurance policy.
Motor vehicle – hybrid GAP insurance	When a vehicle is a total loss, pays an insured the greater of: the original purchase price of the vehicle (if owned outright) less the total loss payment, or the replacement vehicle value less the total loss payment and/or the loan settlement amount due to the financial institution less the total loss payment.
Motor vehicle insurance	Three types of cover: damage to an insured's vehicle (comprehensive) and other people's property; damage to other people's property (third party property); same as third party property with fire and theft cover for the insured's vehicle.
Motor vehicle – loss of personal effects	Covers loss of personal effects that were in a vehicle deemed a total loss under a separate motor vehicle insurance policy due to accident, fire or theft.
Motor vehicle – scratch and dent insurance	Covers the cost of repairing minor accidental scratches and dents to an insured's motor vehicle.
Motor vehicle – novated motor vehicle lease insurance (CCI)	Covers an insured's novated lease repayments if unable to continue them due to involuntary unemployment.
Pet injury insurance	Covers injuries sustained by pets.
Pleasurecraft insurance	Covers vessels used for pleasure or recreation such as boats and personal watercraft.
Pleasurecraft – mechanical breakdown insurance	Covers repair or replacement of specific mechanical parts if an unexpected mechanical failure occurs.

Rental bond insurance	Covers a renter for accidental damage to the rented premises and extra cleaning costs due to an estate agent's final inspection.
Rental vehicle – accidental death, disablement & baggage insurance	Covers accidental death, disablement and damage/loss of baggage/personal effects during the hire period.
Rental vehicle insurance – excess	Covers excess that is payable when a rental vehicle is damaged while in the possession of the hirer.
Ticket event/ticket cancellation insurance	Ticket cover: covers an insured's ticket cost when they cannot attend the event due to for example illness or airline delays. Event cover: covers the insured's loss of costs or expenses or income due to for example cancellation or postponement of the event.
Transit insurance	Covers an insured's possessions when being transported by road, rail, sea, air or post.
Transport package	Package contains several covers including liability, carrier's cargo and business interruption cover.
Travel insurance	Covers an insured for financial losses caused by certain defined events that can affect travel – such as trip cancellation, medical expenses or theft of luggage.
Tyre and rim insurance	This insurance covers the cost of repairing and replacing damaged tyres and rims.