



**ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY - Policy Questions Arising from Module 6**

Eric Insurance welcomes the opportunity to make a submission on the policy questions arising from Module 6 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission).

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

Eric Insurance has closely followed the Royal Commission as well as broader enquiries / review of the general insurance space, particularly add on insurance. This includes work undertaken by the Australian Securities and Investments Commission (ASIC) into the add on insurance sector.

Please note that this submission does not respond to every question raised in the Policy Questions from the Interim Report.



## POLICY QUESTIONS ARISING FROM MODULE 6

### 1. Is the current regulatory regime adequate to minimise consumer detriment? If the current regulatory regime is not adequate to achieve that purpose, what should be changed?

The current regulatory regime applicable to insurance providers comprises multiple legislative instruments including (but not limited to):

- *Corporations Act 2001 (Corporations Act)*
- *Insurance Contracts Act 1984 (Insurance Contracts Act)*
- *Australian Consumer Law 2010 (ACL)*
- *General Insurance Code of Practice 2014 (GICOP)*

We also note revised powers for ASIC under the *Design and Distribution Obligations and Product Intervention Powers Bill 2018*, which has yet to be adopted but will ultimately form part of this regime.

Combined, these instruments provide a comprehensive overlay of compliance obligations for financial service providers. These provide protections for consumers wishing to purchase insurance.

Eric Insurance understands that these obligations are designed to minimise consumer detriment. This is in recognition of the fact that the purchase of financial products, for many consumers, represents a significant decision. Such a decision requires clear and concise information, provided in a transparent and honest fashion.

It is clear from the findings of the Interim Report that notwithstanding these protections, poor consumer outcomes have occurred in the insurance sector. This appears to be largely a result of the conduct of financial services providers whose actions may be consistent with the law as strictly interpreted, but inconsistent with community expectations about the insurance market.

To that end, Eric Insurance does not necessarily believe that the current regulatory regime is inadequate. We do, however, consider that it is incumbent on financial services providers to ensure that they are meeting both community expectations. We also consider it imperative that consumers are informed and aware of their rights in the market. To that end, we support increased education and engagement amongst consumers with respect to financial services products. These factors, when both working properly, should create a functional and fair market. Such a market needs to be supported by effective internal and external controls for financial services providers. Good governance, risk and compliance regimes can bolster the effectiveness of regulatory regimes.

We also note current specific consumer protections which exist within the current regulatory regime, which are designed to empower consumer decision making and experience. These include:

- the obligation on financial services providers to provide documentation including Product Disclosure Statements (PDSs) to assist them in understanding their product,
- the obligation to provide consumers with a cooling off period for financial services products,
- the ability for consumers to cancel their insurance policy and receive a rebate,
- the ability for consumers to refer their grievances to an Internal Dispute Resolution (IDR) committee or forum, and



- recourse to the Financial Ombudsman Service (FOS) where the customer is dissatisfied with their financial services provider (this will become the Australian Financial Complaints Authority (AFCA) from 1 November 2018).

This raises the question of whether additional regulation would necessarily improve consumer outcomes. Eric Insurance considers that without significant investment in lifting financial literacy within Australia, any additional regulation will only add cost and complexity to the financial services sector.

In summary, it appears that the regime is appropriately designed to prevent consumer detriment but has not been applied in good faith, consistently and transparently, across the industry. Eric Insurance therefore supports arrangements to create simpler, clearer guidance on compliance for general insurance providers and targeted consequences for those who do not comply. This should also be coupled with capacity for the industry to develop and implement industry standards which can be updated to reflect community expectations as needed.

## PRODUCT DESIGN

### 2. Are there particular products – like accidental death and accidental injury products – which should not be sold?

There is clear evidence that some financial services products have not delivered customer benefit and/or have been potentially mis-sold. Notwithstanding this, Eric Insurance does not support regulatory or government intervention to ban or prohibit the sale of certain financial products where there is clear customer appetite for those products. Eric Insurance submits that if products are properly designed and explained, and consumers are fully educated and informed of their rights, then a product ban is not necessary. This also contingent on avoiding market distortions such as inappropriate incentives.

We submit that consumer detriment in financial services is not caused by product construct or design alone. Neither do we consider that certain products should simply be banned where there has been historic consumer detriment in a market. It is our observation that the term 'poor product' has been conflated with other factors including:

- The existence of conflicted incentives and remuneration which may cause financial services providers to sell products and / or meet sales targets, rather than matching products to a genuine consumer need (we note that this has been somewhat mitigated by the voluntary introduction of capped transactional commission of 20% for general insurers).
- The apparent unsolicited nature of sales of financial services products which does not allow the consumer sufficient time or information to consider whether the product is right for them.
- The historical use of unconscionable or high-pressure sales tactics, to entice consumers to purchase products with little or no regard to their circumstances.

However, we believe that significant improvements can be (or already have been) made to selling practices and product construction. This ought to alleviate some market failures that have occurred. Therefore, we consider that the correct course of regulatory action is not to ban those products (for which there is a genuine consumer appetite). Instead, a multi-pronged approach (both industry and regulatory) is needed to improve the status quo of the market. This includes:

- Further consideration of the appropriate selling model for these general insurance products, including training and monitoring of authorised representatives (ARs), under which



minimum standards are consistently applied across the industry. These will ensure that product suitability, disclosures, pricing and payment options, are all discussed with consumers at the point of purchase. This might may be supported by a deferred sales model (DSM), as discussed below.

- Further consideration of how financial services products are sold to consumers who may be vulnerable, or otherwise unable to make an informed decision about whether the product is right for them.
- Further oversight and associated regulatory responses for behaviours which fall afoul of the ACL, such as misleading and deceptive or unconscionable conduct.
- Further work by industry to ensure that products appropriately designed, targeted and priced, with ultimate powers reserved for ASIC under the new *Design and Distribution Obligations and Product Intervention Powers Bill 2018*.

There has been scrutiny of the add on insurance market in recent years. This has seen:

- participants exiting the market for add on insurance, and
- remediation programs being undertaken for consumers who have been mis-sold policies.

One of the criticisms of the add on insurance market is that consumers have purchased "low" or "no value" policies. In response, Eric Insurance has undertaken an assessment (and where necessary, a remediation) of polices that may be classified low and no value policies.

This review has shown that of all insurance policies sold, around 0.5% of policies for Guaranteed Asset Protection (GAP) and Loan Termination Insurance (LTI) were revealed to have no or low value. This suggests that for a vast majority of Eric policies, there is consumer value in the insurance purchased, and that examples of low or no value policies are relatively few in Eric Insurance's portfolio. This would again support an argument against banning certain insurance products, but rather, ensuring that products are:

- designed to provide value and assurance for the consumer
- supported by risk rated pricing which is specific to the consumer and their risk profile.

Notwithstanding this, Eric Insurance is concerned at the prevalence of products that appear to be insurance products but are not underwritten by a licensed insurer and hence are not captured within the current regulatory regime. Such products are often sold through intermediaries at inflated prices with higher levels of incentives/returns to the sales agent. An example of this is service contracts that have the appearance of Mechanical Breakdown Insurance (Extended Warranty).

The existence of these products suggests a form of regulatory arbitrage. This has a detrimental consumer outcome and reduces customer confidence in the general insurance industry by close association. We consider that these products either ought to be banned or brought within the remit of financial services regulation as a minimum.

## SALES

7. Should monetary and non-monetary benefits given in relation to general insurance products remain exempt from the ban on conflicted remuneration in Division 4 of Part 7.7A of the Corporations Act 2001 (Cth)? If so, why?



Conflicted incentives may exist in relation to the sale of financial products. This occurs where the remuneration payable may influence financial product advice given to retail clients. This is particularly the case where personal advice is being provided to the consumer about their financial position and/or where the sale of the financial product is unsolicited. Prohibitions on conflicted remuneration arguably prevent high pressure sales tactics, which may influence the nature of personal advice given to clients. Such a prohibition is particularly important for consumers who may not have considered the product prior to the financial services company initiating contact.

In the general insurance sector, product advice is general in nature, and does not necessarily consider the broader financial position of the consumer. General insurance financial products are typically purchased consumers who have themselves initiated the transaction. This includes, for example:

- purchasers of home and contents insurance), or
- those who have been offered insurance in conjunction with another related purpose (for example, travel insurance, ticket insurance or motor vehicle add on insurance).

Eric Insurance considers that remuneration arrangements between general insurers and their agents are problematic only where:

- they encroach on the potential for fair and reasonable customer outcomes to be achieved, and/or
- encourage financial services providers to sell a financial product even if it is not right for the consumer.

We see the potential for this to occur as relatively limited where advice given is general in nature only, and the customer is provided with options for insurance either through their own initiation or as a supplementary purchase to an already contemplated transaction. However, we propose the extension of existing commission cap of 20% for consumer credit insurance under the National Consumer Credit Protection Act (2009) to all general insurance products. This may achieve a more desirable outcome – that is, a level playing field for market participants, and more equitable outcomes for consumers.

**9. Is banning conflicted remuneration sufficient to ensure that sales representatives do not use inappropriate sales tactics when selling financial products? Are other changes, such as further restrictions on remuneration or incentive structures, necessary?**

Although banning conflicted remuneration may provide some mitigation to poor sales practices for the sale of financial products, Eric Insurance does not believe that it is sufficient to entirely mitigate against inappropriate sales tactics. The removal of inappropriate sales tactics within the industry requires a multi-pronged approach. Such an approach should include:

- Ensuring that sales agents are appropriately vetted, trained and monitored throughout the sales life cycle for general insurance. This involves general insurers taking a more proactive approach to compliance by their ARs and distributors.
- Creating, where possible, further system controls throughout the sales processes to ensure that products are not mis-sold to consumers (for example, consumers access risk rated products for which they are clearly eligible at the time of purchase).
- Improvements to internal compliance and risk management so that a risk-based approach is used to monitor and assess the conduct of ARs, and to ensure that any



concerning conduct is identified and managed proactively (including through deregistration of ARs or notification of ASIC for material breaches, where appropriate).

#### D. ADD-ON INSURANCE

##### 13. Should the sale of add-on insurance by motor dealers be prohibited?

Eric Insurance does not support the prohibition of add-on insurance by motor dealers. We believe that where there is a genuine consumer need or desire for a product, the regulatory regime should be designed to ensure that:

- products are appropriately constructed and priced,
- purchased by consumers who are fully informed of the products, including its features and benefits, and any inclusions or exclusions, and
- entered with the informed consent of the consumer.

Criticism of historical sales practices through motor dealers of add on insurance have not been unwarranted. These issues have been highlighted in previous forums, particularly through:

- ASIC Report 492: *A market that is failing consumers: The sale of add-on insurance through car dealers.*
- ASIC Report 470: *Buying add-on insurance in car yards: Why it can be hard to say no.*

Eric Insurance has been aware of the concerns with these practices since the publication of those reports. Eric Insurance has been taking a proactive approach improving the consumer experience in the market for add-on insurance. Several specific examples of these initiatives are outlined below, all of which we submit will contribute to improved consumer outcomes for add-on insurance purchased through motor vehicle dealers:

- Introducing risk rated products where feasible, in which the price of the insurance policy takes account of a consumer's specific circumstances and history to ensure that the cost to the consumer is reflective of the risk carried by Eric Insurance as an insurer.
- Incorporating restrictions on sales of extended warranty so that the intended period of vehicle ownership recognises the manufacturer term and insurer's term.
- Reviewing and amending products (where necessary) available for sale through motor vehicle dealers and distributors to create simpler product offerings for consumers to reduce the 'decision fatigue'.
- Removal of marketing support payments (MSPs) to dealers and the reduction of transactional commissions to 20% for motor vehicle dealers to limit conflicted incentives and improve pricing outcomes for consumers.
- Significant investment in sales systems to ensure that consumers are made aware of available policy options. This also ensures that prices are fully disclosed to the customer as a standalone line item and that full disclosures are made to the consumer on the available range of products, exclusions and limitations with any insurance policy.

##### 14. Alternatively, should add-on insurance only be sold via a deferred sales model? If so, what should be the features of that model?

Eric Insurance does not believe a deferred sales model (DSM) on its own will resolve the challenges associated with mis-selling of insurance products. A DSM may improve consumer



outcomes. However, the foundational issues of training, supervision, product construct and appropriate pricing, and improved sales practices are imperative to creating a functional market which produces consistent consumer outcomes. A DSM would only provide an additional complementary checkpoint to these initiatives.

The purchase of add on insurance products is something that many consumers will necessarily consider at the time they purchase a vehicle. A feature of a DSM could include the concept, as adopted in the United Kingdom, of the 'confident consumer'. The confident consumer is one who is financially literate and able to properly assess their need for insurance products as part of the car sales process, or before they decide to purchase a vehicle.

As noted in our previous submission to ASIC's Consultation Paper 294, we believe that an appropriate DSM could exhibit the broad features attached to the DSM utilised for the distribution of GAP Insurance in the United Kingdom. This model aims to ensure the consumer is fully informed of the features, benefits and financial impacts of a decision to purchase financial products. Similar features could be adopted in Australia, including:

- creation of customer portals at the dealership level upon a vehicle purchase which automatically loads product details for later consideration by the consumer;
- a prohibition on contact by the sales agent for a deferral period of 4 days from the date that consumers first contact the sales agent, and
- finalisation of the transaction(s) through the customer portal where information can be accurately recorded (for example, any relevant documentation and /or disclosures).

Eric Insurance is also considering further work in the digital marketing space to allow consumers to purchase insurance directly without an intermediary. Again, if there was customer appetite to complete this transaction outside of the timeframes imposed by a DSM, we believe that the customer should be allowed to do so. Such a model would allow customer to easily compare products and pricing and enable them to undertake their own research on what products they wish to purchase.

On this basis, Eric Insurance considers that a DSM should not be so strictly applied so that it can be the only method by which consumers can purchase add-on insurance. We believe there should be scope for the consumer to purchase insurance products at the point of vehicle purchase where such a purchase is driven by the consumer. Such a purchase should be supported by sales practices which are clearer, more concise, and shorter, considering issues raised in ASIC's reports 294 and 492 regarding decision fatigue, high pressure sales tactics and appropriate disclosures.