

TOMAS ROCHE

**STEERING CLEAR: ANALYSIS OF NEW ZEALAND'S
MOTOR VEHICLE ADD-ON INSURANCE INDUSTRY**

Submitted for the LLB (Honours) Degree

Faculty of Law

Victoria University of Wellington

2022

Abstract

This paper considers the current state of the motor vehicle add-on insurance industry in New Zealand, in light of the Commerce Commission's 2021 Market Study on motor vehicle financing and add-ons. It suggests the current way the industry functions does not promote competition and facilitates several issues detrimental to consumers. The issues are inadequacy of consumer awareness and understanding of add-on products, brought about by insufficiency of information, a point of sales advantage enjoyed by providers of primary products, and an unsuitable dealer incentive system. These issues are producing negative consumer outcomes, as demonstrated by quantitative and qualitative industry evidence. The paper considers how comparable jurisdictions, namely Australia and the United Kingdom, have corrected similar issues to increase consumer protection within the industry. It advocates that similar industry reform is necessary for New Zealand, which acts in a preventative way to best protect consumers. The primary reform that is recommended is the adoption of an industry wide deferred sales model for add-on products.

Keywords: “motor vehicle add-on insurance”, “competition”, “consumer protection”, “industry reform”, “negative consumer outcomes” “deferred sales model”.

Table of Contents

Abstract.....	2
I Introduction.....	4
II Background.....	4
A What is add-on insurance?	4
B The operation of the motor vehicle add-on insurance industry.....	6
III The issues and outcomes currently present in the motor vehicle add-on insurance industry	6
A Issues	6
B Outcomes.....	8
IV How New Zealand is currently addressing the issue	10
V How the United Kingdom has addressed the issue.....	11
A March 2014 FCA Market Study and associated reforms	11
B Refund scheme	14
VI How Australia has addressed the issue	16
A September 2016 ASIC Report and associated reforms	16
B Refund scheme and consumer action	19
VII Legal solutions currently available to consumers in New Zealand	19
A Common law	19
B Legislation.....	21
VIII Recommendations.....	23
A Deferred sales model.....	23
B Statutory cap on dealer commissions.....	26
C Refund scheme	27
IX Conclusion	28
Word count.....	29
Bibliography	29

I Introduction

Motor vehicles are a major asset for millions of New Zealanders. The New Zealand Commerce Commission (the Commerce Commission) has recognised that “After a house, a vehicle is often the biggest purchase a consumer will make.”¹ Additionally, because vehicles are often a necessity, a consumer may feel obligated to finance the purchase of a motor vehicle if they cannot pay the full price outright.² For these reasons it is natural for consumers to want to ensure their asset is afforded the best protection possible. Consequently, it has become common practice for motor vehicle dealerships to supplement a consumer’s comprehensive vehicle insurance (CVI), with the offer of additional add-on insurance products that accompany the sale of the motor vehicle and the provision of finance.

This paper aims to highlight some of the issues around the sale of add-on insurance products in the context of motor vehicle purchases, consider what New Zealand and other jurisdictions have done to address the issues, analyse the existing legal solutions available to consumers in New Zealand and to finally make some recommendations as to how consumers may be afforded better protection. The recommendations are set out in section VIII below.

II Background

A What is add-on insurance?

Add-on insurance is an insurance product that is “added on” at the time of the sale of a primary product. Consumers are not generally seeking to purchase add-on insurance products, the add-on is ‘sold to’ the consumer rather than ‘bought by’ the consumer.³ In the context of this paper, the primary product being purchased by consumers is a motor vehicle, add-on insurance is then commonly sold by the motor vehicle dealer (the dealer) with the purchase. Four types of add-on insurance have been identified as common within the New Zealand motor vehicle industry:⁴

- (1) *Mechanical Breakdown Insurance* (MBI): MBI provides cover for unforeseen mechanical or electrical faults the vehicle may incur throughout the cover period of the insurance after the expiration of a manufacturer’s warranty.⁵ A successful claim entitles

¹ Commerce Commission New Zealand *Motor vehicle financing and add-ons review* (November 2021) at 1.

² At 1.

³ Australian Securities & Investment Commission *A market that is failing consumers: The sale of add-on insurance through car dealers* (September 2016) at 4.

⁴ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 17.

⁵ At 17.

the consumer to receive the cost of repairing the vehicle less policy excess to any extent applicable.⁶ MBI is the only add-on that relates to the vehicle's actual condition.⁷ MBI is offered by insurers and commonly sold through vehicle dealers, it is unrelated to any finance arrangement the consumer may have entered into.

- (2) *Credit Contract Indemnity Insurance (CCI) and Payment Protection Insurance (PPI)*: CCI and PPI are identical products that insure a borrower of finance in the event they are unable to make repayment on their loan due to the occurrence of a variety of specifically covered events.⁸ Events that are commonly covered include sickness, hospitalisation, accident, redundancy, bankruptcy and death.⁹ If a claim is successful, the insurer will cover the payment proportionate to the number of days the consumer is out of work, as a result of a covered event eventuating.¹⁰ A consumer's pre-existing conditions, which they ought reasonably to have known about, are generally excluded from coverage.¹¹ CCI/PPI is offered by insurers and commonly sold through vehicle dealers at the time the finance is arranged.
- (3) *Guaranteed Asset Protection Insurance (GAP)*: GAP insures a consumer for any 'shortfall' between the consumer's CVI coverage and the amount outstanding on the motor vehicle's finance.¹² GAP will apply where the consumer has incurred a total loss on the vehicle. The effectiveness of GAP is critically reliant on the consumer retaining a CVI policy, if this is not done a GAP claim is likely to be declined.¹³ GAP is offered by insurers and commonly sold through vehicle dealers at the time finance is arranged.
- (4) *Repayment Waivers*: Repayment waivers offer cover for a consumer who is unable to meet repayment obligations because of a covered event eventuating.¹⁴ Repayment waivers are offered by lenders rather than insurers; this means a proportion of the claim will be 'waived' rather than 'insured' based on how long the consumer is unable to work. Similar to CCI/PPI, exclusions are generally in place for pre-existing conditions.

As well as providing the financial benefits identified above, add-ons can also be said to offer some other more intangible benefits to consumers. This includes consumers having added

⁶ At 17.

⁷ At 17.

⁸ At 21; CCI and PPI are two names for the same product.

⁹ At 21.

¹⁰ At 21.

¹¹ At 21.

¹² At 18.

¹³ At 19.

¹⁴ At 22.

peace of mind over the security of their primary product for unforeseen events that may eventuate throughout the life of the policy.

B The operation of the motor vehicle add-on insurance industry

The motor vehicle add-on industry market commonly operates with dealers acting as intermediaries between the consumer and the ultimate provider of the add-on, whether that be an insurer or lender. Consumers will not usually have direct contact with the party they are ultimately contracting with, instead, the dealer is relied on by that party to contract on behalf of them and fulfil any statutory obligations. Dealers are incentivised to sell add-ons with the motor vehicle (the primary product) as they receive fees and commission.¹⁵ A dealer may receive payment in the form of an introducer fee, for initiating the arrangement.¹⁶ The dealer may also receive interest commission where the dealer adds a percentage to the base interest rate set by the lender, in the case of add-ons offered by a lender, or add-on commission where the dealer directly increases the base cost of the add-on for their commission, in the case of add-ons offered by an insurer.¹⁷

III The issues and outcomes currently present in the motor vehicle add-on insurance industry

A Issues

The concept of an add-on insurance product is not in itself explicitly an issue, it can be beneficial for consumers to mitigate the risks of taking on a large debt when financing the purchase of a motor vehicle.

However, the current way in which the industry operates, and the design of products, has led to the industry being described as New Zealand's "least competitive market."¹⁸ This is of serious concern for consumers, particularly vulnerable consumers. Financial mentors have recognised that "these products are not providing value for money and are not useful and affordable insurance options for vulnerable consumers or poorer New Zealanders."¹⁹ A 2021 Market Study conducted by the Commerce Commission (the 2021 Market Study) appears to

¹⁵ At 14.

¹⁶ At 14.

¹⁷ At 14-15.

¹⁸ Rob Stock "Scandal of the least competitive insurance and loan market" *Stuff* (New Zealand, 21 January 2022).

¹⁹ Ronji Tanielu "Not Adding Up: Spotlighting Add-on Insurance in Aotearoa" (14 June 2022) The Salvation Army < <https://www.salvationarmy.org.nz/> > at 5.

have identified some alarming issues within the motor vehicle add-on industry. This paper will focus on three core issues with the way the motor vehicle add-on insurance industry operates, the first two directly relate to the level of competition present within the industry and the third relates to industry practice.

From a microeconomic perspective, five factors can influence a market's competitiveness.²⁰ Two of the factors are present in a way that indicates the motor vehicle add-on insurance industry is not competitive, their presence contributes to the creation of the first two core issues.

The first microeconomic factor is the availability of information. Information availability relates to a consumer's ability to inquire about prices and products other competitors offer. The Commerce Commission has identified in competitive markets, consumers will have ready access to information needed to make well-informed decisions.²¹ Currently, in the motor vehicle add-on insurance industry consumers have a low level of understanding of add-on products and their suitability.²² Additionally, consumers are unable to easily compare prices of add-ons as these are not readily advertised.²³ Information about the coverage and value of add-ons is also not widely available or provided to consumers. A likely consequence of the lack of information regarding the coverage of add-ons is the high number of declined claims due to pre-existing health conditions. The Commerce Commission revealed in the 2021 Market Study, that 57 per cent of declined CCI/PPI claims was due to pre-existing conditions.²⁴ This suggests consumers are unaware of the coverage afforded to them by specific add-ons, and more generally have very little knowledge about the product they are purchasing. A lack of information about add-on products for consumers is the first core issue within the motor vehicle add-on insurance industry.

The second microeconomic factor is sales location. This concerns the ease of access some sellers have over other sellers, to consumers. In the motor vehicle add-on insurance industry, the provider of the primary product is conferred the prime sale location for the add-on sale. The Commerce Commission has identified in competitive markets, consumers will have the ability to easily switch between rival suppliers.²⁵ However, in the motor vehicle add-on insurance

²⁰ Staff Author "What factors influence competition in microeconomics?" (9 April 2020) Investopedia <<https://www.investopedia.com/>>; and Rapahel Cedar "Factors that Influence Competition in Economics" (29 June 2020) Quickonomics <<https://quickonomics.com/>>.

²¹ Commerce Commission New Zealand *Market Studies Guidelines* (19 November 2020) at 5.

²² Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 6.

²³ At 16.

²⁴ At 21.

²⁵ Commerce Commission New Zealand *Market Studies Guidelines*, above n 21, at 5.

industry this appears to be difficult, the provider of the primary product has a considerable competitive advantage to supply the add-on over any standalone provider. The provider of the primary product has direct and sole access to approach the consumer first regarding the sale of the add-on when making the sale of the primary product. They also do not have to devote additional resources, such as marketing costs, that are expended by standalone providers to make a sale. This allows them to effectively fence in consumers, creating the second core issue, a primary product provider point of sales advantage.

The third significant issue in the industry is how dealers are incentivised and permitted to sell add-on products. The operation of the dealer commission system has the potential to encourage dealers to promote the sale of add-ons to consumers regardless of suitability.²⁶ Additionally, the level of commission dealers receive can be incredibly high, the Commerce Commission identified in the 2021 Market Study that in the case of several add-ons, the value of the commission charged by dealers was greater than the actual wholesale value of the product charged by insurers and lenders.²⁷ This means consumers are having, in some instances, to pay double the wholesale value of the add-on, solely because of the dealer's role as a salesperson for the insurer or lender. The third core issue is the composition of the dealer incentive system which is leading to consumers being sold less suitable products and paying significantly higher prices.

B Outcomes

As a consequence of the aforementioned issues, vulnerable consumers are being taken advantage of in the motor vehicle add-on insurance industry, resulting in poor outcomes.

Quantitative evidence from the industry is a key indicator of the poor outcomes consumers within the industry are subject to. The claims ratio of add-on products suggests that the pricing and suitability of add-ons heavily favour the provider at the expense of consumers. A claims ratio represents the value of claims payments received by consumers against the value of premiums paid by consumers.²⁸ The Australian Securities and Investments Commission (ASIC) has noted "The claims ratio is an important indicator of the value consumers derive from an insurance product."²⁹ In the 2021 Market Study, of the four add-ons looked at across

²⁶ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 6.

²⁷ At 16.

²⁸ A claims ratio does not account for the value of intangible worth a consumer may derive from an add-on product, such as added peace of mind from knowing their primary product is better protected.

²⁹ Australian Securities & Investments Commission *A market that is failing consumers: The sale of add-on insurance through car dealers*, above n 3, at 14.

the three-year study, MBI had the most consumer favourable claims ratio at 37 per cent and CCI/PPI had the least consumer favourable at 7 per cent:³⁰

Product	Value of premiums	Value of claims	Claims ratio
MBI	\$312m	\$116m	37%
Repayment Waivers	\$106m	\$11m	10%
CCI/PPI	\$91m	\$7m	7%
GAP Insurance	\$39m	\$5m	12%
Total	\$548m	\$139m	25%

The claims ratios of add-on products can be compared to the loss ratios of other insurance products in New Zealand.³¹ The five-year average to September 2021 for domestic buildings and contents insurance policies was 58.6 per cent, for motor vehicle commercial and private it was 70.6 per cent, and for personal accident, travel, livestock and other it was 52.8 per cent.³² These are all significantly higher than the claims ratios for add-ons, indicating consumers receive significantly more value from general insurance products. The low value nature of these products is a concerning outcome for consumers.

Qualitative evidence from industry participants also raises significant concerns about outcomes for consumers within the industry. A financial mentor working in Auckland has detailed that they routinely work with clients with low financial literacy levels who have incurred significant debts by way of motor vehicle loans.³³ Their client's motor vehicle loans are often large, subject to high rates of interest, and burdened with add-on insurance policies they were unaware of. The mentor expressed concern with the value vulnerable consumers derive from add-on insurance products, in particular, because, based on the 2021 Market Study, the probability of claiming and then having that claim approved is below 2 per cent for three of the

³⁰ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 18 and 23; The data was collected from fifteen lenders and five insurers between financial years 2018 and 2020, it provides a sample of the industry.

³¹ Loss ratios and claims ratios are very similar, however losses in loss ratios include paid insurance claims as well as adjustment expenses. The formula for their calculation is the value of any insurance claims paid plus any adjustment expenses divided by total premiums earned.

³² Insurance Council of New Zealand "Market Data" (September 2021) < <https://www.icnz.org.nz/> >.

³³ Interview with Andrew Mitchell, Financial Mentor Salvation Army Royal Oak Community Ministries (the author, 3 August 2022).

four add-on products examined.³⁴ Furthermore, even if a client does make a successful claim, it is often the case that the claim pay-out is only marginally higher than the premium paid. This financial mentor gave details to the author of a recent specific case of a poor consumer outcome within the industry. In this case, the client financed the purchase of a motor vehicle for \$8,000. CVI insurance was also taken out. The client also purchased GAP, MBI and PPI policies at an additional cost of \$2,701. Not long after the purchase, the client was unable to afford the cost of their CVI policy and cancelled it. The client was unaware of the add-on policies that had been purchased and continued to pay for them even though MBI ceases to be effective without CVI. The client's vehicle was involved in an accident, \$500 was recovered for the wreck and paid against the outstanding loan. The GAP policy was ineffective as the client had not maintained CVI. The client continues to be charged interest on the loan that remains outstanding.

As a result of these sorts of issues and resulting poor outcomes for consumers, the motor vehicle add-on insurance market has been the subject of regulatory scrutiny and observation in the United Kingdom, Australia and more recently, New Zealand.

IV How New Zealand is currently addressing the issue

The Commerce Commission is responsible for administering and enforcing the Commerce Act 1986 (the Act). The purpose of the Act is to promote competition in markets for the long-term benefit of consumers in New Zealand.³⁵ The Commerce Amendment Act 2018 introduced the ability for the Commission to conduct 'market studies' into a particular industry.³⁶ A market study seeks to identify whether markets are working well in their current state for consumers and how they could work better, by investigating "competition features and patterns of consumer and supplier behaviour".³⁷ The Commerce Commission has identified several features that a workably competitive market should possess, (and that the Commission will investigate), including consumer access to information, availability and access to substitutes, cost structures and consumer and business behaviour.³⁸ If a particular market is lacking

³⁴ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 25.

³⁵ Commerce Act 1986, s 1A.

³⁶ Commerce Amendment Act 2018, pt 3A.

³⁷ Commerce Commission New Zealand *Market Studies Guidelines*, Above n 21, at 4-5.

³⁸ At 5.

“workable competition” consumers will suffer negative consequences such as higher prices and lower quality products.³⁹

In November 2021, the Commerce Commission released a comprehensive market study into the motor vehicle financing and add-ons industry in Aotearoa.⁴⁰ This was at the prompting of financial mentors throughout the country who witness first-hand the impacts the sale of add-ons in their current form are having on the vulnerable in New Zealand.⁴¹ In this market study (the 2021 Market Study), the Commission made several important findings regarding the state of the industry in New Zealand. However, to the dismay of financial mentors in New Zealand, it failed to make any significant recommendation for reform.

Whilst the 2021 Market Study offered an in depth look at how the industry currently operates in New Zealand, it did little in the way of proposals for regulation. The Commission proposed that its “next steps” would be to provide advice to industry participants about their obligations, continue to assess compliance and take enforcement action where appropriate, undertake advocacy work with the consumer advisory sector and share observations made with other government agencies.⁴² This low-level response has left some financial mentors disappointed.

Given that the same issues have been identified in other jurisdictions, it is instructive to consider how those other jurisdictions have responded.

V How the United Kingdom has addressed the issue

A March 2014 FCA Market Study and associated reforms

In March 2014, the Financial Conduct Authority (FCA) released a market study on general insurance add-ons (the FCA Study).⁴³ It looked at add-on insurance more widely, not purely motor vehicle insurance add-ons.⁴⁴ The FCA had several concerns around the sale of add-on insurance and identified that “competition in add-on markets is not effective.”⁴⁵ The concerns included the following:⁴⁶

³⁹ At 5.

⁴⁰ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1.

⁴¹ Rob Stock, above n 19.

⁴² Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 7.

⁴³ Financial Conduct Authority *General insurance add-ons: Provisional findings of market study and proposed remedies* (MS14/1, March 2014).

⁴⁴ At 1.

⁴⁵ At 1.

⁴⁶ At 48-49.

- (a) Consumers were paying too much. The point of sale advantage could be exploited leading to prices substantially above costs.
- (b) Consumers were not buying products at all if prices were too high. This means a consumer who would otherwise have purchased a product at a lower price missed out on coverage.
- (c) Consumers were purchasing unsuitable products because consumers had a low understanding of products.

A significant focus of the FCA Study was the lack of information available to consumers when purchasing an add-on. The FCA recognised for a market to work competitively consumers must “have a range of options available to them” and be able to “access appropriate information at the right time about the options available.”⁴⁷ The FCA Study looked at consumer understanding of the add-ons and concluded that generally, consumer understanding was poor with “widespread misunderstanding” of basic policy details.⁴⁸ Additionally, the FCA observed, that for a consumer to be able to make an effective choice they not only need the right information, but it must also be at the right time.⁴⁹ The FCA was concerned the way information relating to the add-on was often presented towards the conclusion of the sale of the primary product, left little time for consumers to consider the add-on.⁵⁰ Without having sufficient time to consider their purchase, consumers cannot make an informed and effective decision. Further, by introducing the add-on product late into the purchase of the primary product, consumers were less likely to shop around for an alternative provider.⁵¹

The FCA Study also identified when there is weak consumer engagement with a product, as is the case with insurance add-ons,⁵² the seller is likely to have a point of sale advantage.⁵³ A point of sale advantage can be of benefit to sellers as it can limit competition from other suppliers. The FCA Study identified several other factors present within the add-on insurance industry that confer a point of sale advantage to the seller of the primary product. The first was the seller already has direct access to the consumer, through the provision of the primary product, which means the seller can devote minimal resources, such as marketing costs, to the

⁴⁷ At 16.

⁴⁸ At 28.

⁴⁹ At 36.

⁵⁰ At 36-37.

⁵¹ At 36-37.

⁵² At 7; The FCA reached the conclusion that when purchasing an add-on product “consumers are often not engaging with the purchase.”

⁵³ At 7.

sale of the add-on.⁵⁴ This also means third party suppliers are at a disadvantage, they need to devote far more resources to attract a consumer's attention. Sellers also have the benefit of being the first to offer the add-on to the consumer solely because they are the supplier of the primary product.⁵⁵ A point of sale advantage disincentivises standalone providers from offering the product as it can be too difficult to overcome the advantages enjoyed by the primary product supplier. This can lead to suppliers exiting the industry which will further worsen the level of competition. Because of this point of sale advantage, the FCA was concerned that sellers could easily increase the price of add-ons significantly above cost, without suffering a significant decrease in consumer demand.⁵⁶

The FCA also considered claims ratios to be a significant indicator of the financial benefit the add-on provides to consumers.⁵⁷ The GAP claims ratio of 10 per cent was so low that it was of particular concern for the FCA, it demonstrated "particularly poor value" for consumers.⁵⁸ This concern was consolidated further when coupled with the claim frequency of add-on products. The claim frequency for GAP was 0.3 per cent, which is very low.⁵⁹

The FCA proposed several reforms designed to enable consumers to better make informed choices and to encourage providers of add-on products to afford more value to consumers.⁶⁰ The first was the imposition of a two-day deferred opt-in sales model for GAP. GAP was specifically targeted by the FCA for being poor value, evidenced by low claims ratios, and because of pressure selling occurring in car dealerships.⁶¹ The deferred opt-in sales model, which was adopted, prohibits the sale of GAP alongside the sale of the primary product. Instead, the consumer can be informed about GAP and then needs to confirm with the seller after the stipulated lapse of time they wish to purchase.⁶² This was implemented to negate the point of sale advantage. It gives consumers time to shop around and research to better inform their decision regarding suitability and need, and to consider alternative suppliers, thereby also improving information availability. The FCA also implemented a requirement that if the introduction to GAP is made alongside the sale of the primary product, the seller must inform

⁵⁴ At 35.

⁵⁵ At 35.

⁵⁶ At 36.

⁵⁷ At 40; The FCA did recognise that claims ratios are slightly limited due to their inability to account for the intangible worth add-on products may offer.

⁵⁸ At 41.

⁵⁹ At 42-43.

⁶⁰ At 53.

⁶¹ At 56.

⁶² At 57.

the consumer purchase can be made elsewhere, ensuring the point of sale advantage is broken down.⁶³ In 2018 the FCA published an evaluation paper on the effectiveness of the deferred sales model.⁶⁴ It concluded the intervention had a positive impact by increasing consumer engagement and had nearly doubled the level of shopping around consumers undertook within the industry.⁶⁵

The FCA also proposed and implemented a ban on ‘opt-out sales’, which is a sale process where consumers have to actively acknowledge they do not wish for the add-on to be purchased with the primary product, rather than actively acknowledging they do wish for the add-on to be purchased with the primary product.⁶⁶ This intends to better enable consumers to make more informed choices.⁶⁷ The FCA also proposed and implemented a requirement that firms provide appropriate and timely information.⁶⁸ This requires that firms introduce add-ons earlier in the sales process, and assist customers in comparing add-ons by displaying the annual and monthly costs of the add-on.⁶⁹ The Commerce Commission has not recommended any of the reforms that were implemented by the FCA.

B Refund scheme

Wide spreading mis-selling of add-ons was also addressed in the United Kingdom through a refund scheme. This focused on the sale of PPI (payment protection insurance) sold across a variety of industries. In August 2010 the United Kingdom Financial Services Authority (FSA) implemented a “package of measures” to remedy issues that had been identified in relation to the sale of PPI.⁷⁰ The FSA identified what it described as “serious concerns about widespread weaknesses in previous PPI selling practices” that were detrimental to consumers,⁷¹ poor handling by the industry of the increasing number of consumer complaints around PPI, and

⁶³ At 57.

⁶⁴ Jennifer Brauner, Lawrence Charles, Jasjit Sansoye and Lachlan Vass *An evaluation of our guaranteed asset protection insurance intervention* (Financial Conduct Authority, Evaluation Paper 18/1, July 2018).

⁶⁵ At 3.

⁶⁶ At 59; and Financial Conduct Authority *General Insurance Add-ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision making for add-on buyers* (PS15/22, September 2015) at 21.

⁶⁷ Financial Conduct Authority *General Insurance Add-ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision making for add-on buyers*, above n 66, at 6.

⁶⁸ At 18-19.

⁶⁹ At appendix 2, p 3.

⁷⁰ Financial Services Authority *The assessment and redress of Payment Protection Insurance Complaints* (PS10/12, August 2010) at 3.

⁷¹ At 3.

neglect of root cause analysis and fairness obligations owed to non-complainants.⁷² Common failings that were identified by the FSA included but were not limited to:⁷³

- (a) The seller pressuring consumers into taking a PPI policy.
- (b) The seller leading the consumer to believe that obtaining PPI was compulsory to obtain finance.
- (c) The seller providing misleading or inaccurate information about the PPI policy.
- (d) The seller not ensuring the consumer only bought a policy under which they were entitled to claim benefits.
- (e) The seller providing a policy to the consumer under which the total premiums paid would exceed any possible claim payable.

These were considered to be failings concerning the various FSA Principles.⁷⁴ The refund scheme was carried out under the FCA's power to make rules through the Financial Services and Markets Act 2000.⁷⁵ Importantly, the FCA mandated that providers of PPI may need to proactively contact consumers and invite them to complain if they believed they had been mis-sold PPI. This was done through the introduction of the Dispute Resolution: Complaints (Payment Protection Insurance) Instrument 2010,⁷⁶ which included "Root cause analysis".⁷⁷

Providers of PPI contested this requirement and sought judicial review, arguing these new standards could not be imposed retrospectively.⁷⁸ In the context of this review, the British Banking Association (BBA) argued that s 150(2) of the Financial Services and Markets Act 2000 prevented the Principles from creating an obligation owed by firms to consumers; the FSA was wrong in law to use the Principles in advising firms in how to assess complaints and assess failings; and the Financial Ombudsman Service (FOS) should not consider the Principles when considering redress for complaints.⁷⁹ However, the High Court determined the wording

⁷² At 4.

⁷³ At appendix 4, p 1-4.

⁷⁴ At appendix 4, p 1-14; The Eleven Principles are contained in PRIN 2.1 of the FCA Handbook. The particularly relevant Principles include Principle 1 requiring firms to conduct business with integrity, Principle 6 requiring a firm to pay due regard to the interests of customers and to treat them fairly, and Principle 7 which requires a firm to pay due regard to the information needs of its consumers and communicate information to them in a way that is clear, fair and not misleading.

⁷⁵ Financial Services and Markets Act 2000 (UK), ss 137, 138, 149 and 157.

⁷⁶ Financial Services Authority *The assessment and redress of Payment Protection Insurance Complaints*, above n 70, at appendix 1.

⁷⁷ At appendix 1, p 7-8.

⁷⁸ *The Queen on the application of British Bankers Association v The Financial Services Authority* [2011] EWHC 999 (Admin).

⁷⁹ At [55].

of s 150(2) did not prevent the Principles from giving rise to obligations,⁸⁰ and Schedule 17 of the Act does confer a broad power to the FOS to decide what it takes into account.⁸¹ The Court held:⁸²

“...it would be a breach of statutory duty for the Ombudsman to reach a view on a case without taking the Principles into account in deciding what would be fair and reasonable and what redress to afford.”

The Court then had to consider the issue of how the general Principles inter-related with specific rules in the industry, as the BBA had contended the Principles could not be interpreted in a way that contradicted or augmented the specific rules handling, the sale of, and complaints about PPI.⁸³ The Court was clear the Principles are an overarching framework for regulation, in place to govern the actions of firms and supplement specific rules where they do not provide adequate provision, therefore specific obligations in the rules can be subject to the wider Principles.⁸⁴ This meant lenders were expected to reopen claims that had been made for mis-selling based on the new standards and to also, where appropriate, contact consumers who could be deserving of compensation because of the requirement for root cause analysis. The FCA set a claim deadline of 29 August 2019.⁸⁵ Over GBP 38 billion has been paid to consumers of PPI products to date.⁸⁶

VI How Australia has addressed the issue

A September 2016 ASIC Report and associated reforms

In September 2016, the Australian Securities and Investments Commission (ASIC), released its report on the motor vehicle add-on insurance industry (the ASIC Report).⁸⁷ The ASIC Report focused on similar products to the Commerce Commission’s 2021 Market Study including CCI, GAP and MBI.⁸⁸ The Australian industry operates similarly to New Zealand.

⁸⁰ At [71].

⁸¹ At [75].

⁸² At [77].

⁸³ At [95].

⁸⁴ At [161]-[166].

⁸⁵ Financial Conduct Authority “After you complain about PPI” (12 August 2020) Financial Conduct Authority < <https://www.fca.org.uk/>>.

⁸⁶ Financial Conduct Authority “Monthly PPI refunds and compensation” (7 May 2020) Financial Conduct Authority < <https://www.fca.org.uk/>>.

⁸⁷ Australian Securities & Investment Commission *A market that is failing consumers: The sale of add-on insurance through car dealers*, above n 3.

⁸⁸ At 5.

Most add-ons are sold on behalf of insurers and lenders to consumers through dealers, with dealers receiving a commission.

The first significant finding of the ASIC Report was the industry had extremely low claims ratios, across the add-ons studied. In the three years of the study, the total claims ratio of all the add-ons combined was 9 per cent.⁸⁹ This means that for every dollar paid by consumers in premiums they received 9 cents in claims. This was compared to other claims ratios in Australia such as that of car insurance at 85 per cent and home insurance at 55 per cent.⁹⁰

The ASIC Report also identified dealer commissions were considerably higher than what consumers received in claims.⁹¹ ASIC identified across the period covered by the Report dealers received four times as much in commissions than what consumers did in claims.⁹² Additionally, because dealers could receive a ‘volume bonus’ there was a conflict of interest as dealers were incentivised to push products onto consumers even when they may not need them, and this “significantly increases the risk of mis-selling.”⁹³ The ASIC Report also noted that the insurers who offered dealers the best maximum rates of commission sold the most policies, indicating that dealers are motivated to sell policies that offer higher commissions.⁹⁴ ASIC also noted the conflict of interest on dealers identified above in relation to volume bonuses is exacerbated by the high level of financial benefit dealers receive generally by way of commission, meaning consumers may be subject to pressure selling.⁹⁵

ASIC also observed that many add-on products were poorly designed concerning consumers’ needs or offered little value.⁹⁶ Furthermore, policies often had significant restrictions on cover, which worsened claims ratios for consumers. In particular, and as identified in the 2021 Market Study,⁹⁷ concerning exclusions for pre-existing conditions that were broad in nature, meaning the cover provided was “inconsistent with the consumer’s reasonable expectations” about what would qualify as a covered event and the amount of coverage.⁹⁸

⁸⁹ At 7.

⁹⁰ At 15.

⁹¹ At 7.

⁹² At 7.

⁹³ At 16.

⁹⁴ At 17.

⁹⁵ At 17.

⁹⁶ At 7.

⁹⁷ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 21-23.

⁹⁸ Australian Securities & Investment Commission *A market that is failing consumers: The sale of add-on insurance through car dealers*, above n 3, at 24.

Shortly after the release of the ASIC Report, a Royal Commission into misconduct in the banking, superannuation, and financial services industry (the Hayne Royal Commission) was conducted.⁹⁹ As part of its inquiry into the insurance industry more generally, the Hayne Royal Commission also considered the sale of add-on insurance products.¹⁰⁰

Springing from the ASIC Report and the Hayne Royal Commission has been some significant reform. The most significant is the introduction of a four-day deferred sales model for all add-on products.¹⁰¹ The adopted model goes significantly further than the United Kingdom's deferred sales model which exists purely in relation to GAP. The Hayne Royal Commission recommended the introduction of a Treasury led working group to develop the deferred sales model.¹⁰² The Australian Treasury in its Proposal Paper stated:¹⁰³

The objective of the proposed deferred sales model is to promote informed purchasing decisions by consumers in add-on insurance markets. The model achieves this by introducing an enforced pause in the sales process between the purchase of a primary product and their decision to purchase add-on insurance. The deferral period will enable and encourage consumers to consider the merits of the insurance offered and to consult alternative providers.

By providing consumers with time to consider the merits of an add-on consumer information will improve and the primary product point of sale advantage is broken down, thereby increasing the level of competition in the industry. The Australian deferred sales model commenced on 5 October 2021.¹⁰⁴ ASIC has provided significant guidance on how the model operates to ensure compliance.¹⁰⁵

The level of commission that can be granted to motor vehicle dealers for selling add-on products has also been capped. Upon inquiry, the Hayne Royal Commission considered that the level of commission paid to dealers for the sale of add-on products contributed to mis-selling.¹⁰⁶ Although in light of the ASIC Report those operating within the industry had

⁹⁹ Kenneth M Hayne *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Commonwealth of Australia, Volume 1, February 2019).

¹⁰⁰ At 288-292.

¹⁰¹ Australian Securities & Investments Commission "ASIC releases guidance and customer information requirements to implement the new add-on insurance deferred sales model" (press release 28 July 2021).

¹⁰² Hayne, above n 99, at 291.

¹⁰³ Australian Treasury *Reforms to the sale of add-on insurance products* (Proposal Paper, September 2019) at 7.

¹⁰⁴ Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth), sch 3.

¹⁰⁵ Australian Securities and Investment Commission *The deferred sales model for add-on insurance* (RG 275, July 2021).

¹⁰⁶ Hayne *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, above n 99, at 291.

voluntarily taken limited steps to lower commissions,¹⁰⁷ the Hayne Royal Commission considered it necessary to have a legal requirement to do so.¹⁰⁸ This was done by amending the ASIC Act, to confer on ASIC the power to place a cap on the level of commission that can be paid to dealers selling add-on products.¹⁰⁹ It is now an offence to provide a commission to another person or to receive a commission from another person that exceeds the value of the cap determined by ASIC.¹¹⁰ The cap is set at 20 per cent. This is significantly lower than the 75 per cent commission some dealers had previously been receiving. By lowering the level of commission dealers can make on the sale of an add-on it is intended that consumers receive more value by paying a reduced price, thereby increasing claims ratios in consumers' favour.

B Refund scheme and consumer action

Australian consumers have also received significant refunds for purchases of add-on insurance products. Refunds of AUD 130 million have been secured by ASIC for 245,000 consumers.¹¹¹ This is to remedy harm already caused to consumers who acquired policies with little to no value.¹¹² Consumers have also taken independent action in several ways. One way is through the consumer established "Demand a Refund" campaign which facilitates consumers making a claim directly against their insurer or lender. Additionally, litigation funding has enabled the onset of a consumer class action which alleges various breaches of s 12 of the ASIC Act and seeks damages for class members.¹¹³

VII Legal solutions currently available to consumers in New Zealand

A Common law

An agreement to purchase an add-on insurance product is a contractual relationship that exists between the consumer and the provider of the product. The equitable doctrines of unconscionable bargain and undue influence may be a source of relief for consumers, who have entered into a contract they then wish to avoid or have set aside.

¹⁰⁷ Peter Kell "Add-on insurance and flex commission practices" (30 March 2021) Australian Securities & Investment Commission <<https://asic.gov.au/>>.

¹⁰⁸ Hayne *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, above n 99, at 292.

¹⁰⁹ Australian Securities and Investments Commission Act 2001 (Cth), s 12DMC(3).

¹¹⁰ Section 12DMC(1).

¹¹¹ Australian Securities and Investments Commission "ASIC announces further add-on insurance refunds, bringing total to over \$130 million" (press release, 19 June 2019).

¹¹² Australian Securities and Investments Commission "ASIC announces further add-on insurance refunds, bringing total to over \$130 million" (press release, 19 June 2019).

¹¹³ *Tracy-Ann Fuller and another v Allianz Australia Insurance Limited and another* (VSC) Proceeding number: S ECI 2020 02853. Consolidated statement of claim filed 15 September 2021.

Generally, at common law, a bargain being harsh is not sufficient to warrant it being set aside. However, the equitable doctrine of unconscionable bargain does allow equity to intervene to relieve a disadvantaged party from a transaction if certain circumstances are present. The leading case in New Zealand is *Bowkett v Action Finance* which set out a five-step test.¹¹⁴ For a successful unconscionable bargain claim, the party alleging the unconscionability must be at a significant disadvantage.¹¹⁵ Although many consumers within the motor vehicle add-on insurance industry may be considered vulnerable, they would be unlikely to meet the threshold of being at a ‘significant disadvantage’. Unconscionable bargain “is not intended to relieve parties from hard bargains or to save the foolish from their foolishness”,¹¹⁶ it is intended to protect those under a significant disadvantage from exploitation.

The equitable doctrine of undue influence allows equity to intervene and set aside a transaction where one party has unconsciously taken advantage of the other party by abusing their position of power or dominance. A leading authority is the House of Lords decision of *Barclays Bank Plc v O’Brien* 1994.¹¹⁷ The House of Lords recalled two classes of undue influence, actual and presumed.¹¹⁸ It is likely the situation of an add-on purchase would need to come under the class of actual undue influence, as to establish presumed undue influence it is necessary a certain relationship exists. To establish actual undue influence the person alleging must prove the wrongdoer exerted undue influence on them to enter the particular transaction which is impugned.¹¹⁹ It may be able to provide redress in significantly severe instances of dealer mis-selling but is unlikely to be established in most cases where add-on products are sold.

Neither of these equitable doctrines (unconscionable bargain and undue influence) provide an effective legal solution for this issue. They can only protect consumers on a specific case by case basis and require certain characteristics to be present. They leave vulnerable consumers to fend for themselves and do not encourage proactive change to industry selling practices. They also require litigation, something which is costly and time consuming. Additionally, this common law is similar to that in the jurisdictions of Australia and the United Kingdom, it has been considered not to be sufficient to remedy the comparable issues.

¹¹⁴ *Bowkett v Action Finance Ltd* [1992] 1 NZLR 449 (HC) at 460.

¹¹⁵ At 460.

¹¹⁶ *Gustav and Co Ltd v Macfield Ltd* [2007] NZCA 205 (CA) at [30].

¹¹⁷ *Barclays Bank Plc v O’Brien* [1993] 3 WLR 786.

¹¹⁸ At 791-793.

¹¹⁹ At 791.

B *Legislation*

Two pieces of legislation are relevant to consider that regulate the actions of those operating in the industry. The First is the Credit Contracts and Consumer Finance Act 2003 (CCCFA) and the second is the Fair Trading Act 1986 (FTA).

The purpose of the CCCFA is to protect the interests of consumers in connection with credit contracts.¹²⁰ For the Act to apply to an add-on insurance contract the add-on being sold must meet the definition of ‘credit-related insurance’.¹²¹ Alternatively, the Act will apply if the add-on meets the definition of ‘repayment waiver’.¹²² The lender responsibility principles, provided in s 9C of the CCCFA, will then apply to ‘relevant insurance contracts’.¹²³ These are ‘credit-related insurance’ contracts where a borrower has entered or is seeking to enter, an agreement with the lender, and the insurance is arranged by the lender.¹²⁴ Insurance is considered to have been arranged by the lender under a variety of circumstances, including where it is financed under the agreement between the borrower and the lender.¹²⁵ The lender responsibility principles also apply to ‘repayment waivers’.¹²⁶

The lender responsibility principles impose two important requirements on providers of relevant insurance contracts and repayment waivers. The first is to assess the product’s suitability for the consumer’s needs, by ensuring the product will meet the consumer’s requirements and objectives.¹²⁷ It is important to note there is a difference between a product being suitable for the consumer and what is the best product for a consumer - there is no requirement to provide the consumer with the best product. The second is to assess the product’s affordability for the individual consumer, by ensuring the consumer can make repayments without suffering substantial hardship.¹²⁸ The Responsible Lending Code provides non-binding guidance on how lenders can comply with the requirements.¹²⁹

A failure to comply with the lender responsibility principles can result in a court order prohibiting the lender from providing credit or being an employee or agent of a lender through

¹²⁰ Credit Contracts and Consumer Finance Act 2003, s 3.

¹²¹ Section 5 provides three definitions of ‘credit-related insurance’. Definition (a) will apply to MBI; Definition (b) will apply to GAP; and definition (c) will apply to CCI/PPI.

¹²² Section 5 provides the definition of ‘repayment waiver’ which will apply to repayment waivers.

¹²³ Ministry of Business, Innovation and Employment *Responsible Lending Code* (Revised June 2022) at 59-60.

¹²⁴ Credit Contracts and Consumer Finance Act 2003, s 9B(1).

¹²⁵ Section 9B(2).

¹²⁶ Section 9B(4).

¹²⁷ Section 9C(5)(a)(i).

¹²⁸ Section 9C(5)(a)(ii).

¹²⁹ Section 9E(2).

s 108 of the Act.¹³⁰ Importantly, any person, including the Commerce Commission can apply for an order under s 108.¹³¹ The court is also able to make an order for compensation if the principles have been breached,¹³² and a borrower can claim statutory or exemplary damages from the lender for a breach.¹³³

The CCCFA has also recently been amended to introduce s 9CA which imposes a record keeping requirement on lenders to record how they have assessed a borrower's suitability and affordability, and the outcome of those assessments.¹³⁴ It is intended that this requirement will improve the enforceability of the rules around responsible lending.¹³⁵ This could serve to be of significant evidentiary assistance for regulators in the future if a refund scheme were to be introduced as records of inquiries made must be available at request to the borrower and the Commerce Commission.¹³⁶

The FTA prohibits persons in trade from engaging in conduct that is misleading or deceptive, or likely to mislead or deceive.¹³⁷ Persons in trade are also prohibited from making false or misleading representations about the need for a good or service.¹³⁸ Consumers can individually bring a claim for a breach of the FTA, this is relatively accessible as a claim can be heard before a Disputes Tribunal which has the power to award civil damages if the action in breach has caused loss. The Commerce Commission is also able to bring those engaging in trade in breach of the FTA to court. In considering enforcement action the Commerce Commission will consider the extent of detriment, the seriousness of the conduct, and any public interest.¹³⁹ The Commerce Commission has recognised operatives within the motor vehicle add-on insurance industry could be in breach for making false or misleading representations regarding the need for an add-on, or regarding the existence, exclusion or effect of any condition included in the add-on contract.¹⁴⁰

Although there appears to be legislation in place that can assist consumers, enforcement appears to be an issue. The Insurance Council of New Zealand (ICNZ) is of the view the

¹³⁰ Section 108.

¹³¹ Section 109.

¹³² Section 9A(2)(a).

¹³³ Sections 88(1)(a) and 94(1)(c).

¹³⁴ Section 9CA(1).

¹³⁵ (12 December 2019) 743 NZPD (Credit Contracts Legislation Amendment Bill - Third Reading, Hon Kris Faafoi).

¹³⁶ Credit Contracts and Consumer Finance Act 2003, s 9CA.

¹³⁷ Fair Trading Act 1986, s 9.

¹³⁸ Section 13.

¹³⁹ Commerce Commission New Zealand "Enforcement criteria" <<https://comcom.govt.nz/>>.

¹⁴⁰ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 30.

necessary legislation is “in place to protect people against being sold financial products that are inappropriate or that they can’t afford. [But] These laws need to be better enforced.”¹⁴¹ It is likely a lack of enforcement would be put down to a lack of resourcing, with the issues occurring in hundreds of car yards throughout the country. Effective enforcement would require widespread consumer reporting of breaches and significant resource devotion from the Commerce Commission to investigate.

The current legislation, if enforced effectively, is satisfactory to remedy individual situations where consumers have been mis-sold products. Reliance on this is an ambulance at the bottom of the cliff approach to industry regulation, this is not sufficient to prevent the issues and outcomes currently occurring. As the FCA recognised in the United Kingdom, because of the profitability of add-on products, warnings and fines are not sufficient to change behaviour.¹⁴² It is therefore suggested any future regulation should adopt a fence atop the cliff approach, preventing issues before they arise. Future regulation should act as a sufficient changer of industry selling practice to protect consumers, whilst at the same time, it should not require significant resource devotion or rely on consumer issue reporting to be effective.

VIII Recommendations

To prevent the issues and outcomes currently occurring within the motor vehicle add-on insurance industry the suggested view is regulation is needed that acts as a fence atop the cliff. Any reform should seek to rectify the three issues identified as present in the motor vehicle insurance add-on industry at the beginning of this paper, those being the lack of consumer awareness and understanding of add-on products brought about by a lack of information; the primary product provider point of sale advantage; and the dealer incentive system.

A Deferred sales model

One significant reform for adoption in New Zealand is a deferred sales model for add-on insurance products sold within the motor vehicle industry. This should be similar to that which applies to GAP in the United Kingdom, and all add-on insurance products sold in the motor vehicle industry in Australia. A deferred sales model introduces an enforced pause in the sales process between the purchase of the primary product and the decision on whether to purchase

¹⁴¹ Insurance Council of New Zealand “Enforcement Key to Consumer Protection” (press release, 15 June 2022).

¹⁴² Financial Conduct Authority *Redress for payment protection insurance (PPI) mis-sales* (TR14/14, August 2014) at 8.

the add-on.¹⁴³ A deferred sales model would aim to decrease the dealer point of sale advantage and provide time to facilitate better consumer understanding of the add-on, thereby improving competition in the industry. A deferred sales model is a demand-side remedy.¹⁴⁴ Demand-side remedies seek to improve consumer decision making and enhance the level of competition within an industry.¹⁴⁵ If the demand-side of a market is operating effectively “...competing firms will win consumers only if, relative to their competitors, they provide them with the products they most want, at the best possible value for money.”¹⁴⁶ To be effective, demand-side remedies should ensure consumers access key relevant information, assess that information effectively and then act on that information accordingly.¹⁴⁷ A deferred sales model can achieve this.

The United Kingdom’s deferred sales model imposed on the sale of GAP is estimated to have increased consumer shopping around by 28 per cent.¹⁴⁸ Additionally, GAP sales are now estimated to be 16 per cent to 23 per cent lower than they would have been without market intervention, which suggests more consumers are making an informed decision that products may not be suitable for them.¹⁴⁹ The FCA reached the conclusion some consumers, on reflection, are deciding not to go ahead with the purchase.¹⁵⁰ The amount of add-ons sold by standalone providers (an alternate provider to the provider of the primary product) has also increased.¹⁵¹ This diversifies the market share benefiting the level of competition. Although the FCA did recognise that this was less than expected,¹⁵² they concluded that there was a noticeable consumer benefit from the intervention.¹⁵³

There are arguments against the adoption of a deferred sales model. The FCA did recognise that consumers do place value on the convenience of being able to purchase the add-on product alongside the primary product.¹⁵⁴ Some consumer convenience would undoubtedly be lost if a

¹⁴³ Australian Treasury *Reforms to the sale of add-on insurance products*, above n 103, at 7.

¹⁴⁴ Amelia Fletcher “The Role of Demand-Side Remedies in Driving Competition” (7 November 2016) Which? < <https://www.which.co.uk/> > at 47-50.

¹⁴⁵ At 12.

¹⁴⁶ At 12.

¹⁴⁷ At 13.

¹⁴⁸ Brauner, Charles, Sansoye and Vass *An evaluation of our guaranteed asset protection insurance intervention*, above n 64, at 4.

¹⁴⁹ At 4.

¹⁵⁰ At 3.

¹⁵¹ At 3.

¹⁵² At 4.

¹⁵³ At 49-54.

¹⁵⁴ Financial Conduct Authority *General insurance add-ons: Provisional findings of market study and proposed remedies*, above n 43, at 54.

deferred sale model was introduced. Additionally, the adoption of a deferred sales model means that consumers are consequently without the cover an add-on affords, for the length of the deferral period.

ICNZ is of the view that rather than have a deferred sales model, the New Zealand approach should be a statutory cooling off period, this would permit consumers to receive a full refund if they decided they did not want the product within a specified period.¹⁵⁵ A statutory cooling off period would ensure consumers still retain the convenience of purchasing an add-on alongside the primary product and additionally are not exposed to the risk of a period without cover.

However, it is unclear how effective a statutory cooling off period would be at increasing competition, it seems unlikely that after a consumer has committed to something they will then withdraw and find an alternative provider. This is especially so considering some of the time consumers do not recognise they have purchased add-on insurance altogether. Furthermore, a statutory cooling off period would also be unlikely to offset any of the competitive advantages primary product providers enjoy over standalone providers. Primary product providers retain the ability to approach the consumer first for minimal cost.

Additionally, concern regarding consumers being under insured may be misplaced. For MBI the Consumer Guarantees Act would alleviate this in some instances as motor vehicles that are sold must be of acceptable quality, and reasonably fit for any purpose the consumer has made known to the dealer at the time of acquisition.¹⁵⁶ For CCI/PPI and repayment waivers, the CCCFA would alleviate this in some instances as it enables borrowers to apply for hardship relief, enabling a debtor to apply to have payments postponed and the term of the contract extended.¹⁵⁷ It is also likely that the potential impacts of consumers being without cover can be lowered by having a relatively short deferral period - this was the approach of Australia.¹⁵⁸

Furthermore, it is possible to mitigate any consumer under insurance and loss of convenience, by permitting the lowering of the deferral period to one day after the completion of the sale of

¹⁵⁵ Insurance Council of New Zealand “Enforcement Key to Consumer Protection” (press release, 15 June 2022).

¹⁵⁶ Consumer Guarantees Act 1993, ss 6, 7 and 8.

¹⁵⁷ Credit Contracts and Consumer Finance Act 2003, ss 55-56.

¹⁵⁸ Australian Treasury *Reforms to the sale of add-on insurance products*, above n 103, at 13-14.

the primary product, if the consumer initiates the completion of the sale of the add-on product.¹⁵⁹

It is suggested a deferred sales model is the more appropriate way to proceed rather than a statutory cooling off period. The length of deferral should provide an opportunity for the consumer to assess the suitability of the product to their needs, whilst at the same time, it should not be so long that it disengages a consumer completely from deciding to purchase.¹⁶⁰ It is suggested a four-day deferral period appropriately does this. This recommendation attempts to address the first and second issues identified in this paper.

It is briefly worth mentioning a reform that can be incorporated to maximise the effectiveness of a deferred sales model is mandated disclosure requirements, as was done by the FCA.¹⁶¹ This regulatory technique aims to improve decision making by requiring that a discloser who holds a superior position provides a consumer with specific information.¹⁶² Providing consumers with information maximises the effectiveness of a deferred sales model. It is however important to acknowledge that mandated disclosure requirements, in the absence of a deferred sales model, are not efficient or effective enough to protect consumers.¹⁶³

B Statutory cap on dealer commissions

It is proposed the third issue identified in this paper should be remedied by the introduction of a statutory cap on the level of dealer commission, mirroring the adoption of a statutory cap on commissions in Australia within the motor vehicle add-on insurance industry. This aims to prevent the retail price that consumers pay from being double the wholesale price that is set by the insurer or lender, as was identified as occurring in the 2021 Market Study.¹⁶⁴ It aims to stop, as recognised in the ASIC Report,¹⁶⁵ a race to the bottom where insurers and lenders, to have dealers prioritise their products, increase the commission they offer dealers, to the

¹⁵⁹ At 14.

¹⁶⁰ At 13.

¹⁶¹ Financial Conduct Authority *General Insurance Add-ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision making for add-on buyers*, above n 67, at 18-19.

¹⁶² Omri Ben-Shahar and Carl E Schneider “The Failure of Mandated Disclosure” (2011) 121 *University of Pennsylvania Law Review* 647 at 649.

¹⁶³ See Omri Ben-Shahar and Carl E Schneider “The Failure of Mandated Disclosure”, above n 162, for a detailed analysis of why this.

¹⁶⁴ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 15-16.

¹⁶⁵ Australian Securities & Investment Commission *A market that is failing consumers: The sale of add-on insurance through car dealers*, above n 3, at 17.

detriment of consumers.¹⁶⁶ A cap on dealer commission would reduce the price consumers pay and consequently improve claims ratios in the industry in favour of consumers. Furthermore, it is not appropriate that dealers are currently able to double the price consumers pay by way of the commission they take. The risk of the add-on contract sits with the insurer or lender, and the consumer offers monetary consideration for the incurrence of that risk. The dealer operates in a facilitatory role as a salesperson, it is difficult to see any rationale for increasing the price this significantly.

Additionally, as the CCCFA lender responsibility principles require that an assessment of suitability be carried out on any borrower,¹⁶⁷ the borrower should only be offered products that are suitable for them. However, this requirement does not mean the borrower must be offered the best product for them. Dealers retain scope to exercise their discretion, as there may be a range of ‘suitable’ products. Naturally, it may be in the dealer’s interest to promote the sale of ‘suitable’ products that confer on them the highest level of commission, this may not correspond to what is the best product for the consumer. By introducing a statutory cap on commissions, dealers would no longer be incentivised to provide less suitable products at the expense of the consumer’s best interest.

C Refund scheme

While the recommendations discussed have so far focused on improving outcomes for consumers in the industry moving forward, it is also important to acknowledge the harm that may already have been caused. It should be considered what can be done to remedy this. As discussed, regulators in the United Kingdom and Australia addressed this by way of respective refund schemes. It is suggested similar could be done here to support consumers who have already been sold add-ons in breach of existing laws. There are strong policy arguments for this including a need to protect vulnerable and innocent consumers from exploitation, a desire to correct unfair and unjust outcomes in markets to ensure consumer trust is maintained in the law, and to act as a deterrent of future behaviour that has the potential to create outcomes of the nature identified. These align with the Commerce Commissions’ considerations for enforcement action.¹⁶⁸

¹⁶⁶ Commerce Commission New Zealand *Motor vehicle financing and add-ons review*, above n 1, at 40.

¹⁶⁷ Credit Contracts and Consumer Finance Act 2003, s 9C(5)(a)(i).

¹⁶⁸ Commerce Commission New Zealand “Enforcement criteria” <<https://comcom.govt.nz/>>.

IX Conclusion

This paper has sought to showcase the major issues currently impacting consumers of motor vehicle add-on insurance products in New Zealand. It has considered how comparable jurisdictions have minimised these issues to better protect consumers. Although New Zealand regulators appear to be well informed by the Commerce Commission's 2021 Market Study, reform of the nature seen in comparable jurisdictions does not appear to be close. Currently, to a certain extent, legislation like the CCCFA and the FTA does position the Commerce Commission well to start driving change through enforcement action. However, this paper suggests this is insufficient as it does not operate in a preventative manner. It is proposed that legal change is needed that reforms the industry in a way that effectively prevents the issues faced by consumers from eventuating. It is only reform of this nature that can adequately protect future consumers of these products from the ongoing issues and outcomes present in the industry.

Word count

The text of this paper (excluding the abstract, table of contents, footnotes, and bibliography) comprises approximately 8,106 words.

Bibliography

A Cases

1 New Zealand

Bowkett v Action Finance Ltd [1992] 1 NZLR 449 (HC).

Gustav and Co Ltd v Macfield Ltd [2007] NZCA 205 (CA).

2 United Kingdom

The Queen on the application of British Bankers Association v The Financial Services Authority [2011] EWHC 999 (Admin).

Barclays Bank Plc v O'Brien [1993] 3 WLR.

B Legislation

1 New Zealand

Commerce Act 1986.

Commerce Amendment Act 2018.

Credit Contracts and Consumer Finance Act 2003.

Consumer Guarantees Act 1993.

Fair Trading Act 1986.

2 United Kingdom

Financial Services and Markets Act 2000 (UK).

3 Australia

Australian Securities and Investments Commission Act 2001 (Cth).

Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth).

C Secondary Legislation

(12 December 2019) 743 NZPD (Credit Contracts Legislation Amendment Bill - Third Reading, Hon Kris Faafoi).

D Papers and Reports

Commerce Commission New Zealand *Motor vehicle financing and add-ons review* (November 2021).

Australian Securities & Investment Commission *A market that is failing consumers: The sale of add-on insurance through car dealers* (September 2016).

Financial Conduct Authority *General insurance add-ons: Provisional findings of market study and proposed remedies* (MS14/1, March 2014).

Commerce Commission New Zealand *Market Studies Guidelines* (19 November 2020).

Jennifer Brauner, Lawrence Charles, Jasjit Sansoye and Lachlan Vass *An evaluation of our guaranteed asset protection insurance intervention* (Financial Conduct Authority, Evaluation Paper 18/1, July 2018).

Financial Conduct Authority *General Insurance Add-ons Market Study – Remedies: banning opt-out selling across financial services and supporting informed decision making for add-on buyers* (PS15/22, September 2015).

Financial Services Authority *The assessment and redress of Payment Protection Insurance Complaints* (PS10/12, August 2010).

Kenneth M Hayne *Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Commonwealth of Australia, Volume 1, February 2019).

Australian Treasury *Reforms to the sale of add-on insurance products* (Proposal Paper, September 2019).

Ministry of Business, Innovation and Employment *Responsible Lending Code* (Revised June 2022).

Financial Conduct Authority *Redress for payment protection insurance (PPI) mis-sales* (TR14/14, August 2014).

Australian Securities and Investment Commission *The deferred sales model for add-on insurance* (RG 275, July 2021).

E Newspaper and Magazine Articles

Rob Stock “Scandal of the least competitive insurance and loan market” *Stuff* (New Zealand, 21 January 2022).

F ***Internet Materials***

Ronji Tanielu “Not Adding Up: Spotlighting Add-on Insurance in Aotearoa” (14 June 2022) The Salvation Army < <https://www.salvationarmy.org.nz/>>

Amelia Fletcher “The Role of Demand-Side Remedies in Driving Competition” (7 November 2016) Which? < <https://www.which.co.uk/>>.

Commerce Commission New Zealand “Enforcement criteria” <<https://comcom.govt.nz/>>.

Insurance Council of New Zealand “Market Data” (September 2021) < <https://www.icnz.org.nz/> >.

Staff Author “What factors influence competition in microeconomics?” (9 April 2020) Investopedia < <https://www.investopedia.com/>>.

Rapahel Cedar “Factors that Influence Competition in Economics” (29 June 2020) Quickonomics <<https://quickonomics.com/>>.

Financial Conduct Authority “After you complain about PPI” (12 August 2020) Financial Conduct Authority < <https://www.fca.org.uk/>>.

Financial Conduct Authority “Monthly PPI refunds and compensation” (7 May 2020) Financial Conduct Authority < <https://www.fca.org.uk/>>.

Peter Kell “Add-on insurance and flex commission practices” (30 March 2021) Australian Securities & Investment Commission < <https://asic.gov.au/>>.

G ***Interviews***

Interview with Andrew Mitchell, Financial Mentor Salvation Army Royal Oak Community Ministries (the author, 3 August 2022).

H ***Press Releases***

Australian Securities & Investments Commission “ASIC releases guidance and customer information requirements to implement the new add-on insurance deferred sales model” (press release 28 July 2021).

Australian Securities and Investments Commission “ASIC announces further add-on insurance refunds, bringing total to over \$130 million” (press release, 19 June 2019).

Insurance Council of New Zealand “Enforcement Key to Consumer Protection” (press release, 15 June 2022).

I ***Articles***

Omri Ben-Shahar and Carl E Schneider “The Failure of Mandated Disclosure” (2011) 121 *University of Pennsylvania Law Review* 647

J ***Statements of Claim***

Tracy-Ann Fuller and another v Allianz Australia Insurance Limited and another (VSC)
Proceeding number: S ECI 2020 02853.