Australian Competition & Consumer Commission

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21 December 2016

Matt Rubinstein
Lawyer
Gilbert + Tobin

By email: mrubinstein@gtlaw.com.au

Dear Mr Rubinstein

Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors (the Applicants) – applications for authorisation A91556 – A91557

I refer to the above applications for authorisation lodged with the Australian Competition and Consumer Commission (the ACCC) on 13 September 2016.

The Applicants seek authorisation on behalf of themselves and potentially other insurers to implement a proposal that will limit the commissions and other payments or benefits paid to distributors of "add-on" insurance products through the motor vehicle dealership channel.[1] The Applicants propose to enter into a contract, arrangement or understanding that will limit commissions to 20% of premiums (proposed conduct).

The ACCC has considered the information put forward by the Applicants and the submissions of various interested parties. Having considered this information the ACCC has concerns about the proposed conduct. The purpose of this letter is to outline the ACCC's preliminary views about the proposed conduct and provide the Applicants with an opportunity to respond.

Rationale for the proposed conduct

The Applicants have described the proposed conduct as a key element of the insurance industry's response to serious concerns raised by the Australian Securities and Investments Commission (ASIC) in relation to the value of add-on insurance products sold through the motor vehicle dealership channel.

[1] Add on insurance products are general insurance policies that are 'added on' to the sale of a primary product, most commonly with the purchase of a motor vehicle.

In short, ASIC found that the market for the sale of add-on insurance products through motor vehicle dealerships is failing consumers.[2]

ASIC found that the key drivers of the issues it identified are the lack of transparency of purchase for consumers as a result of add-on insurance being secondary to the purchase of a new car and/or finance; and as a result of this transparency issue, “reverse competition” whereby insurers compete for access to the dealership sales channel by offering dealers significant commissions as high as 79%.

ASIC found that consumers are being sold expensive, poor value products that provide them very little to no benefit. It also identified a sales environment with pressure selling, very high commissions and conflicts of interest.

The ACCC’s preliminary views

The ACCC does not consider that the proposed conduct directly addresses the market failure identified by ASIC, which is that many consumers are not put in a position to make rational, well-informed choices when buying add-on insurance products through motor vehicle dealerships. Instead, the arrangements are designed to address one of the consequences of this market failure, namely high commissions to motor vehicle dealerships. In turn, the Applicants submit that this will result in lower priced insurance and better value for consumers.

The ACCC considers that as long as the fundamental issue identified by ASIC exists, that many consumers are not put in a position to make rational, well-informed choices when buying add-on insurance products through motor vehicle dealerships, dealerships will have the opportunity and incentive to sell consumers expensive, poor value products. The ACCC considers that this is likely to be the case even if the cap is implemented and the cost (in commissions) incurred by insurers in providing these products through motor vehicle dealerships falls.

The ACCC considers that insurers may continue to have incentives to seek to maximise their returns on add-on insurance products by charging what the market will bear. To the extent that they do so, at least part of the reduction in commissions will likely be reflected in a wealth transfer from motor vehicle dealerships to insurers rather than a reduction in prices for consumers. Because commissions will still be set as a percentage of the price of the policy, when selling add-on insurance products to consumers who are not price sensitive motor vehicle dealerships will also still have incentives to favour higher priced policies over lower priced policies irrespective of which policy may represent the best value for the customer or best suit their needs. In respect of these customers, any insurer unilaterally lowering its prices will run the risk of motor vehicle dealerships switching to offering more expensive policies offered by other insurers.

Accordingly, notwithstanding the cap on commission at 20%, so long as the problem of some consumers not being in a position to make rational, well-informed choices when buying add-on insurance products through motor vehicle dealerships persists, all else being equal it remains in both the insurers’ and motor vehicle dealerships’ interest to continue to

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2 ASIC Report 492 – A market that is failing consumers: The sale of add-on insurance through car dealers

favour policies that maximise their returns rather than those that represent the best value for consumers.

Therefore, the ACCC does not consider that, in and of itself, the cap on commissions will necessarily lead to lower prices or better value for consumers. Nor, as noted, does it address the market failure identified by ASIC.

The ACCC notes the Applicants submission of 14 November 2016, which outlines other proposed measures aimed at increasing consumers' price sensitivity by helping them understand the products that are available and the value they provide, and offering additional opportunities to compare prices, investigate alternatives and choose other options before or after the point of sale. To the extent that these initiatives are successful, other distribution channels for add-insurance may well provide a greater competitive constraint on the motor vehicle distribution channel than is presently the case. However, the success or otherwise of these measures is not related to any cap on commissions, and we do not consider that these other measures address our preliminary concerns about the proposed conduct as outlined in this letter.

The Applicants also argue that the proposed conduct will assist in addressing the problematic sales practices identified by ASIC. Specifically, they argue that the higher the commission the greater the incentive to sell the relevant product and the greater the likelihood of problematic sales practices.

To the extent that higher commissions do lead to problematic sales practices the ACCC considers that the proposed conduct is likely to reduce that risk to some extent, although a 20 per cent commission would still provide strong incentives for dealers to maximise sales of insurance. The ACCC does not consider that, as submitted by the Applicants, the proposed conduct will significantly shift (reverse) competition on commissions to competing for customers based on price and service. As discussed above, so long as the fundamental issue identified by ASIC remains, incentives for both insurers and dealerships to engage in the types of problematic sales practices identified by ASIC will also remain.

If consumers are not making well informed choices, competition will not regulate the market and motor vehicle dealerships are likely to continue to favour the products that most suit them (on the basis of commissions earned, time and effort involved in the sale) rather than the product that is best for the consumer. The proposed conduct does not address this issue.

For these reasons the ACCC's preliminary view is that the extent of any public benefit resulting from the proposed conduct is likely to be limited.

The ACCC notes the other initiatives suggested by interested parties as alternatives to the proposed cap on commissions.

Some interested parties argued that an 'opt-in' model, such as that adopted in the United Kingdom, which only allows consumers to buy an add-on product several days after the primary transaction, would put consumers in a better position to effectively evaluate their add-on insurance requirements and make purchases accordingly and in turn, promotes greater competition in the provision of these services.

Similarly, some interested parties argued that insurers should agree not to offer single premium add-on insurance policies because of concerns that such policies lack price transparency and increase the total cost paid by consumers.

The ACCC's assessment is limited to consideration of the proposed conduct the subject of the applications for authorisation. Accordingly, the ACCC has not considered these alternatives, or other alternatives proposed by interested parties, in any detail, although we note that they appear to more directly address the market failure identified by ASIC.

Next steps

The ACCC invites the Applicants to respond to the preliminary views set out in this letter. We would appreciate your response by **COB 23 January 2017.**

The ACCC has discussed the issues outlined above with ASIC and we will continue to liaise with ASIC as we progress our assessment of the applications for authorisation.

The original timetable for the ACCC's assessment anticipated a draft determination in December 2016. However, we now anticipate issuing a draft determination in February 2017 after allowing the Applicants a further opportunity to respond to the ACCC's preliminary views.

This letter has been placed on the ACCC's public register. If you wish to discuss any aspect of this matter, please do not hesitate to contact Gavin Jones on 03 9290 1475.

Yours sincerely

David Jones
General Manager
Adjudication