COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

Motor vehicle financing and add-ons review

Contents

Executive Summary

Rationale

1 The Commerce Commission (**Commission**) has undertaken a review focused on the sale of motor vehicle financing and related add-on products (**the review**). We have prioritised work in this area because:

1.1 After a house, a vehicle is often the biggest purchase that a consumer will make. Vehicles can be essential for daily life and necessary for getting to work, visiting whānau, childcare and/or medical appointments. Many consumers have no choice but to purchase a motor vehicle on finance.

1.2 The Commission regularly receives complaints about the motor vehicle industry. Previous work in this industry has included visits to motor vehicle dealerships in 2018/19 to assess compliance with certain provisions of the Fair Trading Act 1986 (**FT Act**), including dealer compliance with consumer information standards.[1]

1.3 Assessing lender and dealer compliance with the Credit Contracts and Consumer Finance Act 2003 (**CCCF Act**) and FT Act when selling finance and add-ons can be complex. Industry participants have reported difficulty in understanding whether certain legal obligations sit with the lender or dealer when add-ons are sold.

1.4 Overseas regulators have identified consumer harm within the motor vehicle add-ons industry. In 2014, the United Kingdom's Financial Conduct Authority (**FCA**) undertook a market study into general insurance add-ons and found that the timing of the add-ons discussion with the consumer, lack of transparency around the add-ons and their price and consumers' general lack of engagement with the process and understanding of the products resulted in poor consumer outcomes.[2] In 2016, the Australian Securities and Investments Commission (**ASIC**) conducted a study into the sale of add-on insurance through car dealers and found that the way the add-ons were designed and sold meant that the products often provided poor value for consumers and did not meet their needs.[3]

2 As a result, we undertook the review to:

2.1 better understand the roles and responsibilities of lenders, dealers and insurers;

2.2 identify practices or behaviours which have the potential to cause harm to consumers and to breach the legislation we enforce; and

2.3 inform the focus of our future compliance and enforcement work, and identify opportunities to provide guidance to industry participants, including consumers.

1. FT Act, section 28.
2. https://www.fca.org.uk/publication/market-studies/ms14-01.pdf
3. https://asic.gov.au/media/4042960/rep-492-published-12-september-2016-a.pdf

The review

3 While we looked at the process of motor vehicle financing generally, the review primarily focused on the following add-on products that are commonly sold by dealers alongside motor vehicles purchased on finance:[4]

Add-on products	Brief description
Mechanical Breakdown Insurance (**MBI**)	Cover in the event of an unforeseen mechanical or electrical fault with the vehicle.
Guaranteed Asset Protection (**GAP**) insurance	Cover if there is a shortfall (or 'gap') between the amount owing on the consumer's finance and any amount paid out by their comprehensive vehicle insurance (**CVI**) provider in the event of a total loss on the vehicle.
Credit Contract Indemnity insurance (**CCI**)/ Payment Protection Insurance (**PPI**)[5]	Cover for loan repayments in the event the consumer is unable to make their repayments due to a range of insured events, including sickness, hospitalisation, accident, redundancy, bankruptcy and death.
Repayment waiver	Waiving of loan repayments in the event that: • the consumer is unable to make their repayments due to a range of covered events, including sickness, hospitalisation, accident, redundancy, bankruptcy and death; or • there is a shortfall between the amount owing on the consumer's finance and any amount paid out by their CVI provider in the event of a total loss on the vehicle.

4 These products are referred to as 'add-ons' because the cost of the product is commonly financed by and 'added on' to the loan taken out to purchase a vehicle and is therefore repaid over the life of the loan.[6]

5 Throughout this report, we use **add-ons** to refer to the above four products collectively, whereas **add-on insurance** refers only to MBI, GAP insurance and CCI/PPI as these products are only offered by insurers. Repayment waivers are only offered by lenders.

4. The products are described in further detail at paragraph 69 onwards.
5. For the purposes of the review, we have used CCI and PPI synonymously as they essentially offer the same cover.
6. The figures contained in this report relating to the volume and value of MBI policies do however include some cash sales.

6 To inform our understanding of the industry we:

6.1 collected qualitative and quantitative information from 15 motor vehicle finance providers (**lenders**)[7] and five add-on insurance providers (**insurers**);[8]

6.2 interviewed 62 consumers that had either recently purchased or made a claim on an add-on;[9] and

6.3 consulted with motor vehicle dealers, financial mentors, relevant industry bodies and other agencies and regulators.

7 A high-level description of our methodology, including a list of the lenders, insurers and other parties spoken to as part of the review, is provided in the attachment to this report.

8 Unless stated, the figures within this report do not represent the entire industry, but rather a sample of it.[10] The figures are based on aggregate or average amounts across all of the data provided by the review participants unless otherwise specified.

9 This report identifies the Commission's key observations about motor vehicle financing and add-ons and provides a:

9.1 description of the industry;

9.2 overview of the relevant add-on products;

9.3 summary of relevant CCCF Act and FT Act provisions relating to add-ons; and

9.4 explanation of the vehicle financing and add-ons sales process.

10 The Commission intends for this report to increase awareness of the above for all industry participants, including those that did not take part in the review.

Key observations

Consumer experiences

11 Statements from consumers obtained at interviews which formed part of the review suggested that some industry participants may be falling short of their obligations under the CCCF Act (in the case of lenders) or the FT Act (in the case of dealers).

12 The relevant law in relation to motor vehicle financing and the sale of add-ons includes the:

12.1 lender responsibility principles set out in the CCCF Act, which require lenders to make reasonable inquiries to be satisfied that the finance and any add-ons purchased by consumers are likely to be affordable and suitable, and to assist consumers to reach informed decisions as to whether or not to enter into any such contracts; and

12.2 provisions in the FT Act which prohibit dealers (as well as lenders) from making false or misleading representations.

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7. Five of these lenders also provide repayment waivers.
8. Covering the three years from 1 April 2017 to 31 March 2020.
9. Throughout the period from 1 August to 31 October 2020. In addition to the 62, we spoke to a further 34 consumers however the add-ons purchased by these consumers did not fall within the definition of credit-related insurance or repayment waiver under the CCCF Act. These defintions are explained at paragraph 113 onwards.
10. The data represents five of the biggest add-on insurance providers and 15 of the biggest motor vehicle lenders.

13 The majority of the consumers that we spoke to as part of the review did not tell us anything that gave us cause for concern about their experience when buying or claiming on an add-on. However, some consumers told us that they:

13.1 did not fully understand the add-on before purchasing it; [11]

13.2 only realised that they had purchased the add-on after the contract was entered into, or could not recall that they had purchased the add-on at the time of speaking to us;[12]

13.3 purchased an add-on that was unsuitable for their circumstances (because the consumer did not meet the eligibility criteria to make a claim on the add-on);[13] and/or

13.4 had understood from their interactions with the dealer that the add-on was mandatory in order for the finance to be approved, when in fact the lender may not have required this.[14]

Industry observations

14 We also identified the potential for non-compliance and poor consumer outcomes in the way that add-ons are sold and by virtue of the relationships between lenders, dealers and insurers.

15 The dominant sales model for add-ons relies on intermediaries, with add-ons typically sold at the vehicle point of sale by dealers who have the ability to earn commission on those sales, alongside the ability to earn commission and fees for arranging the finance.[15] [16]

16 While lenders generally assess the *affordability* of the finance and add-ons themselves, they typically rely on dealers to assess the *suitability* of the add-on and to assist the consumer to reach an informed decision about purchasing that add-on.

17 The ability for dealers to earn a sales commission may mean that they prioritise selling add-ons over adequately assessing suitability for the consumer or assisting them to make an informed decision. Therefore, there is a possible tension with lenders relying on dealers to perform these tasks in relation to products where sales commissions can be earned.

18 While agency arrangements such as these are commonplace in many sectors, in these circumstances, lenders must be vigilant to ensure that dealers perform any delegated duties appropriately to enable lenders to comply with their legal obligations. Lenders need to have sufficient audit and assurance processes in place to ensure that dealers, as their agents:

18.1 act appropriately so as to ensure that the lender’s legal obligations are properly discharged; and

18.2 do not prioritise making a sale over performing any delegated duties.

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11. Thirteen out of 62 consumers.
12. Eight out of 62 consumers.
13. One out of 62 consumers.
14. Fourteen out of 62 consumers. For completeness, consumers may be counted in more than one category.
15. We use ‘**intermediaries**’ to refer to dealers, brokers, and in some instances lenders (where they are distributing add-on insurance on behalf of insurers). However, because dealers are the dominant sales channel overall, throughout this report we commonly refer solely to ‘**dealers**’.
16. There are various models used throughout the industry, which are described at paragraph 48 onwards. For the purposes of our report, we have primarily focused on the agency model as it is the most common within the industry.

Next steps

19 Following the release of the report, the Commission intends to:

19.1 provide information to lenders and dealers about compliance with the CCCF and FT Acts, particularly as it relates to information provided by consumers as part of the review;

19.2 engage with the lenders that participated in the review about the December 2021 CCCF Act amendments;[17]

19.3 as part of our wider compliance and enforcement strategy, continue to assess compliance within the industry (including in relation to the new requirements for add-ons) and take enforcement action where appropriate;

19.4 undertake advocacy work with the consumer advisory sector (including financial mentors); and

19.5 share our observations with other relevant agencies, including the Financial Markets Authority (**FMA**) and the Ministry of Business, Innovation and Employment (**MBIE**).

17. Described at paragraph 122.

The Commerce Commission

Role and responsibilities

20 The Commission is an independent Crown entity responsible for enforcing and promoting compliance with a range of laws including those relating to consumer credit contracts (the CCCF Act)[18] and fair trading (the FT Act).

Credit Contracts and Consumer Finance Act

21 The role of the Commission under the CCCF Act is to promote compliance with that Act. Our functions include:

21.1 monitoring trade practices in credit markets;

21.2 taking prosecutions and civil proceedings in relation to breaches of the CCCF Act; and

21.3 making available appropriate information for the guidance of consumers, creditors and other interested persons in relation to promoting compliance with the CCCF Act.[19]

22 The primary purpose of the CCCF Act is to protect the interests of consumers in connection with credit contracts. It is also the purpose of the CCCF Act to:

22.1 promote the confident and informed participation in markets for credit by consumers; and

22.2 promote and facilitate fair, efficient and transparent markets for credit.[20]

23 The CCCF Act achieves these purposes by imposing obligations on lenders to be responsible lenders, disclose adequate information to enable consumers to make informed decisions and comply with rules relating to fees, interest and repossession.[21]

24 Lenders have responsibilities under the CCCF Act when an add-on is financed under a consumer credit contract, including:

24.1 The lender responsibility principles, including the specific responsibilities relating to affordability,[22] suitability and informed decision making, set out in section 9C(5) in relation to relevant insurance contracts, and in section 9C(3) in respect of repayment waivers and extended warranties (both of which are treated as forming part of the consumer credit contract).

24.2 Sections 52, 52A, 52B and 53, which set out the rules for rebates on consumer credit insurance contracts, extended warranties and repayment waivers where a consumer chooses to prepay their consumer credit contract.

24.3 Sections 69 and 70, which set out restrictions on and disclosure requirements for repayment waivers, credit-related insurance and extended warranties.

25 The application of these provisions depends on whether the add-on being financed under the consumer credit contract meets the relevant definitions under the CCCF Act.[23]

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18. A 'consumer credit contract' is defined at section 11(1) of the CCCF Act.
19. CCCF Act, section 111.
20. Ibid, section 3(1) and (2).
21. Ibid, section 3(3).
22. While as part of the review we looked at affordability assessments from a process perspective, we did not assess the adequacy of affordability assessments performed at the individual consumer level.
23. Described at paragraph 113 onwards.

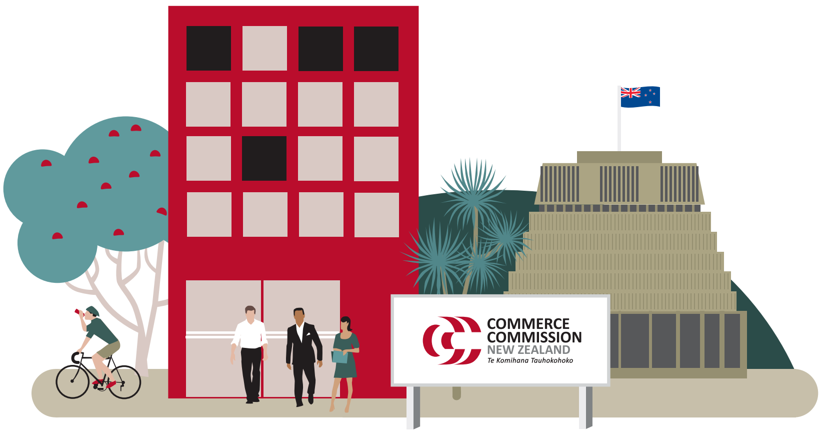
Fair Trading Act

26 The purpose of the FT Act is to contribute to a trading environment in which the interests of consumers are protected, businesses compete effectively and consumers and businesses participate confidently.[24]

27 The following FT Act provisions may apply to the sale of motor vehicle add-ons:

27.1 Sections 10, 11 and 13, which prohibit false and misleading representations and conduct.

27.2 Sections 36U and 36V, which contain the disclosure and cancellation requirements for extended warranties.



24. FT Act, section 1A(1).

Industry overview

Industry landscape

28 In 2019 New Zealand reached record high levels of vehicle ownership per capita.[25] The average age of vehicles in New Zealand is also rising, and is higher than in Australia, Canada and the United States due to the prevalence of used imports.[26] Stats NZ reported that in the three years ending March 2021, more than $13b was spent on motor vehicles (and parts) annually.[27] [28]

29 Based on data provided by the 15 lenders who participated in the review, for the 12 months ending 31 March 2020:

29.1 Used cars made up 85% of the vehicles financed.

29.2 The average age and price of used cars purchased on finance was 10 years and $17,598 respectively.

29.3 The average price of new cars purchased on finance was $38,744.

29.4 The average length of a motor vehicle loan was four years.

Industry participants

Consumers

30 Many consumers need to obtain finance in order to purchase a motor vehicle (as opposed to paying cash). The process of acquiring vehicle finance can be challenging for some consumers due to the complexity of the application process and of the finance itself.

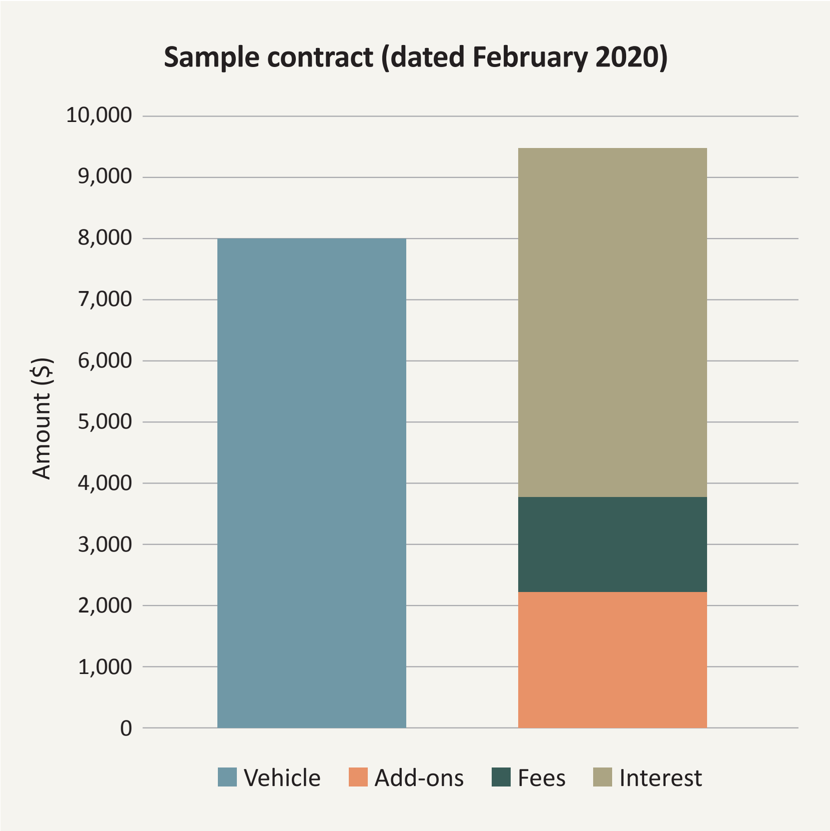
31 There are several reasons why consumers purchase add-ons. Add-ons provide cover for risks such as redundancy or insurance shortfall (being the difference between the amount owed on the vehicle finance in the event of an accident or write-off and the value of any CVI pay-out). Consumers we spoke to also mentioned other motivations for acquiring add-ons, including peace of mind and security in the event that the unexpected occurs (particularly in light of the uncertainty caused by COVID-19), or having had a positive past experience with add-ons (eg, having had a claim approved).

32 While GAP insurance, CCI/PPI and repayment waivers will necessarily be financed, consumers who may not otherwise have had the money set aside to pay for an MBI policy upfront may benefit from being able to finance it and spread the cost over the life of the loan. However, financing MBI means that interest is incurred on the premium and it will therefore ultimately cost the consumer more than if it was purchased outright with cash.

33 The Commission is aware of instances where consumers have financed numerous add-ons alongside a vehicle. In some cases, the add-ons, fees and interest charged under the loan have resulted in the overall amount payable by the consumer over the life of the loan being more than double the price of the vehicle.[29]

25. https://www.transport.govt.nz//assets/Uploads/Report/AnnualFleetStatistics.pdf, page 6.
26. Ibid, page 10.
27. https://www.stats.govt.nz/news/retail-spending-rises-in-first-quarter-of-2021
28. We understand that this includes both consumer and commercial retail spend.
29. Acknowledging that the likelihood of this is influenced by the price of the vehicle.

34 The following graph, based on a consumer's contract given to us as part of the review, gives an example of the cost of the add-ons, fees and interest relative to the price of the vehicle being financed:



35 The interest portion represents the total interest payable over the life of the loan, incurred on the cost of the vehicle, add-ons and fees (given that these are all component parts of the principal amount financed).

Lenders

36 The 15 lenders that participated in the review offered motor vehicle finance across New Zealand.[30]

37 Across the three years covered by the review these lenders collectively entered into consumer loan agreements for motor vehicle financing worth an average of $2.7b per year.[31] In FY20, these lenders offered interest rates between 0% and 29.95% per annum.

38 The majority of the lenders we spoke to have adopted a similar business model: consumers can either arrange finance directly with lenders or via intermediaries such as motor vehicle dealers.

39 In addition to providing finance, five of the 15 lenders we spoke to also offer repayment waivers. Across the three years covered by the review, four of these lenders sold an average of 39,448 repayment waivers annually, resulting in retail premiums averaging approximately $35m per year.[32] An average of 1,400 claims were approved annually, resulting in waived payments valued at approximately $4m per year.

30. A description of how the lender sample was determined is provided in our methodology.

31. This data is based on 14 out of 15 lenders (the remaining lender declined to provide this data). The majority of these lenders reported this figure inclusive of fees and interest, however two did not.

32. The remaining lender declined to provide this data.

Insurers

40 The review involved speaking to five add-on insurance providers.[33]

41 Across the three years covered by the review, these insurers collectively sold an average of 153,918 add-on insurance products annually,[34] resulting in *wholesale* premiums averaging approximately $82m per year.[35] This equated to *retail* premiums averaging an estimated $148m per year.[36] An average of 34,778 claims were approved annually, resulting in payments of $43m per year.

42 These insurers have all adopted a similar business model: add-on insurance is almost exclusively distributed through intermediaries such as motor vehicle dealers. One insurer has also implemented a direct sales model in addition to the intermediary model.

Dealers

43 Individuals or companies that are in the business of motor vehicle trading are required to be registered as a motor vehicle dealer on the Motor Vehicle Traders Register (administered and maintained by Trading Standards, a team within the Consumer Protection and Standards branch of MBIE).

44 A company or individual is considered to be in the business of motor vehicle trading if they:

44.1 hold out (advertise, state, notify or represent) that they are carrying on the business of motor vehicle trading;

44.2 sell, gift or swap more than six motor vehicles within 12 consecutive months; or

44.3 import more than three motor vehicles within 12 consecutive months.[37]

45 The registration process requires the applicant to provide basic contact information, any trading names and pay a registration fee.

46 Trading Standards advised the Commission that as at 31 March 2021, there were 437 individuals and 2,621 companies registered on the Motor Vehicle Traders Register. This represents a slight decrease from the previous year, where there were 503 individuals and 2,656 companies registered.

47 In the three years ending March 2020, dealers sold 94% of the MBI policies, 77% of the GAP insurance policies and 42% of the CCI/PPI policies issued by the insurers in the review.[38] On average, dealers also sold 38% of the repayment waivers provided by the lenders in the review.[39]

33. Some of these insurers also offer other insurance products, including CVI, which were not within the scope of the review.
34. Approximately 25% of the add-on insurance sales reported by the five insurers were financed by the lenders who participated in the review. However, as this data point was not provided by all lenders, the 25% is likely to be understated.
35. One of the five insurers was unable to provide this data for FY18. These figures therefore include actuals-based estimates for that insurer in that year.
36. As described at paragraph 61, sales commissions are added to the wholesale price, resulting in the retail price paid by the consumer. Further description of the method used to calculate the retail price estimate is provided in our methodology.
37. Motor Vehicle Sales Act 2003, section 8.
38. Data provided by insurers indicated that dealers and lenders were the sales channel for 42% and 47% of the CCI/PPI sales respectively.
39. Based on four out of five lenders. The remaining lender declined to provide this data.

Relationships between lenders, insurers and dealers

48 As add-ons are generally sold at the vehicle point of sale, insurers and lenders typically rely on intermediaries such as motor vehicle dealers and brokers as their sales force.[40] Consumers often only interact directly with dealers during the vehicle financing and add-ons sales process, and tend not to have any direct contact with the lenders or insurers who are the parties ultimately contracting with consumers.

49 Various relationships/arrangements exist between lenders, insurers and dealers:[41]

49.1 An **agency** relationship can exist under which lenders and insurers (as principals) each contract dealers to act on their behalf throughout the sales process for finance and add-ons, alongside the sale of the vehicle. These relationships are typically formalised in agency agreements. The agency model appears to be the most prevalent within the industry.

49.2 While acting as agents for insurers, dealers provide consumers with information about add-on insurance products and arrange for any add-on insurance contracts to be entered into. Dealers tend to have exclusive agency relationships with one insurer only.

49.3 While acting as agents for lenders, dealers commonly collect the information required for the consumer's finance application, provide consumers with information about repayment waivers (if applicable) and arrange for the finance contract to be entered into or repayment waiver to be purchased. Dealers will often have relationships with multiple lenders; lenders and dealers therefore generally agree to non-exclusive agency arrangements.

49.4 An **assignment** relationship can exist between dealers and lenders under which consumers enter into the credit contract with originators (ie, dealers), who are themselves the 'lender' until the agreement is assigned to the ultimate lender (usually within 24 hours or such other short time).

49.5 A **distribution** agreement can exist between lenders and insurers, under which lenders agree to offer a particular insurer's products to their borrowers (ie, consumers) either directly or through their dealer network. A distribution agreement between lenders and insurers may also involve 'white-labelling'. In these cases, the add-on insurance documentation carries the relevant lender's branding but is ultimately provided by the insurer (ie, the insurance contract is between the insurer and the consumer).

49.6 While the lender, insurer and dealer are typically unrelated entities, some **vertical integration** exists within the industry. In some instances, a parent company owns a related insurance company, finance company and dealership. Consumers purchasing from that dealership will often be referred exclusively to the affiliated finance company and sold insurance add-ons provided by the affiliated insurer.

50 Irrespective of the sales model adopted, lenders and insurers typically provide dealers with initial and periodic training on how to arrange finance and sell add-ons, and how to use any online portals as part of that process.

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40. This report primarily focuses on dealers given that they are the predominant sales channel.
41. The lender's legal obligations in terms of the sale of add-ons remain the same, irrespective of the various relationships/arrangements.

51 It is also common for lenders and insurers to routinely check in with their dealers and monitor their conduct. Common reasons given for discontinuing relationships with dealers included fraud or a breach of law, a breach of an agreement or ethics and poor quality of finance applications (eg, inaccurate information provided).

Dealer incentives

52 Consumers predominantly interact with dealers, rather than lenders or insurers, during the finance and add-ons sales process. In return for their work in facilitating finance and selling add-ons, dealers are compensated through fees and/or commissions.

Introducer fees

53 Dealers often receive what is commonly referred to as an 'introducer fee' for initiating and providing assistance with a consumer's finance application. Introducer fees are frequently charged to the consumer in addition to any establishment fees charged by the lender.[42]

54 The level of the introducer fee and the method of calculating it differs from lender to lender, but is typically either a fixed amount or calculated as a percentage of the loan (capped at a particular amount). Within the FY20 data provided by lenders, the highest introducer fee was $1,000 while the lowest was less than $5 and the average was $276.[43]

Interest commission

55 The majority of lenders also pay dealers an 'interest commission' (sometimes referred to as 'flex commission'), whereby the dealer adds a percentage to the base interest rate set by the lender for the particular consumer (which is based on the consumer's credit risk), and then is paid that uplift (or a portion of it).[44] This effectively means the dealer sets the interest rate that the consumer pays (within parameters set by the lender).

56 For example: A consumer is applying for finance with a lender through a car dealer. Based on the consumer's risk rating, the lender gives the consumer a base interest rate of 20%. The lender allows the dealer to add up to 6% to the base interest rate. The dealer decides to add 5% to the base interest rate, meaning that the overall interest rate paid by the consumer is 25%. The dealer is paid the additional 5% interest charged on the loan.

57 Most of the lenders that we spoke to that offer interest commission stated that there are system controls capping the maximum interest rate so that dealers cannot increase the interest rate for the consumer to a rate higher than the maximum permitted by the lender.

58 Interest commission is paid to the dealer in full upfront, incrementally over the life of the loan, or at an agreed percentage (less than 100%). If the consumer settles their loan early, the lender may require the dealer to repay a portion of the commission earned, except where the agreed percentage of less than 100% offsets the need for this.

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42. Based on our analysis of consumer credit contracts provided by lenders as part of the review.

43. The $276 is a weighted average based on information provided by eight out of 15 lenders. Either the total number of approved applications and/or the average introducer fee was not provided by the remaining seven lenders.

44. While the method of calculating the interest commission differs between lenders, a greater uplift essentially results in a greater amount of commission for the dealer.

59 Some lenders that we spoke to indicated that they have lost dealers to lenders offering a greater level of interest commission. One of the lenders that did not offer interest commission when we initially spoke to them has since confirmed that they have now adopted this model in order to be competitive in the market.

60 While the interest commission model is widely used among the lenders we spoke to, overseas regulators have taken steps to prohibit the practice:[45]

60.1 In Australia, ASIC banned this commission model from 2018 onwards after determining that consumers were charged greater interest rates than they would have ordinarily been charged, resulting in poor consumer outcomes.[46]

60.2 In the United Kingdom, the FCA banned the use of this commission model from 2021 onwards after finding that it created an incentive for dealers and brokers to charge a higher interest rate to consumers.[47]

Add-ons commission

61 Under the most common pricing model, insurers set the wholesale price of **add-on insurance** products and allow dealers (and other intermediaries) to place a mark-up on that wholesale price, resulting in the retail price.[48] The mark-up is retained by dealers as their commission.[49] Therefore, as well as ultimately setting the interest rate for the finance, in most cases dealers also have control over the price of any add-on insurance (despite the insurance contract being between the insurer and consumer).

62 Insurers typically allow dealers to place a mark-up of up to 100% on the wholesale price of add-on insurance. This means that the retail price paid by the consumer is often double the wholesale price set by the insurer.

63 While most insurers told us that they expect the level of commission earned by dealers for each add-on insurance product not to exceed 100% of the wholesale price, some insurers advised that there are no system controls to ensure this. Further, where it is not mandatory for dealers to record the retail price within the insurer's systems, the level of commissions charged by dealers will not be easily visible to insurers.

64 One insurer involved in the review has adopted an alternative model, choosing to set the retail price paid by the consumer across all products.[50] Under this model, the dealer is able to sell the add-on insurance for below the retail price set by the insurer, but not above it. The commission is calculated as the difference between the retail price and the dealer's wholesale rate, which differs between dealers.

65 Four of the five lenders that provide **repayment waivers** offer dealers a commission, being a fixed percentage/amount or a mark-up of up to 100% on the wholesale price, similar to the prevailing insurer model.

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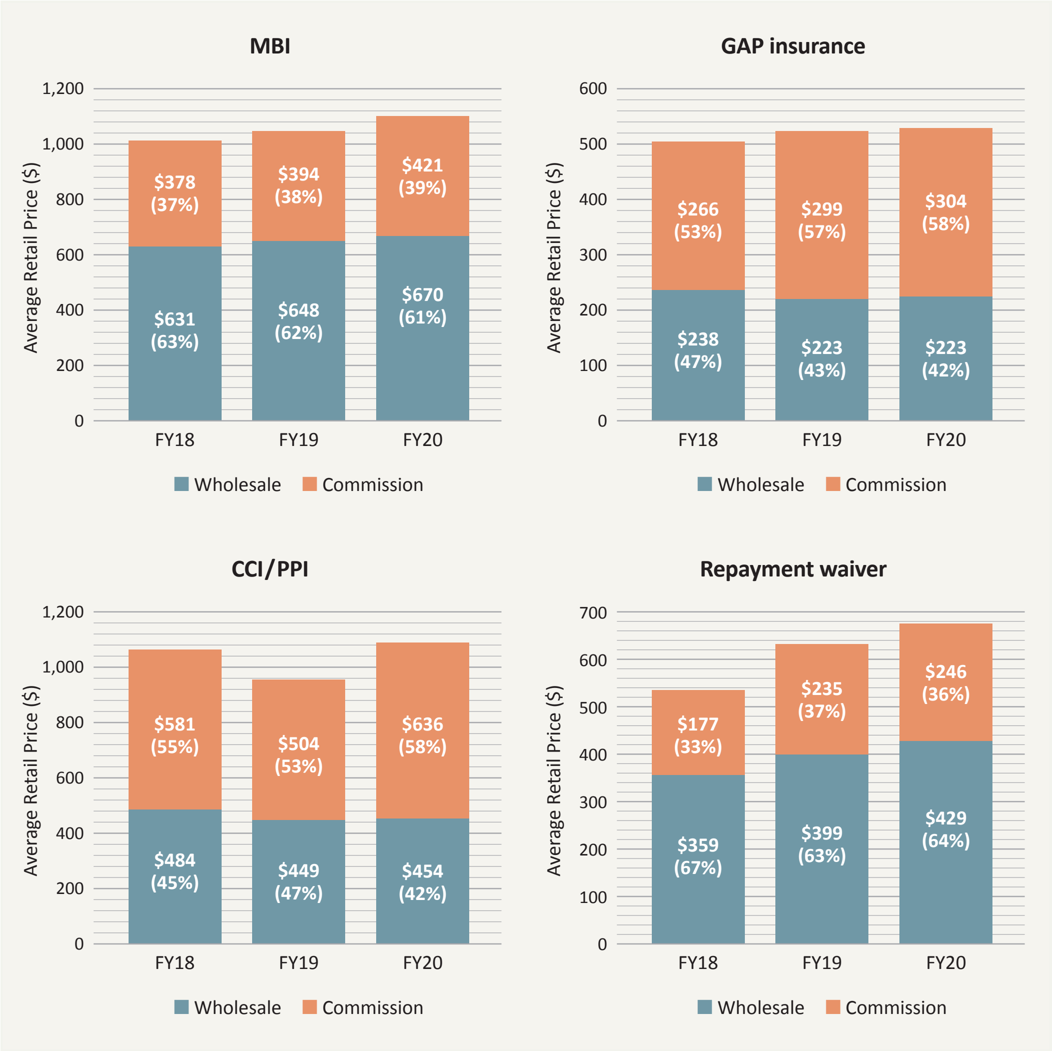
45. Noting that these overseas regulators have the necessary powers and functions to do so.
46. https://asic.gov.au/about-asic/news-centre/find-a-media-release/2017-releases/17-301mr-asic-bans-flex-commissions-in-car-finance-market/
47. https://www.fca.org.uk/news/press-releases/fca-ban-motor-finance-discretionary-commission-models
48. In the event that there is a distribution agreement between a lender and an insurer, the lender obtains the add-on directly from the insurer at the wholesale price, and the dealer is commonly paid a fixed commission.
49. Two out of the five insurers also offer intermediaries the ability to earn additional sales incentives, such as monetary gift cards.
50. Two other insurers have elected to set the retail price for specific products only.

66 As the amount paid by the consumer for an add-on will typically include commission set by the dealer, insurers and lenders are generally unable to advertise the retail price of add-ons (as this is not determined until the point of sale). As a result, consumers cannot easily compare the price of add-ons between providers.

67 The below graphs show the breakdown between the average wholesale premium (paid to insurers or collected by lenders) and the average commission (commonly set and retained by intermediaries),[51] which collectively form the average retail price (paid by consumers) for each product in each year:



68 Based on the data provided as part of the review, across the three years:

68.1 The average wholesale price for MBI and repayment waivers increased year on year, as did the average commission earned by intermediaries.[52]

68.2 The average wholesale price for GAP insurance and CCI/PPI decreased overall, however the average commission earned by intermediaries increased overall.

51. While this report commonly refers to dealers as the main intermediary channel, this analysis includes commissions paid to all intermediaries (including dealers).

52. The repayment waiver data is based on three out of five lenders. One lender did not offer commission on the sale of repayment waivers; the remaining lender did not provide the relevant data.

Overview of products

69 The review covered four add-on products that are available for consumers to purchase alongside a motor vehicle. MBI, GAP insurance and CCI/PPI are only offered by insurers, whereas repayment waivers are only offered by lenders. Five of the 15 lenders we spoke to offered repayment waivers, while all of the insurers offered the full suite of add-on insurance products.[53]

70 Over the three years of data collected and across all of the add-ons, consumers paid approximately $548m in retail premiums:

Product	Number of policies sold	Value of retail premiums
MBI	298,116	$312m
Repayment waivers	118,345	$106m
CCI/PPI	88,301	$91m
GAP insurance	75,339	$39m

Products offered by insurers

Mechanical Breakdown Insurance

71 MBI provides cover if a policyholder suffers an unforeseen mechanical or electrical fault with their vehicle, subject to certain exclusions. In the event of a successful claim, insurers will cover the cost incurred by a vehicle repairer, less any applicable excess. MBI policies commonly also offer additional benefits to consumers including repatriation costs if a vehicle breaks down a certain distance from the consumer's home, and roadside assistance.

72 MBI is the only add-on product in the review that provides insurance cover relating to the vehicle itself as opposed to the finance, and is the only product that can be purchased outright by a consumer paying cash for the vehicle.[54]

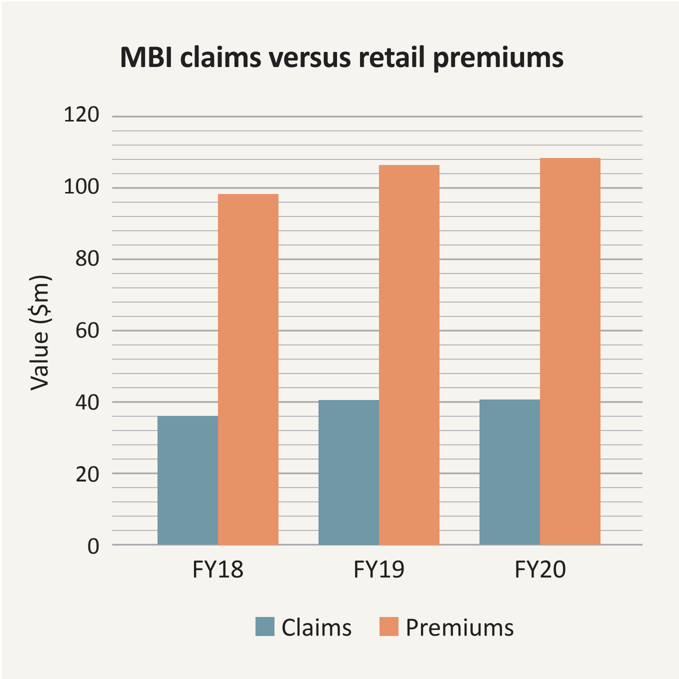
73 MBI cover is categorised by vehicle type (eg, standard, European) and is typically purchased in one, two or three-year cover periods, with three-year policies being the most common. One insurer in the review offered a six-month MBI policy, and another offered a four-year policy for consumers purchasing vehicles through a particular dealership.

74 All of the insurers we spoke to as part of the review provided consumers with a contractual cooling off period (of varying lengths) during which they could cancel the MBI policy and receive a refund of the premium (provided that certain conditions are met). Consumers wishing to cancel outside that period may not receive a pro-rata refund of the premium (insurers' policy documentation was generally silent on this point), however if the vehicle is sold, the consumer may be able to transfer the policy to the new owner (provided that certain conditions are met).

53. One insurer has since ceased offering its CCI/PPI product and has introduced Loan Protection Insurance (LPI) as an alternative product. LPI provides largely the same cover as CCI/PPI but claims are instead paid to the consumer, rather than a lender. Also, LPI can be purchased independently of a finance agreement.

54. GAP insurance, CCI/PPI and repayment waivers are necessarily purchased in connection with a credit contract.

75 The below graph shows the comparison between the amount paid by insurers in claims and the amount paid by consumers in retail premiums for MBI in each year:



76 From FY18 to FY20 there was a 1% increase in the number of MBI policies sold.

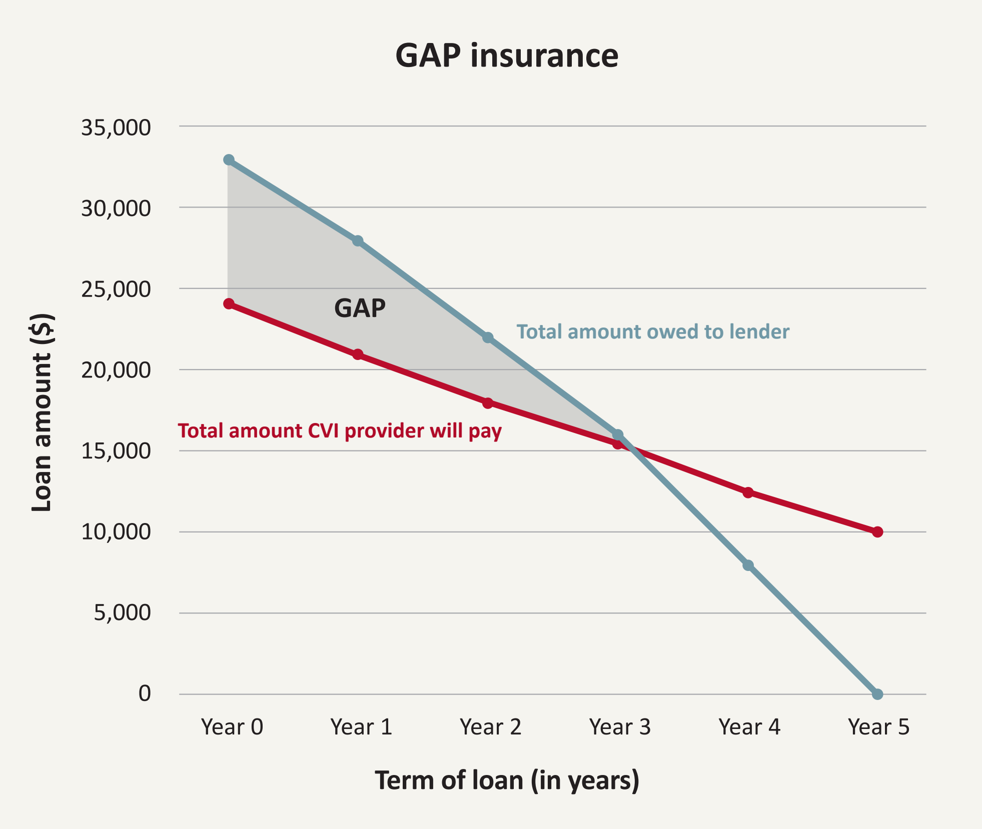
77 Premiums are paid by the consumer upfront, whereas claims can be made over the life of the policy. Our analysis includes premiums paid for all *new* policies taken out within the relevant period, and all claims paid on *existing* policies. Including the claims relating to premiums paid in prior periods off-sets the fact that any claims which are made beyond the data period are not included and avoids the need for future estimates or adjustments.[55]

Guaranteed Asset Protection insurance

78 GAP insurance is designed to protect consumers in the event that there is a total loss (ie, the vehicle is uneconomic to repair or is stolen) and there is a shortfall, or 'gap', between the amount owing on their credit contract and the amount paid out by their CVI provider (typically being the market value of the vehicle).

55. The same method is applied when calculating the claims/premium ratio for GAP insurance, CCI/PPI and repayment waivers. Further explanation of this approach is provided in our methodology.

79 The graphic below illustrates the principle of GAP insurance and demonstrates the 'gap' between the amount paid out by the CVI provider and the amount owing on a consumer's contract, which reduces over time:



80 In the event of a successful GAP insurance claim, once the CVI provider has paid the amount associated with the loss, the add-on insurer pays the remaining balance of the consumer's loan to the lender (less any arrears owing at the time of the vehicle's write-off).

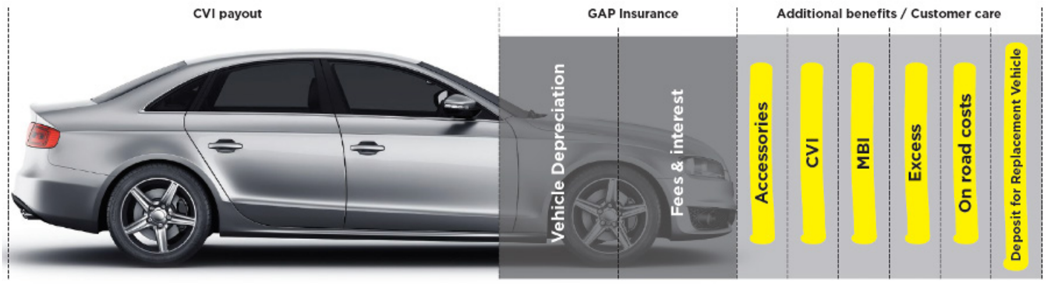
81 As a successful GAP insurance claim relies on the consumer having CVI, it is critical that consumers with GAP insurance ensure that they also maintain their CVI policy. While GAP insurance cover tends to last for more than a year, CVI policies are generally renewed annually (and GAP insurance and CVI policies will typically be provided by different insurers).

82 For the three year period covered by the review, only one insurer was able to provide details of declined GAP insurance claims.[56] This insurer advised that three out of the four times that a GAP insurance claim was declined, it was due to the consumer not having CVI (with the fourth claim declined due to the consumer's CVI provider declining the consumer's CVI claim).

83 All GAP insurance policies provide benefits additional to the 'gap' cover in the event of a claim, including payment of the excess on the consumer's CVI, money towards a replacement vehicle and MBI cover on that vehicle. The nature and value of those benefits differs from insurer to insurer.

56. Of the four remaining insurers, one reported that they did not decline any GAP insurance claims during the relevant period, while the other three did not capture information on declined claims in a reportable format.

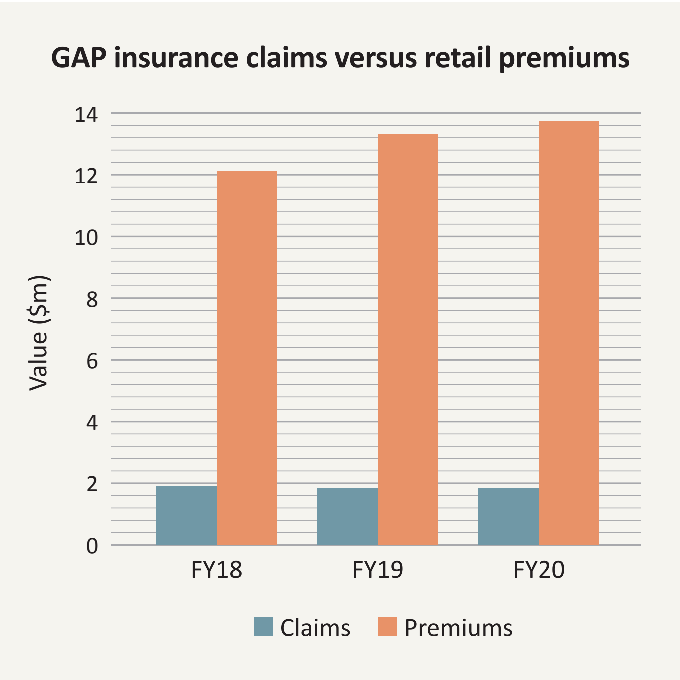
84 The graphic below illustrates the various components of GAP insurance cover that are available after the CVI pay-out, being the amount paid by the add-on insurer in response to an approved GAP insurance claim and possible additional benefits including those relating to the consumer's new vehicle:



Source: 'Product Summary' page from one of the insurers' websites.

85 Consumers will generally be entitled to receive a refund of the premium if they cancel their GAP insurance policy within the contractual cooling off period, and some insurers offer pro-rata refunds for cancellations outside of this period.

86 The below graph shows the comparison between the amount paid by insurers in claims and the amount paid by consumers in retail premiums for GAP insurance in each year:



87 From FY18 to FY20 there was a 9% increase in the number of GAP insurance policies sold. The total claims value decreased over the same period.

Credit Contract Indemnity insurance/Payment Protection Insurance

88 CCI/PPI provides cover for a consumer's loan repayments in the event the consumer is unable to make their repayments due to a range of insured events, including sickness, hospitalisation, accident, redundancy, bankruptcy and death.

89 The combination of insured events covered varies by policy type, and is generally based on income source, eg, salary/wage earner or self-employed. For example, salary/wage earner cover includes redundancy, whereas self-employed cover includes bankruptcy. There is typically also a cover category which captures anyone not in full time employment (eg, beneficiaries and retirees).

90 In some respects, this makes the task of choosing the cover simpler for consumers. However this also means that consumers must purchase all of the cover offered by the applicable policy type, rather than being able to choose insurance for specific events. For example, a consumer that wishes to only purchase cover for redundancy will necessarily have to purchase cover that includes a range of insured events, including redundancy.

91 In the event of a successful claim, the insurer covers the payment/s proportionate to the number of days the consumer is unable to work, less any arrears owing at the time of the claim. For example, if a consumer is unable to work for five days, CCI/PPI will cover five days' worth of their repayments. Stand down periods and cover limits apply to the duration and amount of payments, which vary depending on the insured event and insurer.

92 Policies are also subject to standard insurance exclusions, such as pre-existing conditions or events that the consumer ought reasonably to have known about at the time of taking out the policy. Across the three years of data provided by insurers, the most common reason that CCI/PPI claims were declined (equating to 57% of the declined claims) was that the event claimed for was a pre-existing condition.[57]

93 CCI/PPI is generally able to be cancelled for a refund of the premium if cancelled within the contractual cooling off period.[58] For cancellations outside the cooling off period, our review of the insurers' policy documentation found that:[59]

93.1 one insurer offers a pro-rata refund of the premium for cancellations outside of the cooling off period;

93.2 one insurer offers a pro-rata refund of the premium for cancellations outside of the cooling off period in limited circumstances; and

93.3 the remaining two insurers' policy documentation was silent as to whether a consumer could cancel outside of the cooling off period and receive a pro-rata refund of the premium.

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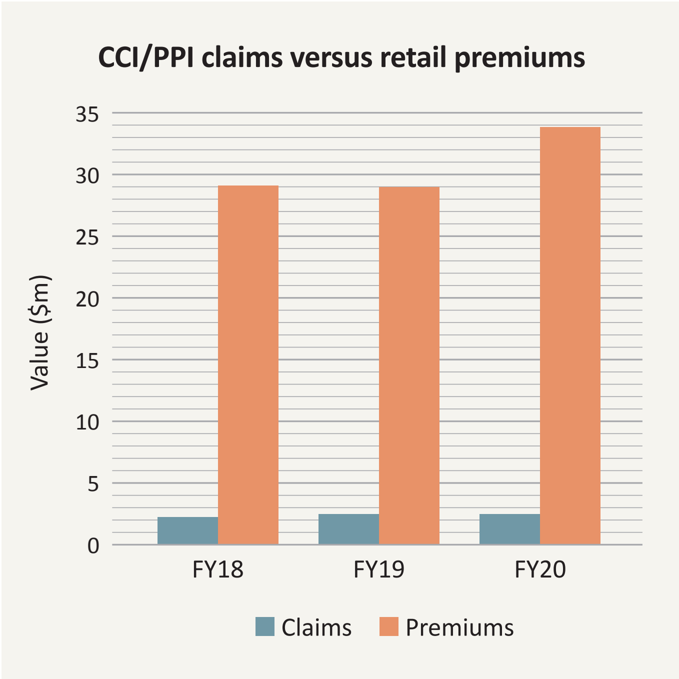
57. Based on data provided by two out of the five insurers; the remaining three insurers did not capture information on declined claims in a reportable format.
58. One insurer's policy documentation was silent as to the ability to cancel the policy within this period.
59. We reviewed the policy documentation available on each insurer's website as at July 2021. The one insurer that had ceased offering this product by this date was excluded from this documentation review.

94 The below graph shows the comparison between the amount paid by insurers in claims and the amount paid by consumers in retail premiums for CCI/PPI in each year:



95 From FY18 to FY20 there was a 14% increase in the number of CCI/PPI policies sold. The total claims value remained relatively flat year on year.

Products offered by lenders

Repayment waivers

96 Like with CCI/PPI, some repayment waivers provide for the consumer's loan repayments to be waived if the consumer suffers a covered event (eg, sickness or unemployment). In the event of a successful repayment waiver claim, the lender will waive a proportionate amount of the consumer's repayments based on the period of the claim, less any arrears owing at the time of the claim. For example, if a consumer is unable to work for five days, the repayment waiver will cover five days' worth of their repayments.

97 Some lenders also offer repayment waivers akin to GAP insurance, under which the lender will waive any shortfall between the amount due under the loan and the amount covered by the consumer's CVI policy in the event of a vehicle write-off.

98 Repayment waivers provide similar cover to CCI/PPI and GAP insurance, however:

98.1 they are provided by lenders and not insurers; and

98.2 they are not classed as a contract of insurance.[60]

60. Insurance (Prudential Supervision) Act 2010, section 7(3)(c).

99 Repayment waiver cover options differ between lenders:

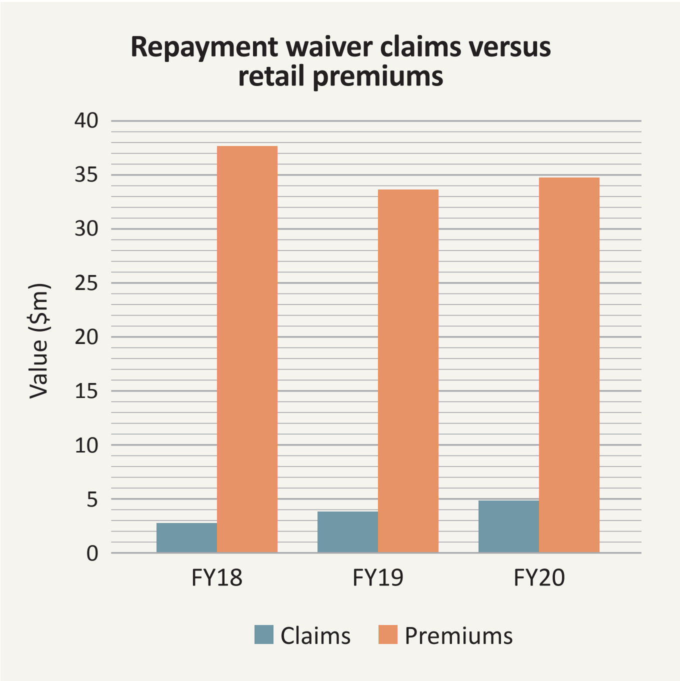
99.1 Some lenders split the cover by either income source (like with CCI/PPI) or by event (eg, redundancy).

99.2 Some lenders offer tiered levels of cover ranging from one event only (eg, death) to all or a mixture of the events for which the lender provides repayment waiver cover (eg, insurance shortfall, terminal illness, disablement, redundancy and death).

100 Similar exclusions to CCI/PPI apply for pre-existing conditions and events that ought reasonably to have been known about at the time the repayment waiver was purchased.

101 Three out of the five lenders offered consumers the contractual right to cancel their repayment waivers within a cooling off period. Some lenders also offered the ability for the consumer to obtain a pro-rata refund in the event that their consumer credit contract was repaid early.

102 The below graph shows the comparison between the amount waived by lenders in payments and the amount paid by consumers in retail premiums for repayment waivers in each year:



103 The number of repayment waivers sold fluctuated across FY18 to FY20, however the total claims value increased year on year.

Summary of comparable product attributes

Attribute	MBI	GAP insurance	CCI/PPI	Repayment waiver
Cover	Motor vehicle (repair costs in the event of mechanical or electrical faults)	Finance (balance owed to lender in the event of total loss)	Finance (repayments owed to lender)	Finance (repayments owed to lender)
Must be financed	No	Yes[61]	Yes[62]	Yes
Provided by	Insurers	Insurers	Insurers	Lenders
Commonly distributed by	Dealers	Dealers	Dealers and lenders	Dealers and lenders

Add-ons value proposition

104 Over the three years of collected data and across all add-ons, consumers received approximately $139m in claims:

Product	Number of claims made and approved	Value of approved claims
MBI	98,850	$116m
Repayment waivers	4,200	$11m
CCI/PPI	3,618	$7m
GAP insurance	1,867	$5m

105 The value consumers derive from add-ons is not only linked to the difference between what is paid in a premium and what is received under any paid claim though, as add-ons offer security and peace of mind for unforeseen events that could affect a consumer's vehicle or their ability to repay their loan.

61. With the exception of one insurer that has recently begun to offer this insurance payable in weekly instalments, outside of a credit contract.

62. Ibid.

106 However, based on our analysis of data provided as part of the review, there was a 1-15% probability of consumers claiming against and being paid out on their policy, as shown in the below table:[63]

	MBI	GAP insurance	CCI/PPI	Repayment waiver
Claims made as a percentage of active policies	22%	1%	3%	3%
Claims approved as a percentage of claims made	70%	89%	73%	64%
Probability of claiming and having that claim approved	15%	1%	2%	2%
Average claim pay-out	$1,246	$2,925	$1,824	$2,685
Average retail premium	$1,047	$518	$1,036	$897

107 We identified that although consumers were least likely to claim on their GAP insurance policy, GAP insurance claims had the highest approval rate and the highest average claim pay-out, as well as the lowest average retail premium.

108 Conversely, while consumers were most likely to claim on their MBI policy, these claims had the second lowest approval rate and the lowest average claim pay-out, despite having the highest average retail premium.

109 Unlike with GAP insurance, where claims are relatively easy for insurers to assess (ie, it is clear when a vehicle has been written off), whether or not an issue is covered by the MBI policy involves more of a case-by-case assessment. Based on information provided by insurers as part of the review, the three most common reasons for MBI claims to be declined were that:

109.1 the issue was not covered by the MBI policy;

109.2 the vehicle issue was pre-existing; and

109.3 the vehicle servicing requirements outlined in the policy were not met.

63. We have not compared these probability ratios against other products or jurisdictions as this was outside the scope of the review.

Legal definitions and responsibilities in respect of add-ons

Credit Contracts and Consumer Finance Act

Lender responsibility principles

110 Section 9C of the CCCFA sets out the lender responsibility principles.

111 Every lender must comply with these principles and cannot avoid their responsibilities by delegating them to another party.[64] The various industry models and contractual arrangements between the lender, insurer and/or dealer do not alter the lender's legal obligations under the CCCF Act. This means that while a lender can engage a dealer to act as their agent and perform some of the tasks required in order for the lender to meet their statutory obligations, the responsibility for complying with the law ultimately rests with the lender.[65]

112 The lender responsibility principles include an overarching requirement for lenders to ensure that they make reasonable inquiries to be satisfied that the consumer credit contract (as a whole) is likely to be suitable and affordable for the consumer, and that the consumer is treated reasonably.[66]

CCCF Act definitions

113 The lender responsibility principles also set out specific obligations relating to add-ons that meet the CCCF Act definitions of credit-related insurance or repayment waiver. The CCCF Act provides separate definitions for credit-related insurance and repayment waiver and sets out responsibilities for lenders in respect of each.

114 **Credit-related insurance** is defined under the CCCF Act as, in connection with a credit contract:

114.1 insurance over secured property (eg, MBI); or

114.2 insurance that provides cover for the shortfall that occurs if secured property or leased goods are totally or substantially destroyed and the insurance proceeds from another insurance contract are insufficient to pay any outstanding obligations of the borrower under the credit contract (eg, GAP insurance); or

114.3 consumer credit insurance, being insurance cover in the event of the insured's disability or death or the insured contracting a sickness, sustaining an injury, or becoming unemployed (eg, CCI/PPI).[67]

115 **Repayment waivers** are defined under the CCCF Act as agreements between a lender and a consumer under which the lender, for a fee, agrees to waive their right to any amount payable under the credit contract in the event of the unemployment of, sickness of, injury to, or the disability or death of the consumer.[68]

64. However, some lenders have adopted an assignment model whereby the dealer is themselves the 'lender' until the agreement is assigned to the ultimate lender (within 24 hours or such other short time). In this scenario, all relevant responsible lending obligations, including the obligations to inquire as to the suitability and affordability of the loan or add-ons, initially sit with the dealer, as they are the 'lender' at the time the inquiries are required to be made.

65. See p. 11 of the Responsible Lending Code for further commentary.

66. CCCF Act, section 9C.

67. Ibid, section 5.

68. Ibid.

Insurance related lender responsibilities

116 A **relevant insurance contract**[69] is defined under the CCCF Act as a **credit-related insurance contract**[70] entered into by a consumer if:

116.1 the consumer is also entering into a loan agreement with a lender; and

116.2 the insurance is arranged by the lender.

117 Under the CCCF Act, insurance will be 'arranged' by the lender in a range of circumstances, including where the insurance add-ons are financed under the agreement entered into by the consumer and the lender.[71]

118 The lender responsibility principles that apply to relevant insurance contracts include:

118.1 Section 9C(2)(a)(ii), which requires lenders to exercise the care, diligence and skill of a responsible lender:

118.1.1 in any advertisement for providing credit-related insurance under a relevant insurance contract;

118.1.2 before entering into an agreement to provide a relevant insurance contract; and

118.1.3 in all subsequent dealings with a borrower in relation to a relevant insurance contract.

118.2 Section 9C(5)(a), which requires lenders to make reasonable inquiries before the relevant insurance contract is entered into so as to be satisfied that it is likely that the insurance provided under the contract will meet the consumers' requirements and objectives, and that they will be able to make payments under the contract without suffering substantial hardship.

118.3 Section 9C(5)(b), which requires lenders to assist consumers to reach an informed decision as to whether or not to enter into the contract and to be reasonably aware of the full implications of entering into the contract, including by ensuring any advertising or information presented to consumers is not (or is not likely to be) misleading, deceptive or confusing to consumers.

Repayment waiver related lender responsibilities

119 If an agreement (ie, a loan) includes a repayment waiver as defined under the CCCF Act, the repayment waiver is to be treated as forming part of the agreement for the purposes of the lender responsibility principles.[72]

120 Therefore, if the agreement includes a repayment waiver, the lender responsibility principles that apply include:

120.1 Section 9C(3)(a), which requires lenders to make reasonable inquiries, before entering into the agreement, so as to be satisfied that the credit or finance provided under the agreement (which includes any repayment waiver) will meet the consumers' requirements and objectives, and that they will make the payments under the agreement without suffering substantial hardship.

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69. CCCF Act, section 9B.
70. Being CCI/PPI, and MBI and GAP insurance when the lender takes the vehicle as security under the contract.
71. CCCF Act, section 9B(2).
72. Ibid, section 9B(4).

120.2 Section 9C(3)(b), which requires lenders to assist consumers to reach an informed decision as to whether or not to enter into the agreement and to be reasonably aware of the full implications of entering into the agreement, including by ensuring any advertising or information presented to consumers is not (or is not likely to be) misleading, deceptive, or confusing to consumers, and that the terms of the agreement are expressed in plain language in a clear, concise and intelligible manner.

Other relevant CCCF Act provisions

121 There are a range of other CCCF Act obligations that apply to add-ons beyond the point of sale:

121.1 Section 50: a creditor must accept any full prepayment of a consumer credit contract from a debtor at any time.

121.2 Section 51: the amount required for full prepayment of a consumer credit contract must be less a proportionate rebate of a consumer credit insurance contract, repayment waiver or extended warranty (if applicable).

121.3 Section 52(1): in the case of a consumer credit insurance contract that is financed under the consumer credit contract, an amount to be deducted under section 51 is an amount equal to a proportionate rebate of the premium paid under the insurance contract.[73] However, under section 52(3) the amount is to be deducted under 52(1) only if the creditor has arranged the insurance.[74]

121.4 Section 52A: in the case of a repayment waiver, an amount to be deducted under section 51 is an amount equal to a proportionate rebate of the additional consideration paid for that waiver.

121.5 Section 53: a consumer credit insurance contract financed under a consumer credit contract is terminated on the full prepayment of the consumer credit contract unless the consumer credit insurance contract provides insurance cover in connection with one or more credit contracts or otherwise provides a benefit, or insurance cover for, the debtor.

121.6 Section 69: in connection with a consumer credit contract, a creditor must not impose any unreasonable requirement as to the terms on which the consumer is to take out or obtain credit-related insurance, a repayment waiver or an extended warranty. Under section 69(2) a requirement is unreasonable if it is not reasonably necessary for the protection of the legitimate interests of the creditor, or not reasonably justifiable in light of the risks undertaken by the parties to the arrangement.[75]

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73. The proportional rebate is only available for CCI/PPI policies, as MBI, GAP insurance and repayment waivers do not meet the definition of consumer credit insurance under section 5 of the CCCF Act.

74. Insurance is 'arranged by the creditor' where the creditor or a related company of the creditor is the insurer, acts as the agent in relation to the insurance, receives a commission in relation to the insurance, or requires the consumer to obtain insurance from a particular insurer (section 52(5) of the CCCF Act).

75. For example, it will likely be unreasonable for a lender to require a consumer to obtain CCI/PPI in the event that the consumer already has existing income protection insurance. This is because the risk the lender wishes to insure against is already likely to be sufficiently protected by the consumer's existing insurance.

121.7 Section 70: if a consumer credit contract involves credit-related insurance (and that insurance was 'arranged by the creditor' under the contract),[76] a repayment waiver, or an extended warranty (as defined under the CCCF Act), the creditor must ensure that every insured person is supplied with a copy of the terms of the credit-related insurance, repayment waiver, or extended warranty before the credit-related insurance, repayment waiver or extended warranty is arranged.[77]

December 2021 CCCF Act amendments and new regulations

122 From 1 December 2021 lenders will be subject to new regulations.[78] These will prescribe the types of inquiries that will need to be made to meet the statutory obligations under sections 9C(3) and 9C(5) of the CCCF Act to ensure that any add-ons are suitable for the consumer.[79] [80]

123 Lenders financing add-on products will be required to make inquiries about the consumer's requirements and objectives in purchasing the add-on, including asking:

123.1 whether they have existing cover, or if there are existing rights under the Consumer Guarantees Act 1993 (**CGA**) that may protect them against the risks they are seeking to cover;

123.2 whether their employment status, residency or age may make them ineligible to claim any of the benefits available under the add-on product; and

123.3 what benefits and cover they require.[81]

124 Under section 9CA of the CCCF Act, which also comes into force on 1 December 2021, lenders will be required to:

124.1 maintain records showing how they assessed the suitability of the add-on for the particular consumer in order to meet their obligations under sections 9C(3) and 9C(5);

124.2 retain copies and/or records of any inquiries made in relation to that assessment (including the results of those inquiries) for seven years; and

124.3 upon request, supply copies of these records to the Commission, the consumer or an approved dispute resolution service.

76. Insurance is 'arranged by the creditor' where the creditor or a related company of the creditor is the insurer, acts as the agent in relation to the insurance, receives a commission in relation to the insurance, or requires the consumer to obtain insurance from a particular insurer (section 70(3) of the CCCF Act).

77. CCCF Act, sections 70(1) and 70(2).

78. These amendments and regulations were initially intended to come into force on 1 October 2021.

79. Set out in the Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020.

80. The new regulations also prescribe additional requirements, including in relation to assessing affordability, and on directors and senior managers of lenders to exercise due diligence to ensure that the lender complies with its duties and obligations under the CCCF Act.

81. Credit Contracts and Consumer Finance (Lender Inquiries into Suitability and Affordability) Amendment Regulations 2020, regulation 4AB(2).

Fair Trading Act

False or misleading representations

125 The FT Act prohibits anyone in connection with the supply or possible supply of goods or services, or with the promotion by any means of the supply or use of any goods or services, from making several kinds of false or misleading representations, including concerning:

125.1 the need for any goods or services; or

125.2 the existence, exclusion, or effect of any condition, warranty, guarantee, right or remedy, including any guarantee, right or remedy available under the CGA.[82]

Extended warranties

126 In the majority of circumstances, MBI will be an extended warranty for the purposes of the FT Act.[83] This is defined as an agreement entered into between a consumer and a warrantor:[84]

126.1 in relation to a purchase by the consumer of goods or services;

126.2 entered into at, or at about, the same time as those goods or services are purchased;

126.3 whereby the warrantor provides specific warranties, guarantees, or undertakings (either directly or through a third person) in relation to those goods or services; and

126.4 for which a consumer pays a price that is separate from, or additional to, the price at which the goods or services are offered for sale.

127 The FT Act requires disclosure by the warrantor to the consumer of information such as the consumer's right to cancel the agreement. Disclosure must be provided at the time the consumer purchases the warranty.[85]

128 The CCCF Act includes a different definition of extended warranty. The CCCF Act defines an extended warranty as an agreement between a creditor and a consumer under which the creditor, for an additional consideration, agrees to repair or replace defective goods outside the warranty period that would otherwise apply.[86] Because MBI is provided by an insurer (rather than a lender), and the contract is entered into between the consumer and the insurer, the MBI policies we looked at as part of the review did not meet the definition of extended warranty for the purposes of the CCCF Act.

82. FT Act, section 13.

83. MBI will not meet the definition of an extended warranty under the FT Act if the policy is not obtained at the time of the vehicle purchase, eg, if it is purchased six months later (acknowledging that this is not likely to occur under the prevailing sales model).

84. FT Act, section 36T.

85. Ibid, section 36U.

86. CCCF Act, section 5.

Overlap between certain add-ons and existing statutory rights

Consumer Guarantees Act and MBI

129 The CGA provides some protections for consumers purchasing motor vehicles. Vehicles must be of acceptable quality and reasonably fit for any particular purpose that the consumer makes known at the time of purchase or the dealer indicates the vehicle is fit for. These guarantees apply for a period of time after the vehicle is purchased. The appropriate length of time will depend on the circumstances, including the type, age, kilometres and usage of the vehicle.

130 MBI, which will often be an extended warranty under the FT Act,[87] provides insurance against vehicle failures where similar remedies could also be available for breaches of the CGA. MBI policies are intended to cover mechanical and electrical breakdowns or faults with the vehicle, with cover generally commencing immediately after the vehicle is purchased.[88]

131 Therefore, there is likely to be a period of time where a consumer that purchases MBI will be covered by both the CGA and their MBI policy for any faults that arise with their vehicle.

132 To help consumers understand the cover provided under an extended warranty and the CGA, section 36U(2) of the FT Act requires the front page of an extended warranty agreement to clearly set out:

132.1 a summarised comparison of the relevant CGA guarantees and the protections provided by the extended warranty; and

132.2 a summary of the consumer's rights under the CGA and the right to cancel the extended warranty under section 36V.

133 MBI may provide some benefit over and above the CGA. Unlike the CGA, MBI has a defined cover period, making it easier for the consumer to know whether they may be covered for an issue.[89] Also, making an MBI claim could result in the mechanical fault being resolved faster and avoid the potential difficulty for consumers in pursuing their rights under the CGA. Enforcing their rights under the CGA can be challenging for consumers because:

133.1 it may be difficult to determine whether or not the issue is covered by the CGA;

133.2 the period during which the guarantees of acceptable quality and fitness for purpose apply is not defined by the CGA and can be open to debate; and

133.3 enforcement is only available if the consumer brings a claim (ie, the Commission cannot investigate or bring enforcement action on a consumer's behalf).

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87. MBI will not meet the definition of an extended warranty under the FT Act if the policy is not obtained at the time of the vehicle purchase, eg, if it is purchased six months later (acknowledging that this is not likely to occur under the prevailing sales model).

88. In some instances, the start of the cover will be deferred until the expiry of any manufacturer's warranty.

89. Typically one, two or three years.

134 That said, unnecessarily claiming on an MBI policy when a CGA remedy could be available might result in negative consumer outcomes, including:

134.1 eroding the consumer’s maximum sum insured;[90]

134.2 erasing their no-claims status (which may remove their ability to transfer the policy if the vehicle is sold);

134.3 requiring payment of any insurance excess; and

134.4 over time, potentially increasing the MBI premiums for consumers.

CCCF Act hardship provisions and CCI/PPI/repayment waivers

135 The CCCF Act contains the right for consumers to apply to lenders for hardship relief on the grounds of illness, injury, loss of employment, the end of a relationship or other reasonable cause.[91]

136 Hardship relief can be in the form of:

136.1 extending the term of the contract and reducing the amount of each payment due;

136.2 postponing, during a specified period, the dates on which the payments are due under the contract; or

136.3 extending the term of the contract and postponing, during a specific period, the dates on which the payments are due under the contract.[92]

137 The CCCF Act provides that if these changes are made, no consequential change is made to the annual interest rate or rates.

138 Events that could provide a basis for a consumer to apply for changes to be made to their contract due to hardship (eg, injury or redundancy) may also be covered by CCI/PPI and some repayment waivers. However, consumers can apply for hardship in wider circumstances than they could make a claim on their CCI/PPI and/or repayment waiver policy (given that the breakdown of a relationship or the loss of employment, as well as “any other reasonable cause” are provided as possible grounds for hardship).

139 That said, CCI/PPI and repayment waivers provide benefits over and above the CCCF Act hardship protections:

139.1 In many cases, being granted hardship relief will likely result in additional interest being payable over the life of the loan compared with the scenario if the change had not been made. By contrast, a successful CCI/PPI and/or repayment waiver claim has the effect of reducing the consumer’s debt. This is because payments continue to be made, in that they are either paid by an insurer or waived by a lender.

139.2 While there is a prescribed process that lenders must follow when considering a hardship application, lenders are not required to grant the relief requested (although they must comply with their responsible lending obligations in making the decision).

90. Typically either the purchase price or market value of the vehicle.

91. CCCF Act, section 55(1).

92. Ibid, section 56.

The motor vehicle financing and add-ons experience

140 This section summarises the motor vehicle financing and add-ons process for a typical consumer purchasing a vehicle and an add-on through a dealer.

Initial contact with the dealer or lender

141 The process commonly begins with the consumer contacting either the dealer or the lender, with some consumers shopping around in order to find the vehicle they are interested in purchasing before arranging finance, and others obtaining pre-approval from lenders and then deciding on the vehicle they can afford based on their approval limit.

Finance discussion

142 Once a consumer has chosen a vehicle, the dealer[93] and consumer may discuss the option of the consumer purchasing the vehicle on finance.[94] While we heard anecdotally that dealers may be encouraging consumers to purchase their vehicle on finance instead of with cash (eg, by offering to reduce the purchase price of the vehicle if it is purchased on finance) consumers we spoke to did not report experiencing this.

143 Once the consumer has chosen to purchase the vehicle on finance, the dealer will collect the necessary information to support the consumer's finance application (eg, bank statements and proof of income/expenses). Lenders commonly rely on dealers to gather this information to help assess the affordability and suitability of the finance and meet their responsible lending obligations.[95]

Add-ons discussion (including suitability assessment)

144 The dealer and consumer will then typically discuss the availability of add-on insurance and/or repayment waivers to go with the vehicle finance.[96] Some of the consumers we spoke to advised that they initiated the add-ons discussion, having purchased these products in the past.

145 As described above, lenders have an obligation under the CCCF Act to assist the consumer to reach an informed decision as to whether or not to purchase the add-on, and to be reasonably aware of the full implications of entering into the contract. Lenders must also be satisfied that the product is likely to meet the consumer's requirements and objectives.

146 The sections of the CCCF Act that require lenders to comply with these responsibilities vary depending on whether the product is a relevant insurance contract or a repayment waiver.[97]

147 Through the review we identified that some lenders actively take steps to assess whether the add-on is likely to be suitable for the consumer themselves (eg, by assessing whether the consumer's employment status renders them unable to benefit from the add-on), while others delegate this responsibility to dealers.

93. Or dedicated finance and insurance representative employed by the dealership.
94. Consumers that have been pre-approved for finance will likely not require this discussion, or any further work by the dealer in arranging the finance.
95. CCCF Act, sections 9C(3)(a) and (b).
96. Consumers that purchase a vehicle with cash would only be offered MBI by dealers.
97. Described at paragraph 113 onwards.

Finance application process (including affordability assessment)

148 If the consumer decides to purchase an add-on, the dealer will include its cost within the consumer's finance application and send the application and supporting information to one of the lenders they are affiliated with.

149 Lenders generally perform the affordability assessments themselves using information collected and provided to them by dealers.

150 Many of the lenders we spoke to use some form of automation to assess affordability. However, it is common for there to be a manual review of applications that are outside of the lender's normal lending criteria. Data provided by lenders indicated that in FY20, the average approval time for a loan was 2 hours.[98]

151 When assessing whether to approve the consumer's finance, the lender will commonly categorise the consumer based on their creditworthiness. Almost all of the lenders we spoke to had adopted some method of differentiating between categories of consumers (commonly referred to as 'tiers'). Tier one consumers tend to be those most likely to be able to repay their loan, whereas tier three consumers represent a greater risk.

152 The affordability assessment carried out by the lender takes into account the price of the vehicle and the price of any add-ons. Some lenders have implemented loan to value ratios that consider the price of the add-ons relative to the price of the vehicle – for example one lender said that it will not finance add-ons worth more than 30% of the vehicle's value. Other lenders take the add-ons into account as part of the finance and ensure that the finance as a whole is affordable.

153 Based on their assessment, lenders will either:

153.1 approve the application outright;

153.2 approve the application with conditions, for example, that a co-borrower (ie, a second person to take on the responsibility of the loan) is required; or

153.3 decline the application.

154 In FY20, there was an average loan approval rate of 45% across our sample of lenders.[99] The most common reasons given by the lenders we spoke to for declining a loan application included that the consumer had a poor credit rating, poor repayment history with the lender or there were affordability concerns.

155 If the consumer's application is approved, the lender will commonly take security over the vehicle being financed and require the consumer to purchase CVI to protect the vehicle. Some lenders may also require a disabling device to be installed.[100]

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98. Weighted average based on eight out of 15 lenders. Either the total number of approved applications and/or the average approval time was not provided by the remaining seven lenders.

99. Based on 11 out of 15 lenders. The remaining four lenders did not provide the number of applications received and/or approved.

100. A disabling device is a device attached to consumer goods, the functions of which, when activated, include to prevent the consumer from using the car, limit the consumer's use of the car, enable the lender to locate the car, or achieve any other similar outcome that is of direct or indirect benefit to the lender in relation to the relevant credit contract (CCCF Act, section 83L(3)). Section 83L of the CCCF Act sets out the rules that govern a lender's use of these devices.

156 While the majority of lenders we spoke to stated that no form of add-on insurance or repayment waiver would ever be compulsory in order for the finance to be approved, a small number of lenders indicated that an add-on might be required in some circumstances, eg, if the applicant or vehicle sits outside of their normal lending profile.

157 During the application process, the consumer is commonly provided with a quote setting out how much the finance (including add-ons) will cost, any relevant fees, the stated interest rate and the timing and amount of loan repayments required.

Finalising the vehicle purchase

158 The lender will then inform the dealer of the lending decision. If the loan application is approved, prior to the consumer signing the agreement, they must be provided with a copy of the agreement (including any relevant repayment waiver terms) in accordance with the lender's initial disclosure obligations.[101]

159 The dealer will also facilitate the purchase of any add-on insurance through the use of the insurer's online portal. The consumer will receive an insurance certificate and related policy documentation containing key information, such as a description of the cover provided, any exclusions or cover limits, and details of any special benefits.

160 In order to pay for the various elements of the transaction, typically:

160.1 the lender advances the value of the vehicle and the retail price of the add-on insurance to the dealer, plus any fees and/or interest commission that the dealer has earned for arranging the finance and, if applicable, any repayment waiver sales commission; and

160.2 the dealer then pays the insurer the wholesale price of the add-on insurance premium, retaining the difference between this and the retail price as their commission for selling the add-on insurance.

Post-vehicle purchase

161 Under the CCCF Act, a statutory cooling off period applies during which the consumer can cancel the consumer credit contract.[102] Separately, some lenders and insurers provide consumers with a contractual cooling off period for add-ons.[103] Providing a cooling off period ensures that consumers can change their mind after the purchase.

162 Assuming they are not cancelled by the consumer, any monetary benefits of the add-ons purchased will potentially be realised by the consumer in the event of an issue with either the vehicle or their ability to meet their loan repayments.

162.1 If the consumer has MBI and has an issue with their vehicle following the purchase, they will commonly approach the dealer in the first instance. They may then make an MBI claim (to the relevant insurer) or pursue their rights under the CGA.

101. CCCF Act, section 17.

102. Ibid, section 27.

103. There is no statutory requirement for lenders (or insurers) to provide a cooling off period for add-ons under the CCCF Act.

162.2 If the consumer has GAP insurance and suffers a total loss on their vehicle, they will first need to lodge a claim with their CVI provider. They may then make a GAP insurance claim (to the relevant insurer) if their CVI claim is approved.

162.3 If the consumer has CCI/PPI and suffers an issue with their ability to meet their loan repayments, they will commonly contact the lender or insurer directly. They may then make a claim on their CCI/PPI policy.

162.4 If the consumer has a repayment waiver and suffers an issue with their ability to meet their loan repayments, or a total loss on their vehicle, they will commonly contact the lender directly. They may then make a claim on their repayment waiver.

163 In order to make an add-on claim, consumers will typically need to fill out a claim form and likely provide additional paperwork (eg, medical certificates or letters evidencing redundancy) in support of the claim.

Key observations

Consumer experiences

164 Statements from consumers obtained at interviews during the review suggested some industry participants may be falling short of their obligations under the CCCF Act (in the case of lenders) or the FT Act (in the case of dealers).

165 As part of the review, we spoke to consumers that had either recently purchased or made a claim on an add-on in the period from 1 August to 31 October 2020.[104]

166 Of the 96 consumers we spoke to, 62 had purchased an add-on that fell within the definition of credit-related insurance or repayment waiver under the CCCF Act, meaning lenders had responsible lending obligations in respect of the sale of those add-ons.[105]

167 The majority of the consumers that we spoke to did not tell us anything that raised concerns about their experience when buying or claiming on an add-on. However, some consumers' recollections suggested there may have been non-compliance with the CCCF or FT Acts.

168 Responses given by consumers to inquiries made by dealers and/or lenders may be influenced either by their desire to secure the vehicle and their need for finance, or limited engagement with the financing and add-ons sales process. Some of the consumers we spoke to also appeared to be willing to accept a relatively low level of understanding of the add-on or its suitability, and some expressed the view that dealers were acting in their best interests.

169 We did not investigate the information provided by consumers, nor put their recollections to lenders or dealers for their comment. However, we discuss some of the information they provided in more detail below. This information will inform the further compliance and advocacy work that the Commission intends to undertake.

Obligation to assist consumers to reach an informed decision

170 **Thirteen** consumers recalled not fully understanding the product before purchasing and attributed this to a lack of information or explanation provided by the dealer (acting as agent of the lender).[106]

170.1 Two of these 13 consumers also reported either only realising that they had purchased the add-on after the contract was entered into, or that they could not recall that they had purchased an add-on at the time of speaking to us.[107]

170.2 Six of these 13 consumers also reported that they believed that it was compulsory to purchase the add-on.[108]

104. We compelled this information from insurers and lenders by way of Statutory Notices issued under sections 98(1)(a) and (b) of the Commerce Act 1986 via section 113(c) of the CCCF Act.

105. Thirty-four consumers purchased add-ons that did not meet the relevant definitions under the CCCF Act (eg, where the consumer paid cash rather than financing the add-on under a consumer credit contract).

106. A further four consumers reported not fully understanding the product before purchasing, however the add-ons purchased by these consumers did not meet the relevant definition under the CCCF Act.

107. These consumers are therefore also included in the count of eight consumers referenced at paragraph 171.

108. These consumers are therefore also included in the count of 14 consumers referenced at paragraph 180.

171 **Eight** consumers either only realised that they had purchased the add-on after the contract was entered into or could not recall that they had purchased an add-on at the time of speaking to us.[109] Of these eight consumers, some:

171.1 were made aware, or were reminded, of their purchase due to our phone call;

171.2 advised that they had been made aware of their add-on purchase as a consequence of suffering an event that may be covered (eg, upon writing off their car, the consumer's CVI provider advised them to check whether they had any other kind of insurance); or

171.3 remained convinced they had not purchased an add-on, despite being informed that the relevant lender or insurer had provided us with evidence of their purchase.

172 The 21 consumers discussed above purchased add-ons that met the definition of either a relevant insurance contract or a repayment waiver under the CCCF Act.[110] Therefore, in accordance with the lender responsibility principles, lenders were under an obligation to assist these consumers to:

172.1 reach an informed decision as to whether or not to enter into the contract; and

172.2 be reasonably aware of the full implications of entering into the contract.[111]

173 Assuming that the consumers' recollections were accurate, if a consumer did not fully understand the add-on before purchasing it or was unaware that they had purchased the product at the time of the sale, the lender may not have complied with its duty to assist the consumer to make an informed decision, or have ensured that the consumer was aware of the implications of entering into the agreement.

Obligation to make reasonable inquiries as to suitability

174 **One** consumer we spoke with had purchased a policy for the specific purpose of providing cover for a pre-existing chronic illness. When the consumer made a claim in respect of this illness, it was declined on the grounds that pre-existing conditions were not covered by the policy.

175 The add-on purchased by this consumer met the definition of a repayment waiver under the CCCF Act. The lender was therefore under an obligation to make reasonable inquiries before entering into the agreement so as to be satisfied that it was likely that the finance (including the repayment waiver) would meet the consumer's requirements and objectives.[112]

176 If the consumer's circumstances at the time the add-on was sold meant that they would be ineligible for the cover that they purchased the add-on for, the lender may not have sufficiently inquired about what cover the consumer was seeking. In that case, the lender may have failed to comply with its duty to make reasonable inquiries so as to be satisfied that the repayment waiver would meet the consumer's requirements and objectives.

109. A further five consumers reported that they could not recall that they had purchased an add-on at the time of speaking with us, however the add-ons purchased by these consumers did not meet the relevant definition under the CCCF Act.

110. Being the 13 consumers included in the count at paragraph 170 and the eight consumers included in the count at paragraph 171.

111. CCCF Act, section 9C(3)(b) in relation to repayment waivers and section 9C(5)(b) in relation to relevant insurance contracts.

112. CCCF Act, section 9C(3)(a)(i) in relation to repayment waivers and section 9C(5)(a)(i) in relation to relevant insurance contracts.

177 We intend to meet with and inform the lenders that financed the add-ons discussed at paragraphs 170, 171 and 174 of the issues raised, and engage with them to ensure they are aware of their obligations to:

177.1 assist the consumer to reach an informed decision about purchasing the add-on; and

177.2 ensure that the add-on will meet the consumer's requirements and objectives.

178 We also consider that the December 2021 CCCF Act amendments, including the new regulations, will heighten expectations relating to lender compliance in this area. The new regulations will prescribe the types of inquiries lenders must make and require that records of these inquiries be kept. As well as the targeted lender engagement described above, we intend to meet with all of the lenders that participated in the review to help ensure that they understand their obligations and the measures required to comply with them.

179 As part of our wider compliance and enforcement strategy, in addition to these initiatives we will continue to assess compliance within the industry, including in relation to the new requirements for add-ons, and take enforcement action where appropriate.

Representations concerning the need for add-ons

180 **Fourteen** of the consumers that we spoke to advised us that they had understood from their interactions with the dealer that they needed to purchase an add-on in order for their finance to be approved.

181 The majority of lenders we spoke with advised that they would not require a consumer to purchase an add-on in order for their finance to be approved. The two lenders that did indicate that add-ons could be made mandatory advised that this would only be in limited circumstances (such as when the consumer represents a higher risk to the lender).

182 Dealers must ensure that they do not breach the FT Act when selling add-ons, for example, by making false or misleading representations.[113] Given that we were told by lenders that add-ons are rarely mandatory, if dealers have in fact told consumers that they are mandatory in circumstances where they are not, these statements may have been misleading.

183 In response to the above, we intend to take an educative approach and remind dealers of their FT Act obligations in relation to any representations made about add-ons during the sales process.

184 We will also highlight to lenders that their audit and assurance processes should address the risk of consumers being misled about whether or not add-ons are mandatory.

113. FT Act, sections 10, 11 and 13.

Industry participants

185 We also identified the potential for non-compliance and negative consumer outcomes in the way that add-ons are sold and by virtue of the relationships between the relevant industry participants.

Lenders and dealers

186 Lenders must meet the requirements of the CCCF Act by ensuring that the finance and add-ons are likely to be both affordable and suitable, and that consumers have been assisted to reach informed decisions.

187 However, under the prevailing model, dealers (as agents of lenders):

187.1 tend to be the only party dealing directly with consumers during the financing and add-ons sales process;[114]

187.2 are commonly involved in assessing add-on suitability and/or assisting consumers to make informed decisions about acquiring finance and add-ons;

187.3 usually earn fees and/or interest commission for arranging finance (by contrast, both ASIC and the FCA have banned the industry use of interest commission in their respective countries due to poor consumer outcomes); and

187.4 usually earn a commission for selling add-ons.

188 As noted by the FMA and Reserve Bank of New Zealand in their 2019 'Life Insurer Conduct and Culture' report,[115] incentive structures can create the risk of intermediaries prioritising sales over the consumer's best interests.

189 In the context of motor vehicle finance and add-ons, the ability for dealers to earn a sales commission may mean that they prioritise selling add-ons over adequately assessing suitability for the consumer or assisting them to make an informed decision.[116] Further, the dealer's selection of lender could potentially be influenced by the level of fees and/or commission earned for referring a consumer's finance application.[117]

190 While agency arrangements are commonplace in many sectors, in these circumstances, lenders must be vigilant to ensure that dealers comply with the legal obligations owed by their principals.

114. However, as noted at paragraph 47, data obtained as part of the review indicated that lenders are less reliant on intermediaries for the sale of CCI/PPI and repayment waivers.

115. https://www.fma.govt.nz/assets/Reports/Life-Insurer-Conduct-and-Culture-2019.pdf

116. Dealers may be further incentivised to sell MBI as it could provide an alternative avenue for the consumer to pursue in the event there is an issue with the vehicle post purchase.

117. Similarly, the dealer's selection of insurer could potentially be influenced by the level of commission earned for selling an add-on insurance product.

191 Lenders, in exercising the care, diligence and skill of a responsible lender, must:

191.1 Understand their legal obligations. Some of the lenders we spoke with did not appear to recognise that, in the event of compliance tasks being delegated to an agent, the responsible lending obligations remained with the lender. The Responsible Lending Code provides:

> Lenders may meet the lender responsibility principles through agents or other persons, but the lender remains responsible for ensuring that these obligations are met…
>
> Any... contractual arrangement [between dealers and lenders] does not affect the obligations or liabilities of those lenders under the [CCCF] Act.[118]

191.2 Provide clear instructions to dealers about how to carry out any delegated tasks. Some of the lenders we spoke with did not appear to provide any guidance to their intermediaries about how to conduct suitability assessments.

191.3 Implement sufficient audit and assurance processes to ensure that any delegated tasks are being carried out appropriately, with consequences for compliance failures.

191.4 Ensure that the maintenance of their sales channels and agency relationships, including incentive arrangements, do not take priority over, or adversely affect, compliance.

192 We intend to engage with the lenders that took part in this review about the importance of these measures to safeguarding compliance where responsibilities are delegated to a third party. Our engagement will also extend to raising awareness among the wider industry, including those that did not take part in the review.

193 Our industry engagement and advocacy work will also include providing information about the December 2021 CCCF Act amendments requiring directors and senior managers of lenders to exercise due diligence to ensure that the lender complies with its duties and obligations under the CCCF Act.

194 In light of the recent and ongoing amendments to the Financial Markets Conduct Act (in respect of the new financial advice regime and proposed new conduct of financial institutions regime) we also intend to engage with both MBIE and the FMA to share our observations about the involvement of intermediaries in the sale of add-ons.

Insurers

195 Insurers must meet the requirements of the FT Act by ensuring that their MBI policy documentation complies with the extended warranty disclosure requirements.

196 Our desktop review of insurer’s policy certificates and documentation indicated some insurers may not be fully compliant with the extended warranty disclosure requirements under the FT Act.

197 We intend to engage with insurers to ensure they fully understand their obligations with the extended warranty provisions of the FT Act.

118. Responsible Lending Code, commentary at p. 11.

Conclusion

198 This review has improved the Commission's understanding of the motor vehicle financing and add-ons industry. We have published this report to share our observations with the wider industry.

199 We consider that for this industry to work well, lenders, dealers and insurers must understand their CCCF Act and FT Act obligations and have sufficient processes in place to ensure compliance.

200 Our increased understanding of the add-ons offered, the roles and legal responsibilities of industry participants and where there is the potential for consumer harm will inform the focus of the Commission's future compliance and enforcement work. This will include advocacy work and continued assessment of compliance in the industry with the CCCF and FT Acts, including taking enforcement action where appropriate.

Attachment: Methodology

Products in scope

1 Our analysis focused on the following products commonly sold in connection with motor vehicle financing:

1.1 Mechanical Breakdown Insurance (**MBI**);

1.2 Guaranteed Asset Protection (**GAP**) insurance;

1.3 Credit Contract Indemnity insurance (**CCI**)/Payment Protection Insurance (**PPI**); and

1.4 repayment waivers.

Industry identification

Insurers

2 Through open-source research and discussions with industry, we identified insurers who offered one or more of the relevant products.[119] The following insurers agreed to provide information to the Commission on a voluntary basis:

2.1 DPL Insurance Limited t/a Autosure;

2.2 Janssen Insurance Limited (underwritten by Quest Insurance Group Limited);

2.3 Protecta Insurance New Zealand Limited (underwritten by Virginia Surety Company);

2.4 Provident Insurance Corporation Limited; and

2.5 Quest Insurance Group Limited.

Lenders

3 Given the high number of lenders registered on Financial Service Providers Register, we elected to focus on those responsible for issuing the highest volume of motor vehicle loans. To identify these lenders, we obtained information from the Companies Office about the number of securities registered on the Personal Property Securities Register (**PPSR**) over four sample months, being March, July, November and December 2020.

4 Based on the PPSR data, we identified those lenders that had registered a total of 1,000 or more securities during the sample period, resulting in identification of 43 lenders.

5 From this list, we excluded:

5.1 banks (due to the Commission's concurrent review of how banks were complying with their responsible lending obligation to assess suitability and affordability of loans and consumer credit insurance);

5.2 service providers that register securities on behalf of other entities (eg, Equifax New Zealand, TradeMe – Motorweb and Creditworks Data Solutions Limited);[120] and

5.3 commercial lenders (as the CCCF Act does not extend to commercial lending).

119. Two of the insurers involved in the review sell products that are ultimately underwritten by another party. In these instances, the insurance contract is between the consumer and the underwriter, even though the insurance carries the insurer's branding.

120. These service providers confirmed that the materiality threshold (of 1,000 or more securities registered) was not met for any of the individual entities for which they provided this service within the sample period.

6 The resulting list included a number of financial service providers linked to a particular vehicle brand. Rather than having these brand-affiliated lenders over-represented in our sample, we included only the first two brand-affiliated lenders that met the materiality threshold (of 1,000 or more securities registered).

7 This led to the identification of 15 lenders offering motor vehicle finance, five of whom (identified with an *) also offered repayment waivers:

7.1 Auto Finance Direct Limited*;
7.2 Avanti Finance Limited;
7.3 BMW Financial Services New Zealand Limited;
7.4 Community Financial Services Limited;
7.5 European Financial Services Limited;
7.6 Finance Now Limited;
7.7 Geneva Finance Limited;
7.8 Go Car Finance Limited*;
7.9 Instant Finance Limited;
7.10 MARAC, a division of Heartland Bank Limited;
7.11 Motor Trade Finance Limited*;
7.12 Oxford Finance Limited*;
7.13 Thorn Group Financial Services Limited*;
7.14 Toyota Financial Services Limited; and
7.15 UDC Finance Limited.

Dealers

8 Throughout the course of the review we met informally with a small number of motor vehicle dealers to understand their perspective of the industry.

Other parties

9 We also spoke to a number of industry participants and/or stakeholders, to gather industry insights and to inform the scope of the information requests which were ultimately issued to the participating insurers and lenders. These parties included:

9.1 Australian Securities and Investments Commission;
9.2 CARE Waitakere Trust;
9.3 Christians Against Poverty New Zealand;
9.4 Family Finances Service Trust – Upper Hutt;
9.5 Financial Markets Authority;
9.6 Financial Services Complaints Limited;
9.7 Financial Services Federation;
9.8 Ministry of Business, Innovation and Employment;
9.9 Motor Trade Association;
9.10 Motor Vehicle Disputes Tribunal;
9.11 North Harbour Budgeting Services;
9.12 Tamaki Budgeting;
9.13 The Salvation Army; and
9.14 Training and Budget Services Incorporated.

Information gathering

10 After interviewing each of the identified insurers and lenders (referred to at paragraphs two and seven above), we issued voluntary information requests.

11 The information requests sought quantitative and qualitative data, covering the 2018-20 financial years, across the following areas:

11.1 sales and revenue models (including process and pricing data);

11.2 volume and value of products sold and/or contracts entered into;

11.3 product terms; and

11.4 claims data.

12 We also issued Statutory Notices to the five insurers, and the five lenders offering repayment waivers, seeking contact information for consumers who had either purchased and/or made a claim on one (or more) of the relevant products during August and October 2020.[121]

13 This resulted in the provision of contact information for 219 consumers, of whom we were able to speak to 96. This was consistent with our expectation that a number of consumers for whom we sought contact information might not wish to discuss their experiences with us.

Data analysis

Qualitative data

14 We reviewed:

14.1 trader websites;

14.2 sales, marketing and training materials;

14.3 policy documentation (including terms and conditions); and

14.4 proforma and actual (redacted) consumer credit contracts.

Quantitative data

15 We analysed the data provided by lenders and insurers in response to our voluntary information requests. The results of that analysis are reported based on aggregate or average amounts across the relevant data set (ie, insurer and lender respectively). In the event that data was either incomplete and/or incomparable within the relevant data set, it has been excluded from our analysis (as specified within the report).[122]

16 Within their response, insurers provided *wholesale* premium data for the period covered by the review, but the majority were unable to provide *retail* premium data over the same period as this was not routinely/consistently collected by all insurers and/or recorded by dealers. The average and total retail premiums estimated within the report were therefore calculated by reference to the available information, specifically:

16.1 wholesale premium and commissions data (provided by insurers); and

16.2 retail premium data (provided by lenders).

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121. Statutory Notices were issued under sections 98(1)(a) and (b) of the Commerce Act 1986 via section 113(c) of the CCCF Act.

122. For example, only one of the five insurers offers MBI over a six-month term, therefore this product data has been excluded from the analysis.

17 Consistent with the approach taken by ASIC in its 2016 study of add-on insurance sold through car dealers,[123] the claims ratio used in this report is based on total premiums paid by consumers compared to total claims paid out by insurers (during the 2018–20 financial years).

18 We share ASIC's view that this method "reflects value from a consumer perspective". In its report, ASIC explained that the calculation can be easily understood and does not rely on future estimates or adjustments.[124]

19 Like ASIC, we acknowledge that the methodology of this claims ratio does not adjust for premiums yet to be earned on multi-year policies, which would increase the claims ratio. However, the claims ratio captures claims paid on all existing policies during the relevant financial years, while only capturing premiums for new business. An adjustment to account for claims only for new business would subsequently decrease the claims ratio.[125]

COVID-19

20 The data we requested from lenders and insurers (covering the three years ending 31 March 2020) overlapped with New Zealand going into Level 4 lockdown on 25 March 2020. As dealers were unable to operate during Level 4, consumers were generally unable to purchase motor vehicles and/or add-ons during this time.

21 As the period of overlap between our data and the lockdown was minimal (seven days) relative to the period of data collected, we do not consider that COVID-19 will have materially impacted the data.

123. https://asic.gov.au/media/4042960/rep-492-published-12-september-2016-a.pdf
124. Ibid, paragraph 226.
125. Ibid, paragraph 227-228.

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