

19 August 2020

Ward Sutcliff
Acting Senior Manager - Insurers
Financial Services Group
Australian Securities and Investments Commission
Level 2, 2 Allsop Street
Canberra ACT 2601

By email: product.regulation@asic.gov.au

Dear Ward

THE SALE OF ADD-ON MOTOR VEHICLE FINANCIAL RISK PRODUCTS: SUMMARY OF CHANGES TO DRAFT PRODUCT INTERVENTION ORDER AND QUESTIONS FOR FEEDBACK (THE CONSULTATION)

The Australian Finance Industry Association (AFIA) appreciates the opportunity to comment on the changes to the Draft Legislation Instrument in relation to the Sale of Add-On Motor Vehicle Financial Risk Products (the **PIP Order**) as well as to respond to the additional questions on which ASIC is seeking feedback.

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia including retail banks, finance companies and fintechs, which provide innovative consumer products and specialised finance to meet small to medium enterprises (SMEs) working capital, cashflow and investment needs. For more information about AFIA, please see **Attachment A**.

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes, and to work with the Federal Government, financial regulators, and other stakeholders to promote a supportive environment for the financial services industry.

OUR SUBMISSION

We welcome ASIC's further consultation and understand that through the PIP Order, ASIC is seeking to protect consumers from significant detriment through the sale and purchase of add on products sold with motor vehicles.

We have previously provided a response to ASIC's Consultation *Paper 324 Product Intervention: The sale of add-on financial products through caryard intermediaries* in our submission (**CP 324**) dated 17

November 2019 (our **Previous Submission**). We also made comment on the exposure draft legislation in relation to Treasury's response to the recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, and in particular specific regulations in relation to deferred sales model for add on insurance (**FSRC Submission**).

We noted in our FSRC Submission that ASIC's product intervention power (**PIP**) is a significant addition to its suite of enforcement tools – in particular, to protect consumers from risk of financial harm. We also noted there are limits to ASIC's PIP powers (as discussed below) so, in some cases, it is more prudent to regulate a particular practise through statute law.

We again welcome the opportunity for consultation to assist in shaping how ASIC seeks to utilise this power given the potential impact it will have on providers of consumer credit (or other regulated entities).

We understand that this is a narrower consultation to that of CP 324 and focuses on:

1. Consultation in relation to amendments to the PIP Order as a result of responses to CP 324 – please see our comprehensive responses to these changes at **Attachment B**; and
2. Follow up questions to which ASIC is seeking feedback – please see our responses to these questions at **Attachment C**.

At the outset, we reiterate comments that we have made in prior submissions:

- While there have been instances of consumer detriment regarding add-on insurance sales, there has been significant industry change in the last two years.
- AFIA's motor finance members have made significant improvements to their products, including withdrawal of many products.
- Our members are not product issuers but are instead often asked to finance add-on products.

Please read our submission in this context.

Key recommendations

Recommendation 1 – ASIC does not issue its PIP Order but instead its approach is incorporated into the Treasury Model

As noted above, since the release of CP 324, Treasury has released its exposure draft legislation which was the subject of significant consultation earlier this year on a comprehensive regulatory regime relating to the sale of insurance products through motor dealers.

This regime includes regulation of add-on insurance products through a deferred sales model, no hawking of superannuation and insurance products as well as caps on vehicle dealer commissions

(**Treasury Model**)¹ all which is to be introduced by 30 June 2021 following a six month deferral as a consequence of the COVID-19 pandemic.²

In our Previous Submission to CP 324, we noted that the interaction between the Treasury Model and the PIP Order was unclear and this remains the case. The Treasury Model, including the definition of key concepts varies considerably from the model proposed in the PIP Order. For example, the Treasury Model refers to *add-on insurance product* whereas the PIP Order has now amended the reference to that off *add on motor vehicle financial risk products*. Further examples are that warranty products are not included in the Treasury Model but are included in the PIP Order.

We also note that ASIC's enforcement powers are limited on this subject matter compared to much broader enforcement in the soon to be legislated Treasury Model.

Finally, we note that the Explanatory Memorandum to the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* states:

2.3 *ASIC has powers under certain parts of the Corporations Act to impose conditions and take actions to rectify consumer detriment after a breach or suspected breach of the law. **However, these powers provide ASIC with limited scope to regulate proactively.***

2.4 *ASIC can only intervene in certain situations where there is a suspected contravention of the law. For example, ASIC can stop the issuance of products where the disclosure documents are defective. **This limits ASIC's ability to intervene in the distribution of products where there is no defective disclosure.***

As a result, we therefore recommend that ASIC not issue its PIP Order, but instead incorporate the intent of the Order into the Treasury Model for the following reasons:

- So as to avoid confusing, conflicting, overlapping regulatory requirements and so there is an efficient, simple and single regulatory framework for the sale of add-on insurance through car-yard intermediaries.
- The differences in regimes create regulatory confusion and overlap for those who are required to comply and their advisors.
- The PIP Order will only be in effect for 18 months, whereas the Treasury Model (due to be introduced by 30 June 2021) will be a permanent regulatory requirement. We believe it is a more sensible and practical approach to set aside a temporary order for a permanent and enduring regulatory framework.
- The issues being addressed by the PIP Order are arguably not new and therefore do not arguably warrant special or urgent treatment outside of statute law.
- The Treasury Model provides ASIC with further and broader enforcement powers than the PIP Order.

¹ <https://treasury.gov.au/consultation/financial-services-royal-commission-enhancing-consumer-protections-and-strengthening>

² <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/update-implementation-banking-superannuation-and>

Recommendation 2 – Defer the making of the PIP Order until the Treasury Model comes into effect to take into account the disruption of the COVID-19 pandemic on industry

We note that on 8 May 2020, the Federal Government announced a six month deferral of the implementation of commitments associated with the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, as a result of the significant impacts of the coronavirus³.

The intent of the deferral was to enable the financial services industry to focus its efforts on planning for the recovery and supporting their customers and staff during this unprecedented time. The deferral included those commitments associated with the Treasury Model.

Given the current economic circumstances, the deferral of the Treasury Model, and recent progress made by the industry, we believe that a reassessment of the need for a PIP be considered at this time. We encourage a reassessment of the need as well as timing of the PIP Order in light of the aforementioned factors.

If ASIC continues to pursue the PIP Order, we recommend a transition period greater than the 3 months proposed and equivalent to at least the date of the commencement of the Treasury Model. The cost of implementation of a deferred sales model for financiers who are asked to finance add-on motor vehicle risk products (in particular the costs and lead time for upgrading systems) particularly at a time when the COVID pandemic and its ensuing volatility is incredibly challenging to business resourcing and continuity.

Recommendation 3 – Review and amend PIP Order to ensure no duplication or conflict

If ASIC continues to pursue the PIP Order, we note that there are several drafting issues with the current proposed draft, these are:

- There appears to be a conflict in terms of the drafting of section 12 with sections 13(a) and 13(f) in relation to warranty products:
 - Section 12 requires a manufacturer’s warranty to have expired, or close to in specified circumstances, before a mechanical risk product can be arranged by an intermediary or sold by a product issuer – refer to sections 8(3) and (4).
 - By contrast, sections 13(a) and (f) prohibit terms in mechanical risk products which overlap with manufacturer warranty or impose servicing requirements more frequent than under the manufacturer’s warranty – products which do not meet these and other requirements are prohibited from being arranged or sold (refer to section 8(5)).
 - The drafting seems inconsistent in that it prohibits product sales (section 12) on terms which section 13 controls. The outcome is that the arranging and the sale of mechanical risk products is largely curtailed, except for vehicles which are out of manufacturer warranty (up to 7 years), or close to.
 - If that is the intended outcome, it should be made clearer.
- In relation to Section 13(d), we are concerned that a warranty product (as defined in the PIP Order) could be read as a ‘maintenance services contract’ for the purposes of this section. We

³ <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/update-implementation-banking-superannuation-and>

do not think the intent of the definition of warranty product is intended to include a 'maintenance services contract' and therefore recommend excluding from the definition of a warranty product or mechanical risk product "any product that is intended for the maintenance or service of a vehicle."

CLOSING COMMENTS

I would appreciate the opportunity to discuss our recommendations and provide ASIC with further information about the specialised products, services and technologies offered by our members.

Should you wish to discuss our submission or require additional information, please contact Naveen Ahluwalia on naveen@afia.asn.au or me at karl@afia.asn.au or 02 9231 5877.

Yours sincerely



Karl Turner

Executive Director, Policy and Risk Management

ATTACHMENT A: AFIA BACKGROUND

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance industry.

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia, which includes:

- Major, regional and mutual/community owned banks
- Providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers
- Providers of land finance, including residential and commercial mortgages and bridging finance
- equipment financiers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing
- Motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance
- Fleet leasing and car rental providers, and
- Providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- Consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services.
- Commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see [here](#).

ATTACHMENT B: AMENDMENTS TO LEGISLATIVE INSTRUMENT

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
Section 1	The title of the order referred to 'add on insurance and extended warranties'	Section 1	The title of the order now refers to 'add on motor vehicle financial risk products'	No comment
Section 2	The order did not provide for a general transition period	Section 2	The order now provides for a general transition period of three months	<p>As noted above, since ASIC's consultation in relation to CP 324, Treasury has released exposure draft legislation in relation to the regulation of add-on insurance products through a deferred sales model⁴ i.e. Treasury Model.</p> <p>It would be more prudent, sensible and efficient for ASIC's proposed PIP Order to be incorporated into the Treasury Model.</p> <p>If ASIC continues to pursue the PIP Order, we recommend a transition period to at least mirror the commencement of the Treasury</p>

⁴ <https://treasury.gov.au/consultation/c2020-48919d>

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
				<p>Model. The cost of implementation of a deferred sales model for financiers who are asked to finance add-on motor vehicle risk products (in particular the costs and lead time for upgrading systems) particularly at a time when the COVID pandemic and its ensuing volatility is incredibly challenging to business resourcing and continuity. A three-month timeframe is not adequate.</p>
Section 3	No change	Section 3	No change	N/A
Section 4	<p>The order included a definition of 'add-on insurance product.</p> <p>'Arrange' was not defined for the purposes of the order (e.g. 'arrange for the issue of an add-on insurance product')</p> <p>'Comprehensive motor vehicle insurance' was not</p>	Section 4	<p>'Add-on insurance product' has been changed to 'add-on motor vehicle financial risk product', which is defined to include both insurance and warranty products.</p> <p>The order includes a definition of a new class of products – 'assistance insurance products'.</p>	No comment.

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
	<p>defined for the purposes of the order.</p> <p>The order included definitions of 'online consumer roadmap' and 'extended warranty product'.</p>		<p>The class of products 'loan or lease termination insurance products' has been removed.</p> <p>The concept 'arranging conduct' has been introduced and defined.</p> <p>The product class 'comprehensive motor vehicle insurance' is now defined.</p> <p>The prescribed form and content of the 'online consumer roadmap' have been modified.</p> <p>'Warranty product' has been substituted for 'extended warranty product' and defined. This definition now expressly excludes comprehensive motor vehicle insurance.</p>	
Section 5	This section set out a prohibition applying to intermediaries and product	Sections 5-9	This section is now split into three general prohibitions (sections 5-7)	N/A

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
	issues, as well as three exceptions to the prohibition		and one specific prohibition (section 8). The exceptions to the prohibitions are set out in a separate condition in Section 9.	
Section 6 and 7	Section 6 of the order set out a condition relating to the 'online consumer roadmap' and stated at paragraph 6(2) that intermediaries must determine 'unsuitable classes' of retail clients for each add-on product. Section 7 set out a condition related to the 'deferral period'.	-	See "Section 11".	N/A
Section 8	The order included a condition relating to 'unconscionable conduct or manipulation', which has the effect of prohibiting any technique 'that should not in	-	The condition has been replaced with a general prohibition in section 7 that is limited to requiring the retail client to sign an acknowledgement: see 'Sections 5-9'	We agree with these changes.

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
	good conscience have been used'.			
Section 9	The order included a condition requiring product issuers to provide a written statement containing specified information upon request by ASIC.	Section 10	The condition now: <ul style="list-style-type: none"> • Specifies the types of information for which ASIC can request a written statement; and • provides that ASIC may only request a written statement once every six months. 	No comment.
-	-	Section 11	The conditions relating to the 'online consumer roadmap' and the 'deferral period' in sections 6 and 7 of the previous draft order have been merged into one section. These conditions now come into effect six months after the commencement of the order. The requirement to determine 'unsuitable classes' or retail clients in paragraph 6(b) of the previous draft order has been removed.	See comments above in relation to transition period.
-	The order did not restrict the sale of mechanical risk products in relation to the	Section 12	A new condition has been added prohibiting the sale of mechanical risk products where a retail client has	We do not object to this new condition, however, note that there appears to be a conflict in terms of the

Previous draft order	Relevant feature	Revised draft order	Relevant Change	AFIA Comments
	level of cover remaining on any manufacturer warranty, provided the terms of the product met the requirements in section 10.		a certain level of cover under a manufacturer warranty. This was previously consulted on: see paragraphs 181-191 and paragraphs 231-234 of CP 324.	drafting of this section with sections 13(a) and 13(f). We have provided examples of this above.
Section 10	The order included a condition relating to the terms of mechanical risk products	Section 13	<p>A new condition has been added at paragraph 13(b) stating that mechanical risk products must provide cover for at least 12 months.</p> <p>A new condition has been added at paragraph 13(g) stating that a mechanical risk product holder must not be required to pay an amount to a third party on cancellation of the product.</p>	<p>See our comments in relation to section 12 above in relation to drafting.</p> <p>We also note that a warranty product (as defined in the PIP Order) may be read as a 'maintenance services contract' for the purposes of section 136 of the National Credit Code.</p> <p>We recommend that the definition of mechanical risk product clearly exclude products that are intended for the maintenance or service of a vehicle.</p>

ATTACHMENT C: SPECIFIC QUESTIONS FOR FEEDBACK

1. **Please summarise your views on any of the changes made to the revised product intervention order, including whether the changes would be more or less effective in addressing the significant consumer detriment previously identified by ASIC, including in CP 324. Please explain the reasons for your position.**

Our main recommendation, as noted in our covering letter is that ASIC does not issue its PIP Order, but instead incorporate the intent of the Order into the Treasury Model. Our reasons are as follows:

- So as to not create a duplication in regulatory burden and so there is an efficient, simple and single regulatory framework for the sale of add-on insurance through car-yard intermediaries.
- The differences in regimes create regulatory confusion and overlap for those who are required to comply and their advisors.
- The PIP Order will only be in effect for 18 months, whereas the Treasury Model (due to be introduced by 30 June 2021) will be a permanent regulatory requirement. We believe it is a more sensible and practical approach to set aside a temporary order for a permanent and enduring regulatory framework.
- The issues being addressed by the PIP Order are arguably not new and therefore do not arguably warrant special or urgent treatment outside of statute law.
- The Treasury Model provides ASIC with further and broader enforcement powers than the PIP Order.

Further to this, we noted in our Previous Submission that, while acknowledging a key issue identified by ASIC's *Report 470 Buying add-on insurance in car yards: Why it can be hard to say no* was information overload and fatigue experienced by consumers when buying a vehicle and add on products, we expressed the view that the length of the deferral period is unlikely to facilitate any greater clarity or certainty as to the value position and relevance of add on products.

Our view remains that timing should not be the issue but instead recommend:

- clearer and more effectual education of add-on products provided to consumers to assist them in making a fully informed decision; and
- inclusion of cooling off rights to an extended warranty.

2. **Do you consider that any further changes should be made to the revised draft order before ASIC proceeds to a final decision on whether to exercise the product intervention order?**

We do not consider further changes necessary and note that industry practises and behaviours have significantly changed since ASIC's *Report 470 Buying add-on insurance in car yards: Why it can be hard to say no* was published. Those changes include:

- voluntary withdrawal of products;

- redesign of products to better meet customer needs;
- repricing of products translating to improved value.

3. **Do you consider there is a significant risk of avoidance of the revised draft order as a result of any changes made by ASIC? If so, should ASIC introduce additional measures to address that risk?**

We noted a risk that ASIC has previously raised namely, that dealers may have been embedding the cost of add-ons in the vehicle price. This still exists, so an add-on product can appear to be for 'no consideration', i.e. free. Our members are concerned that this risk would be significantly increased with the proposed deferred sales model as it would be unlikely that dealers would be able to provide a full breakdown of costs in their dealer invoice.

4. **Do you consider that the consequences of the COVID-19 pandemic have had, or are likely to have, any effect on the significant consumer detriment identified by ASIC in CP 324? Please provide evidence in support of your response.**

We have no comment.

5. **Please provide any information on likely compliance savings or costs, the likely effect on competition and other impacts, costs and benefits.**

AFIA and its Members have expressed concerns with the costs of implementation of a deferred sales model and, in particular, the costs and lead time for upgrading systems into members' loan application systems. Vehicle loan and facilitating systems have been developed as a one-off loan with disbursements as directed by the customer. These systems are not readily modified to allow for variable drawdowns over time and the introduction of this complicated procedure will result in significant regulatory and operational risk for disclosures, calculations (including back testing and user acceptance) and consumer understanding.

Due to the COVID-19 pandemic and resources responding to the unfolding crisis, members are unable to provide an estimate of costs, as the requirements are yet to be confirmed. Members have also indicated, if the deferred sales model is to be implemented, there will be significant cost, system, internal and dealer training and procedural changes involved.

As such and noting our comments in relation to not proceeding with the PIP Order, we suggest an implementation period to mirror that of the Treasury Model.

We also reiterate our concerns with the deferred sales model (i.e. the imposition of a 4 day process) which will be cumbersome and provide a less than ideal customer experience for

consumers. In our view, it is doubtful whether the length of the deferral period will facilitate any greater clarity or certainty as to the value proposition and relevance of the add-on products.

We suggest that the focus should be on the quality of the disclosure process, rather than the deferral period, where it is likely that consumers will not take advantage of the extra time, but are likely to be at a disadvantage by forgoing the opportunity to be made aware of add-on products, and are therefore put at a higher risk of harm.