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17 November 2019

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Dear Christian

ASIC Consultation Paper 324 Product Intervention: The sale of add-on financial products through caryard intermediaries

The Australian Finance Industry Association [**AFIA**] welcomes the opportunity to comment on the exposure draft of Consultation Paper 324 Product Intervention: The sale of add-on financial products through caryard intermediaries [the **Consultation Paper**] and the Attachment to CP 324: Draft Legislative Instrument [the **Instrument**].

AFIA Background

By way of background, AFIA is the voice of a diverse Australian finance industry. AFIA supports our Members to ensure a fair, equitable and competitive market for customers through representation, insights and connectivity.

AFIA is uniquely placed to respond given our broad and diverse Membership of over 100 financiers operating in the consumer and commercial markets (including small-medium business and agri-finance). AFIA Members:

- include banks (major, regional and mutual/community-owned) and non-banks;
- range from ASX-listed public companies through to small businesses providing finance;
- operate via a range of distribution channels including bricks and mortar premises, intermediaries (finance brokers, dealerships, suppliers) through to online / digital access
- collectively operate across all states and territories in Australia in capital cities through to regional and remote areas: the majority operating across at least one border;
- have customers from all demographics, all age groups (legally able to borrow) in support of Australia's diverse and multi-cultural community with:

    - consumers ranging from high to low-income earners (including some whose main income source may be government welfare); many with substantial assets, others with few; single borrowers through to blended families; covering the whole range of employment scenarios, full-time, part-time, seasonal or casual employment.
    - commercial entities ranging from sole traders and partnerships through to the more complex corporates (e.g. trusts, corporate group) and government-entities some with no employees through to others with hundreds (if not thousands) of employees.
- provide a broad range of products:
    - consumer: from personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), loans secured by land or personal property; consumer leases of assets (including household/electrical/IT or cars) and buy-now, pay later solutions;
    - commercial: asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); working capital solutions (online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards) together with more sophisticated and complex finance solutions.

AFIA KEY POSITIONS SUMMARY

ASIC's product intervention power [PIP] is a significant addition to its suite of enforcement tools available to deliver its regulatory objectives - in particular, to protect consumers from risk of financial harm.

AFIA welcomes the opportunity for consultation to assist in shaping how ASIC seeks to utilise this power given the potential impacts it will have on a provider of consumer credit (or other regulated entity).

Conceptually, AFIA and its Members understand what ASIC is trying to achieve but believe that the proposed Deferred Sales Model (DSM) may not deliver this solution as consumers may have the costs of the DSM passed onto them, and may miss out on becoming appropriately informed on valuable add-on products (such as extended warranty). This in turn could potentially be inefficient, and unlikely to deliver the proposed outcome of an informed purchase of relevant insurances and warranties meeting a customer's requirements and objectives.

Members believe that more meaningful market outcomes and better customer outcomes are more likely to be redressed by the comprehensive redesign of add-on products to provide enhanced and continued value to consumers and a more efficient and compliant sales model. These are responsibilities that largely sit with product issuers and will be enforced through the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*. In this regard, we note that the financiers are actively working with product issuers to address concerns regarding product, cover and sales, training and compliance support.

AFIA's Members have indicated that a DSM may, due to the 4-day time period, be impractical for both customers and financiers:

- Customers may be forced to forgo add-on products to avoid delays in the delivery of their financed vehicle, which in the absence of equivalent aftermarket products, may result in them bearing additional risks, such as detrimental harm in unforeseen circumstances.
- For financiers, the delay creates operational inefficiencies with delayed settlements and increased costs. Dealers may also face additional holding costs – the quantum of which need to be considered before considering whether they are passed back to consumers in the sale price.

AFIA'S INSIGHTS - PROCESS

To examine this issue AFIA has engaged with our Members. Our submission focuses on sections in the Consultation Paper where Members had some commentary or were seeking greater clarification.

A large number of members have contributed to our feedback. We note, however, that while generally the position put by AFIA represents the general view, there may be variances at individual member level on specific matters. These will get captured through the relevant member's organisationally targeted submission.

AFIA KEY ISSUES

1. C7 Q1 – Do you consider that there is significant consumer detriment from the sale of add-on financial products by caryard intermediaries? Please provide evidence in support of your response.

AFIA notes that ASIC is relying on past studies to form their viewpoints as set out in the Consultation Paper. Members seek to emphasise that behaviours have significantly changed in the last 18 months including the voluntary withdrawal of many products, which whilst still offering value to the customer, no longer meet the expectations of the current regulatory landscape.
As such, the financial marketplace is significantly different than where it was when *REP 470 Buying add-on insurance in car yards: Why it can be hard to say no* was published.

In particular, Members are already seeing improvement in the product design and pricing of add-on products and therefore improved value. Members acknowledge that ASIC's engagement with issuers and insurers of add-on products appears to have resulted in a reduction in the volume of add-on products sold and financed, and believe that this is largely a result of insurers implementing better compliance frameworks including enhanced training, monitoring and supervision of representative and reduced commissions

We understand that ASIC still has concerns and believes that sales practices have yet to be sufficiently improved. To address this AFIA collected data from Members. Whilst the sample collected could not be argued to be statistically valid, it does indicate that the amount of people electing for add-products in the sales process has decreased since 2016, and the amount of complaints of add-on products has significantly decreased - with one major financier only having three complaints pertaining to add-on products since 2016.

As noted above, this reflects the improvement to the sales process which have been re-engineered in order to allow the consumer to elect for add-on products in a more suitable environment.

AFIA Recommendation

AFIA recommends that due to a reduction in the amount of 'trade-offs' in the proposed DSM, ASIC's original hypothesis may no longer remain valid. ASIC may like to consider conducting further studies of the current marketplace - AFIA would be willing to assist in the process. If more analysis was undertaken, ASIC would be more fully informed of the impact of the trade-offs and would be able to assess, in the current environment, whether potential customer detriment likely to be suffered would outweigh the proposed advantage of the DSM.

2. C7 Q2 – If you consider there is significant consumer detriment, do you think that it should be addressed by the proposal in this section, or by some other intervention or action by ASIC?

AFIA and its Members acknowledge the issue with information overload or fatigue, given the challenges consumers face in assessing the add on product value proposition and whether the costs meet their requirements, particularly having regards to the range of add on product offerings available in through dealerships and finance brokers.

However, we note 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. ASIC recently published *REP 632 'Disclosure: Why it shouldn't be the default'*, whereby it highlighted a study undertaken showing that out of 100 people surveyed, only 20 said they would read the disclosure. Further, the number who followed through on that reading is unknown. In line with this, 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.

AFIA Recommendation

AFIA recommends that ASIC should further regulate the disclosure process by requiring that a clearer and more effectual education of add-on products is provided to consumers, in order to assist them in making in fully informed decisions, along with enhanced training and monitoring of the dealers – AFIA would be willing to co-facilitate a workshop to explore this further.

Further, we recommend inclusion of cooling-off rights to an extended warranty as this would provide consumers with a stronger outcome as opposed to an extended deferral period.

As part of these requirements, a formal post sale confirmation of cover and advice on cooling off or cancellation of the add-on policy should also be mandatory, in order to assist consumers to know and understand their rights. This process could include a SMS/email prompt or follow up call to the consumer to advise them that their cooling off period is ending, and thereby provide a post-sales opportunity for consumers to cancel their add-on product, in a low-pressure environment.

3. C7 Q3- Please summarise your views on the proposal for a deferred sales model in this section (e.g. whether it should apply across all sales channels where intermediaries regularly arrange finance for cars). Please explain the reasons for your position

AFIA believes that the proposals to enhance the value proposition of add-on insurance and risk products including improved and relevant cover and more competitive pricing, improved sales processes, comprehensive dealer and broker training and improved monitoring and supervision will mitigate the need for a DSM. Similarly, for add-on products which form part of salary packaging options.

AFIA and its Members are keen to work with add-on product issuers and insurers and their dealer networks to ensure stronger consumer outcomes irrespective of whether a DSM is implemented.

We note that ASIC believes that only a small number of consumers would miss out on add-on products in the DSM process, and that the 'trade-off' in the risk of significant harm these consumers would face would be justified.

As mentioned above, we sought data from Members and whilst the sample collected could not be argued to be statistically valid, it does indicate that:

- 30% of all New and Demo cars are ready for collection after 5 days from when the sales contract was signed.
- 60% of all Used cars are ready for collection within 5 days from when the sales contract was signed.

This indicates that the current marketplace is perhaps somewhat different to the marketplace that ASIC has understood, and that potentially more than a small percentage of consumers would be impacted. As a result, we believe it is critical that consumers are given an opt-out process.

AFIA Recommendation

AFIA and its Members recommend that, if the DSM is implemented, that an early opt-out process for consumers that will receive their vehicle within the DSM period (as well as repeat/informed buyers/self-initiators) is adopted.
We note that ASIC has modelled the DSM off the UK DSM approach, and that there is a similar process in the UK for GAP cover as recommended by the Insurance Council on behalf of insurers. We note that whilst the UK model may have some benefit for UK consumers as they can purchase the GAP product elsewhere, there are currently no after-market insurance and risk products to support an opt-out process in Australia, and therefore it is vital that affected consumers are allowed an opt-out process.

4. C7 Q4 - Please summarise your views on the additional obligations in this section (e.g. whether 'knock out' questions should be introduced), Please explain the reasons for your position

AFIA and its Members support ASIC's proposal that 'knock out' questions are to be determined by product issuers on their own, but with them needing to be submitted to ASIC for approval.

AFIA Recommendation

We recommend that, as ASIC will be reviewing the 'knock out questions' across the whole industry, clarification is given as to when the providers will have to submit their questions, and whether they will be subject to approval prior to implementation.

*As the knock out questions to be used by product providers are likely to be an extension of the framework developed for their Target Market Determination as part of their Design and Distribution Obligations **(DDO)**, we recommend that implementation of the use of knock out questions aligns with the DDO start date of April 2021 (at a minimum), in order to provide sufficient time to undertake the market research needed to form the appropriate 'knock out' questions.*

5. C7 Q5 - How would the proposal and obligations set out in this section affect businesses (e.g. insurers, car dealers, finance brokers, credit providers)?

The responsible lending obligations under the National Consumer Credit Protection Act (NCCP) and ASIC's RG 209 require financiers to ensure a proposed credit contract meets the customer's requirements and objectives and is not unsuitable. Where those requirements and objectives include the financing of add-on insurances and other products, the proposed DSM will inhibit the lender from comprehensively identifying the policies which the customer wishes to finance.

The DSM may, depending on its duration, also impact on the lender's responsible lending obligations by requiring the re-verification of income (pay-slips) and expenses, additional credit checks and re-assessment of the proposed loan contract including any add-on products to be financed to ensure that the customer is still in a position to meet the increase in the amount to be financed without undue hardship.

Under the DSM model it is likely that the following sale/originations flow will occur:

1. Vehicle sale contract signed by customer, almost always subject to finance
2. Online portal access given to customer by dealer/broker re add on options available [Day 1] - bearing in mind, if a broker is looking to sell add-ons to their customers, it is they who trigger online portal access, not the selling dealer
3. 2 clear days follow
4. Beginning of Day 4, the customer can indicate to the dealer if they require any add-on products – however, the dealer/broker cannot initiate contact with the customer unless they have provided consent for them to do so via the portal

Practically, we note that:

- It is only at point 4 that the financier will know the customer's requirements and objectives for responsible lending purposes, including the amount of credit that will be needed – both of which are mandatory responsible lending requirements.
- It is that amount of credit on which a credit inquiry will be made of a Credit Reporting Body
- The customer is no longer going to be on the dealer's premises to apply for finance.

Further, AFIA's Members are concerned that with the adoption of a DSM, there is likely to be an increase in the sale of add-on products by dealers and brokers using unregulated providers of credit rather than regulated providers of credit – we do not believe that this was ASIC's intention in seeking the introduction of such a model

While dealers and brokers would still have to comply with the DSM, the challenges in financing add-on through vehicle finance may result in quarantining add-on from regulated vehicle finance.

Needing to repeat a responsible lending assessment is likely to create delays and extra compliance and operational costs, the quantum of which needs to be better understood.

AFIA Recommendation

AFIA and its Members recommend that the approach discussed in Point 3 be adopted. However, if the DSM is implemented, we recommend that the DSM should start from the time the customer signs the requisite paperwork to test drive a car.

Members are moving towards a faster experience for the customer and the DSM almost conflicts with improving the customer experience. Members note that with the release of RG 209, customers are already noticing longer wait times and more intrusive questioning, which is leading to an in increase in complaints. The DSM will likely exacerbate this situation, leading to more customer dissatisfaction.

Further, the sales process has changed. When customers are entering a dealership/caryard intermediary, they have already done background and research on the car they are interested in.

Therefore, a test drive of a car would be a reasonable indication that they will continue in the sales process. We recommend that ASIC considers this when finalising the consultation paper.

6. C7 Q6 - If you are able to do so, please provide an estimate of the impact of implementing the proposed model, or any changes or variations to this model set out in your response, including:

a. the likely compliance costs (e.g. training, software);
b. the likely effect on competition;
c. the impact of additional costs on businesses and consumers;
d. who would bear the cost; and
e. other impacts, costs and benefits

AFIA and its Members have expressed their concerns with the costs of implementation of a DSM and, in particular, the costs and lead time for upgrading systems into Members' loan application systems.
Due to the volume of other regulatory work being undertaken at this time, they are unable to provide an estimate of costs, as the requirements are yet to be confirmed. Members would like to engage further with ASIC on this point in future.

Members have also indicated if the DSM is to be implemented, there will be significant cost, system, internal and dealer training and procedural changes involved. As such, they suggest an implementation period of potentially 18 -24 months.

This arises because 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.

AFIA Recommendation

We recommend that at least an 18 month transitional time period is granted, and that ASIC clarifies for each instance of training, software, portal set-up and maintenance etc, as to whether the onus will lie on the issuer (i.e. the insurer) or the financier to be liable for the costs and monitoring.

7. C7 Q7 - Do you consider there is a significant risk of avoidance of the proposed obligations? If so, should ASIC introduce additional measures to address that risk?

AFIA notes that a risk that ASIC has previously raised, is that dealers may have been embedding the cost of add-ons in the vehicle price. Members are concerned that this risk would be significantly increased with the proposed DSM model, as it would be unlikely that dealers would be able to provide a full breakdown of costs in the dealer invoice.

We note that as financiers do not have oversight over the dealerships, if the add on costs were to be built into the vehicle price, then ASIC may not have jurisdiction over the sales process (unless the dealers were providing their own dealer warranty).

AFIA Recommendation

We recommend that ASIC consider further how add on costs are disclosed to customers.

8. E3 Q3 - How would the proposal in this paper affect businesses (e.g. insurers, car dealers, finance brokers, credit providers)?

AFIA and its Members note with the restriction on requirements to service vehicles, many products include for a future value product (whereby a consumer can sell the vehicle back to the dealership for a guarantee price).

As the financier is guaranteeing the price, it is critical that the financier can be assured a vehicle will be serviced to a certain standard, and that it will be sold back in a certain condition - this ultimately benefits the consumer to have that certainty.

AFIA Recommendation:

AFIA recommends that ASIC clarifies that a preferred mechanic providers list will be allowed and that it will not come under the proposed prohibition of a financier being unable to prescribe only a particular mechanic.
This will allow consumers the flexibility to choose a mechanic from the preferred list, whilst also ensuring that the vehicle is serviced to the required standard.

8. E3 Q4- What would be the advantages and disadvantages of car dealers no longer being able to rely on the exemption for incidental financial products (as a result of the proposal in paragraph E1(a))?

Under the DSM, car dealers would no longer be able to rely on the exemption for incidental financial products, due to the separation between the sale contract and the add-on products. A disadvantage from this is that if dealers were providing extended warranty, they would be unable to do so under the DSM, and could only provide it through a product issuer, unless the dealer was an AFSL holder.

In addition, many dealers will not have the resources to ensure compliance obligations as an AFSL holder – please refer to Annexure 1 – this is a summary of the research conducted by AFIA in conjunction with the Australian Automotive Dealer Association which evidences that many dealerships are struggling profitability wise in the current marketplace. The removal of the ability for them to sell extended warranty to a customer whose needs are genuinely being met by the product will exacerbate this situation.

AFIA Recommendation

AFIA and its Members recommend that ASIC consider the potential implications and effects that the implementation of a DSM could have on financiers and dealers, who have already undergone multiple regulatory changes in the past 18 months, and will continue to encounter significant changes to the industry in 2020, with the removal of the POS exemption.

Next steps

We would welcome the opportunity to discuss our feedback further in a meeting with ASIC or provide additional information. Please contact me at karl@afia.asn.au or Chalisa Parekowhai, Associate Director, Policy at chalisa@afia.asn.au or both via 02 9231 5877.

Kind regards

[redacted]

Karl Turner
Chief Executive Officer (Acting)