NALSPA

National Automotive Leasing
and Salary Packaging Association
ACN 169 223 161

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Mr Ward Sutcliffe
Acting Senior Manager — Insurers
Financial Services Group
Australian Securities and Investments Commission
Level 2, 2 Allsop Street, Canberra, 2601

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

Dear Mr Sutcliffe,

PART A – INTRODUCTION

The National Automotive Leasing and Salary Packing Association (**NALSPA**) welcomes this opportunity to provide a submission in response to ASIC's *Consultation Draft Product Intervention Order – The sale of add-on motor vehicle financial risk products* released on 5 August 2020 (**Draft PIO**).

NALSPA refers to our submission made to ASIC on 22 November 2019 in respect to ASIC Consultation Paper 324. In the interests of brevity, we have not repeated our previous submissions here, although we have cross referenced them where relevant below.

PART B - NALSPA'S SUBMISSIONS IN RESPECT OF THE DRAFT PIO

The key considerations NALSPA would like to emphasise to ASIC in response to the draft PIO are set out in the following paragraphs. We have separately responded to ASIC's specific questions in the latter part of this letter.

1. **IMPACTS OF COVID-19**

The release of the Draft PIO and the proposed implementation timelines could not possibly come at a worse time. Like most parts of the economy, the automotive and related sectors have been hard hit by the impacts of COVID-19. These impacts are continuing with the length and depth of their tenure uncertain at this time. This has been particularly exacerbated as a result of the Stage 4 restrictions now in place in Victoria, where a State of Emergency has been extended until 13 September and further restrictions are likely to continue thereafter.

We appreciated ASIC's proactive steps to understand the express impacts (and likely future impacts) of COVID-19 through engagement with our sector in May 2020. We understood that ASIC was, sensibly, collating industry data regarding the declines in the sales of both add on insurance products and mechanical risk products, and motor vehicles.

We had reasonably assumed that following these discussions and in light of the global pandemic ASIC would either chose to defer its decision to exercise its product intervention powers, or at a minimum, follow recent delay precedents established by both the Federal Government <u>and</u> ASIC itself.

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In terms of delay precedents, we note the following:

(a) On 8 May 2020, the Federal Government, recognising the impacts of COVID-19 on the economy and businesses, announced it would be delaying the legislative passage of recommendations relating to the Banking, Superannuation and Financial Services Royal Commission by a period of 6 months.

On 13 May 2020, Finance Minister Senator Matthias Cormann, made the following comments in the Senate on the rationale for the deferral:

…"I don't think that any reasonable Australian would argue with the proposition that given the circumstances—given the extent of the crisis and given the need to ensure that our banks and our financial system can focus 100 per cent on supporting our economy through this period—the decisions that were made by the Treasurer to defer the implementation of relevant measures is appropriate. I don't think that anyone would disagree—that is, I don't think anyone reasonable would disagree—with the proposition that, in the circumstances, it is entirely appropriate for this deferral to have occurred, and of course, at the right time, we will revisit those reforms"….

(b) On 8 May 2020, ASIC announced that it would defer the commencement date of the mortgage broker best interest duty and remuneration reforms and the design and distribution obligations for six months from their original commencement dates, given *"the significant impact of COVID19 on the Australian economy, especially on the financial system and consumers"*.

In making the announcement, ASIC passed the following comment:

"The deferral of these reforms follows, and is consistent with, the Government's announcement today to defer by six months 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 COVID-19".

VFACTS data shows that in the July 2020 year to date, the total number of new vehicles sold in Australia was down 122,730 units or 19.2% compared with the same period to July 2019. Despite the lessening of COVID-19 related restrictions in most States, new vehicle sales in July 2020 were still the lowest July total vehicles sales volume since 2002. Recent Federal Government assistance programs such as the extended Instant Asset Write Off policy announced in March 2020 have not been able to reduce this decline and industry disruption.

Clearly, NALSPA members have not been immune to the impacts of COVID-19. Each NALSPA member has recently finalised and released their financial results to 30 June 2020 which each show a significant decline in earnings compared to the prior calendar period[1].

The focus of all NALSPA members has been and continues to be on the delivery of their services in response to various Government-imposed health restrictions, ensuring the sustainability of their businesses and maintaining the safety and preserving the jobs of their employees.

[1] The McMillian Shakespeare Group reported a 25% decline in EBITDA for FY20 vs FY19; SG Fleet Group reported a 34.5% decline in Operating EBITDA for FY20 vs FY19 and Smartgroup Corporation reported an 18% decline in EBITDA for the 6 months to 30 June 2020 vs the prior corresponding period. Note that in some cases these figures include support from JobKeeper.

In addition to the impacts of COVID-19, the motor vehicle industry is also contending with a range of other difficulties including:

(a) the General Motors Holden decision to vacate the Australasian market resulting in the closure of 185 dealers at 203 sites nationwide;

(b) moves by other car manufacturers and distributors to also unilaterally change business and product sale and distribution models impacting dealer networks;

(c) supply chain difficulties for product, parts and accessories; and

(d) maintaining employee roles and offering job security if possible.

With automotive businesses focused on survival, and the health and welfare of their people, we consider that now is simply **<u>not the time</u>** to expect such businesses (including NALSPA members) to consider the Draft PIO.

Although the consultation in relation to a proposed deferred sales model has been ongoing for a reasonable period of time, due to the uncertainty surrounding the proposals, the amount of advance preparation that businesses have been able to do undertake is limited. The competing models proposed by Treasury <u>and</u> by ASIC, as well as the ongoing uncertainty about whether or not ASIC will in fact exercise its product intervention powers and, more recently the COVID-19 pandemic, has made it impossible for businesses to prepare.

As a result, the lead time required once a final outcome has been determined is greater than that presently provided for in the Draft PIO. In the current circumstances, the significant management time and monetary investment required to implement the Draft PIO could be better served protecting jobs and trying to transition our businesses to the new post COVID-19 operating environment, and NALSPA members respectfully submit that ASIC should defer further consideration of the PIO until the business environment has sufficiently stabilised from the impacts of COVID-19.

2. THE TREASURY MODEL ACHIEVES THE DESIRED OUTCOME AND SHOULD BE SUFFICIENTLY TESTED BEFORE ASIC USES ITS PRODUCT INTERVENTION POWERS

NALSPA submits that, to the extent regulation is deemed necessary for the salary packaging sector, the process presently to be introduced into legislation by the Government in December through the Treasury deferred sales model (**Treasury Model**) set out in the (*Financial Sector Reform [Hayne Royal Commission Response – Protecting Consumers (2020 Measures)] Bill 2020: Deferred sales model for add-on insurance* is more than sufficient to achieve the desired outcome in respect of the distribution of insurance through salary packaging providers. Further, the Treasury Model will achieve the desired outcome without the need for a significant capital outlay, as it does not require additional infrastructure to be developed, implemented and maintained. The importance of this cannot be underestimated in the current environment.

We consider that a period of **at least 18 months should be allowed by ASIC to assess the effectiveness of the Treasury Model**, before ASIC should assess whether there is still the significant consumer detriment present that would warrant ASIC exercising its product intervention power.

This is particularly important in light of the detrimental impact of COVID-19 on the economy, the business community, the automotive industry and our employees and customers, as discussed in more detail above.

3. SIGNIFICANT INDUSTRY AND STRUCTURAL PRODUCT CHANGES HAVE ALREADY BEEN IMPLEMENTED AND CONTINUE TO BE IMPLEMENTED

3.1 AOI products and retailers have seen a large volume of regulation in recent times and this needs to be given sufficient time to take effect

In addition to other changes, NALSPA notes the role of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth) (**Design and Distribution Act**) in ensuring products are designed to meet the requirements, financial situation and needs of consumers to whom they are offered.

To ensure compliance with the Design and Distribution Act, NALSPA members have been undertaking significant work with their insurance partners over the past 18 months to ensure salary packaging customers are only offered AOI products which represent value to them, including implementing measures such as:

(a) the introduction of additional scripted “knock-out questions” to mitigate the risk of salary packaging customers being sold AOI products that offer no value to them;

(b) improving product design to ensure AOI product inclusions and exclusions are appropriate and satisfy the requirements and needs of salary packaging customers; and

(c) ensuring premiums are set at competitive and appropriate levels.

In addition, the salary packaging industry is already taking significant positive steps to self-regulate its sales practices and procedures, with the development of a Code of Practice, which NALSPA Members will aim to implement in 2021, and which will include requirements covering full add on insurance premium disclosure, positive customer opt-in and other measures to help ensure consistency across the sector.

We submit that the cumulative impact of these changes should be given an opportunity to take effect before ASIC decides whether it is appropriate to exercise its Product Intervention Power to further regulate this industry.

3.2 Industry remediation has already occurred and continues to occur

NALSPA notes the acknowledgement by ASIC in Media Release 20-179MR that insurers have already taken steps to remediate the historic practices in this space, by paying refunds, improving product coverage and reducing commissions.

Each NALSPA member has seen the impact of these changes flow through with their own insurance underwriters, with a significantly increased focus on product design, changes to commission structures and an increased focus on disclosure and complaints management.

3.3 **The data shows a significant decline in the sale of AOI products**

We note that NALSPA members participated in the ASIC data collection process earlier this year in relation to AOI products. Whilst we do not propose to reiterate the data here, we note that all NALSPA members have experienced declines in the sale of both mechanical risk and other AOI products in the past 18 months (this is without taking into account the impacts of COVID-19).

Our observation is that one of the major contributors to the reduction in volume is the comprehensive changes that have been made by NALSPA members, and their insurance partners, to the product design and disclosure regimes. A significant tightening of the criteria has narrowed the target market and improved sales and disclosure processes have ensured that these products are only being sold where the customer has determined they see value in the product.

As authorised distributors of these products, we can each attest to the increased engagement over the past 18 months with our insurance underwriting partners regarding sales practices, product design and disclosure, reflecting the industry focus on ensuring the products sold offer real value to our customers and are sold in a clear, transparent and appropriate manner.

Mechanical risk products (Warranty) are also reducing significantly because of the increased number of new motor vehicles with longer time periods for application of their manufacturers' warranties.

PART C – RESPONSE TO ASIC'S SPECIFIC QUESTIONS

4. **PLEASE SUMMARISE YOUR VIEWS ON ANY OF THE CHANGES MADE TO THE REVISED DRAFT PIO, INCLUDING WHETHER THE CHANGES WOULD BE MORE OR LESS EFFECTIVE IN ADDRESSING THE SIGNIFICANT CONSUMER DETRIMENT PREVIOUSLY IDENTIFY BY ASIC?**

While a number of positive changes have been made to the drafting of the Revised Draft PIO, some of the substantive issues we identified in our response to the initial Draft PIO have not been addressed. Additionally, the proposed drafting of the Revised Draft PIO introduces some new issues and ambiguities, which we have set out in more detail in our response to Question 2 below.

In NALSPA's view, the Revised Draft PIO is no more or less likely to address any issues that may be of concern to ASIC in relation to the sale of AOIs in the salary packaging sector than the initial Draft PIO. This is because, fundamentally, the consumer detriment identified by ASIC in CP324 related to the sale of AOIs in a different channel, with relevantly different features. On the other hand, without further amendment and clarification, the Revised Draft PIO risks creating significantly worse consumer outcomes for customers in the salary packaging channel. These are explained in more detail in Response 2 below.

5. **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 POWER?**

As stated in our previous submissions to ASIC in relation to CP324, NALSPA notes that the sales practices and processes of salary packaging providers are **materially different** from the sales practices of caryard intermediaries. In this regard, we note the commentary by ASIC in CP324, where ASIC acknowledged that "*we think the proposed reforms should also apply to the salary packaging sales channel with refinements or adaptations as necessary*".

Accordingly, we have set out below the changes we believe are necessary for the ASIC Draft PIO to be able to function sensibly in a salary packaging channel.

5.1 **The customer should be able to accept the AOI Products beyond the end of the deferral period and follow up communications should be allowed after the four-day deferral period**

(a) The current drafting of section 11(1) provides that the customer **must** respond **via the online consumer roadmap** **before** the expiry of the deferral period. NALSPA understands the purpose of the deferral period to be a mechanism to ensure that the customer is not swayed by pressure-selling tactics and to allow the customer to consider the relevant information about the product at a time, and in a location, which suits them. NALSPA considers that, as the salary packaging customer will not be "face-to-face" with the sales person, or subjected to the kind of "pressure selling" environment identified by ASIC, there would be no harm to a salary packaging customer if they were able to indicate their acceptance of the product AFTER the deferral period has ended.

(b) The 'General Prohibition – second' in section 6(2) already prohibits any 'arranging conduct' until the deferral period has finished (by virtue of section 11(3)), meaning that the purpose of the deferral period is achieved. A requirement that confirmation **must** be received prior to the end of the deferral period creates a situation where:

(i) customers may feel that they are under time-pressure to respond (which NALSPA understands to be contrary to the intention of the deferred sales model); and

(ii) customers who are busy, and for whom it may be inconvenient to access the portal during the deferral period, will miss out on products which they may wish to acquire – and in cases where the novated lease benefit is made available to the customer by their employer, subject to a requirement to include an AOI (for example consumer credit insurance), this will have the additional result that the customer is unable to have a novated lease.

(c) Given the length of the engagement period between a salary packaging customer and their salary packaging provider in the establishment of their novated lease, it is important that:

(i) a salary packaging provider can still have a recorded conversation with a salary packaging customer in relation to an AOI product; and

(ii) a salary packaging customer has the option of going back into the online portal to indicate their desire for the product, after the conclusion of the four day deferral period and up to the time that the lease settles.

(d) This is particularly an issue in circumstances where a salary packaging customer may not have concluded their decision about their novated lease arrangements and are unlikely to separately have concluded their decision about the associated AOI products, as both decisions are necessarily intertwined. If the four-day deferral period has expired and no response has been received, the customer should still be able to accept the AOI products until such time as the lease settles without triggering a new offer and new deferral period.

(e) In this regard, we note that the Treasury Model proposes a **6-week period**, in which a provider is able to initiate written communications with a customer and a customer is able to accept the AOI product after the conclusion of the deferral period. Should ASIC not be persuaded by our other submissions regarding the appropriateness of the Treasury Model, we urge ASIC at a minimum to consider the inclusion of a similar model within its PIO.

5.2 **The online portal should not be mandatory**

(a) The Revised Draft PIO still includes the mandatory use of an 'online consumer roadmap'. This can be contrasted with the proposed Treasury model, which allows the mandated information to be provided in a manner which fits the circumstances. Making the use of an 'online consumer roadmap' mandatory is highly undesirable for the following reasons:

(i) It imposes a significant financial, management and compliance burden in the form of investment (time and money) into the development, implementation and maintenance of the online consumer roadmap without there being, in the salary packaging context at least, the justification of addressing an identified harm. This burden is thus both unnecessary and, in the current climate, extremely untimely. In the salary packaging context, the sale is formally concluded when the customer provides, usually by email, a copy of the relevant documentation – which has been signed by the customer away from the influence of the salesperson.

Together with the separation in time of the two purchases (being, for example, the novated lease and, after the mandated 'pause', the add-on insurance), this already achieves the objectives of the proposed online consumer roadmap. Mandating the creation and use of such an interface will be extremely costly and serves no purpose in the salary packaging context.

(ii) It introduces an additional channel of communication to the salary packaging sales process, which doesn't add anything in terms of achieving the objectives. – In the salary packaging sector, the vast majority of the communication in relation to novated lease products is undertaken transparently by recorded telephone calls and email. Mandating the use of an additional channel such as the portal will result in duplication of information and may increase the risk of information overload or confusion about where complete information about the entire package can be found.

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(iii) Requiring provision of certain information through an online portal could mean that salary packaging customers may not be able to receive all the information they want in a manner that is convenient for them and that allows them to make a fully informed decision. NALSPA considers that a better solution is for the additional prescribed information to be incorporated into the mandatory prescribed information as provided for by the proposed Treasury model, together with records of consent captured electronically.

5.3 **Insufficient time is allowed for the development and implementation of the online consumer roadmap and insufficient consideration has been given to the (unnecessary) financial burden which will result from mandating the use of an online consumer roadmap, particularly in light of COVID-19**

Although the Revised Draft PIO does recognise that some time will be required for the development of the 'online consumer roadmap', it fails to take into account either the length of time required to do this, or the management time and costs involved in doing so.

(a) **Cost**: As explained in our previous submission, the estimated cost of developing, testing and maintaining such an 'online consumer roadmap' is **$1.5 to $2 million per NALSPA member**. These are significant costs at any time, but in the midst of a global pandemic, it would be a severe blow to require businesses in the salary packaging sector to outlay such significant amounts – particularly in circumstances where such costs are unbudgeted and, in our view, unnecessary. (Unnecessary because the aim of the reforms can be achieved in the salary packaging sector without the development and implementation of an online portal.)

(b) **Time to develop and implement:** As set out in more detail in response to Question 5 below, the estimated time to develop, test and implement the deferred sales model, including the online consumer roadmap was a minimum of 12 to 18 months. That estimate was given in pre-COVID times – it is likely that given the additional operating difficulties present during the ongoing global pandemic, the time to develop, test and implement will be at the upper end of that estimate. The Revised Draft PIO only allows for 9 months, which is manifestly inadequate.

6. DO YOU CONSIDER THERE IS SIGNIFICANT RISK OF AVOIDANCE OF THE DRAFT ORDER AS A RESULT OF ANY CHANGES MADE BY ASIC? IF SO, SHOULD ASIC INTRODUCE ADDITIONAL MEASURES TO AVOID THAT RISK?

NALSPA has not identified any significant risk of avoidance of the draft PIO as a result of changes made by ASIC.

7. **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 CP324? PLEASE PROVIDE EVIDENCE IN SUPPORT OF YOUR RESPONSE.**

It is not obvious to NALSPA's members that the COVID-19 pandemic has had, or is likely to have, a direct impact on the specific consumer detriment identified by ASIC in CP324. However, it appears likely that there will have been some indirect consequences, including:

(a) The significant reduction in the number of vehicles purchased through car yard dealers as a result of i) the economic uncertainty caused by the pandemic; and ii) the 'lock-down' restrictions means that the number of AOIs sold in connection with the purchase of a motor vehicle through that channel will, necessarily due to reduced activity and car dealerships being closed, have significantly decreased.

(b) The 'lock-down' restrictions and physical distancing measures may well have resulted in a reduction in the face-to-face 'pressure selling' tactics identified by ASIC.

On the other hand, the NALSPA members have noticed that the Hayne Royal Commission into Superannuation, Insurance and Financial Services and other measures have already had a significant positive impact in terms of customers demonstrating a much better understanding of – and a much greater willingness to engage with – the information provided in relation to 'add-on' products.

8. **PLEASE PROVIDE ANY INFORMATION ON LIKELY COMPLIANCE SAVINGS OR COSTS, THE LIKELY EFFECT ON COMPETITION AND OTHER IMPACTS, COSTS AND BENEFITS?**

8.1 **Compliance and implementation costs are significant and unbudgeted**

(a) NALSPA members have estimated that the timing and costs to implement ASIC's proposed deferred sales model are as follows:

(i) Costs to introduce the portal and implement the necessary system, process, compliance and training changes are estimated in the range of **<u>$1.5 to $2 million per NALSPA member</u>**.

(ii) Timing to set up the deferred sales model **<u>ranges from a minimum of 12 to 18 months</u>**.

(iii) This timeframe considers each step required to make the necessary changes to implement the new processes and operations, including:

(A) scoping, development, testing and roll out of the consumer portal;

(B) operational and system changes to re-design the AOI sales process;

(C) alteration of any contractual arrangements which currently require novated leases to be sold with insurance products that cover the employer in the event of redundancy (e.g. LPI cover);

(D) training of staff in both the new sales model and the consumer portal;

(E) changes to disclosure materials; and

(F) compliance and Q&A implementation to ensure compliance with the new regime.

(b) These significant costs, management time and compliance obligations are unbudgeted and are coming at a time when each NALSPA member, and the automotive industry more broadly, is already suffering through the most significant economic downturn since the Great Depression. Each NALSPA member has already taken steps to reduce its costs (including restructuring, standing down employees- reducing employee hours and/or making employees redundant) in response to the COVID-19 Pandemic.

(c) These **significant and unbudgeted costs cannot simply be absorbed** and NALSPA members are concerned about the further cost cutting measures they will each need to take to be able to fund this project.

8.2 **Will the provision of the AOI Product disclosure information be sufficient to meet the requirement to "clearly inform" under sub-section 35(2) of the *Insurance Contracts Act 1984?***

(a) As ASIC would be aware, sub-section 35(2) of the Insurance Contracts Act 1984 provides that an insurer must "clearly inform" the insured customer in writing of the relevant terms and limits of an insurance policy before that contract is entered into.

(b) We are aware that in a number of recent decisions, AFCA has determined that the provision of a PDS via hyperlink or other electronic means is not sufficient to "clearly inform" an insured for this purpose. AFCA has found that the PDS must be provided either as a hard copy or a PDF attachment to an email.

(c) Without examining, or accepting, the correctness of AFCA's position, given the nature of these AFCA decisions, we query whether the provision of the PDS via the portal will be enough to satisfy AFCA that the requirements of section 35(2) of the Insurance Contracts Act have been met. It would be unfair in the extreme if a requirement imposed by the PIO was deemed to be insufficient by AFCA.

(d) This is another reason why it seems sensible to NALSPA members to continue to allow the provision of the AOI product information via email, rather than forcing consumers and providers to only engage through an online consumer portal.

CONCLUSION

NALSPA would welcome the opportunity to provide further input throughout the consultation process, and would be pleased to discuss this letter with ASIC in further detail. Should you have any questions whatsoever, please contact me on mob 0466 207 822 or at rmartin@nalspa.org.au.

Rohan Martin
Secretary
NALSPA