CUSTOMER OWNED BANKING ASSOCIATION

23 April 2021

Ms Emma Curtis
Senior Executive Leader, Insurers
Australian Securities and Investment Commission
GPO Box 9827
Brisbane Qld 4001

By email: deferred.sales.model@asic.gov.au

Dear Ms Curtis

ASIC consultation on implementing a deferred sales model for add-on insurance products

COBA appreciates the opportunity to provide a submission to ASIC's consultation on implementing a deferred sales model for add-on insurance.

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has $146 billion in assets, around 10 per cent of the household deposits market and more than 4 million customers.

Customer owned banking institutions account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition, choice and market leading levels of customer satisfaction in the retail banking market.

COBA recognises that the deferred sales model for add-on insurance was recommended by the Royal Commission and has been implemented by amendments to the Australian Securities and Investments Commission Act 2001 (the ASIC Act).

> *"Under the deferred sales model, providers of add-on insurance must wait for four clear days after a customer has committed to acquire a principal product or service before selling them an add-on insurance product: s12DP(1) of the ASIC Act.*
>
> *The deferred sales model applies to an 'add-on insurance product'. The legislation specifies the type of financial product and the nature of the offer or sale for a product to be an 'add-on insurance product': s12DO(1)."*[1]

Key points:

- **The extent of classes of insurance products exempt under the deferred sales model regime is not yet known, making any response to the draft Regulatory Guidance difficult**
- **There is a lack of clarity about how the deferred sales model will interact with the anti-hawking regime, due to a range of unknown elements within the anti-hawking regime, and**
- **Due to the various uncertainties that continue to remain around this suite of reforms, COBA is concerned that there is not enough time for industry to prepare for the**

[1] Consultation Paper CP 339: Implementing the Royal Commission recommendations: The deferred sales model for add-on insurance

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commencement of the new regime on 5 October 2021. COBA requests that ASIC and Treasury consider delaying the commencement of the new regime for six months after all regulations and regulatory guidance are completed, to allow adequate time for implementation.

Exempt classes of add-on insurance

COBA's ability to respond to ASIC's consultation materials is limited by uncertainty around the classes of insurance products that will or will not be exempt from the regime.

ASIC will be aware of Treasury's consultation on deferred sales model exemptions by class, conducted in January and February 2021.[2]

> *"The Treasurer has noted there may be a limited number of add-on insurance product classes that represent a very high level of value for consumers and where it would not be appropriate that they are captured by the deferred sales model."*[3]

COBA responded to Treasury requesting the class exemption of home building insurance from the deferred sales model regime, on the basis that it could have unintended consequences for the distribution of the product, resulting in consumer detriment.

In our submission (attached), COBA said:

> *"These new laws flowing from the Financial Services Royal Commission are intended to protect consumers, particularly from "junk" products or from sales pressure in relation to products they don't really need. However, home building insurance is not a "junk" product. Home building insurance is a necessary product, not an optional product. These new laws raise barriers to offering home building insurance, exposing borrowers to significant financial risk and inconvenience and ADIs to conflicting regulatory obligations."*[4]

COBA expects that Treasury would also have received submissions requesting to exempt additional classes of insurance products relevant to our members' businesses.

The outcome of Treasury's consultation and the scope of exempt classes of insurance products is not yet known.

This creates a great deal of uncertainty for COBA members in understanding what products will be exempt from the deferred sales model regime, and to what extent they will be required to apply for exemptions under ASIC's individual product exemption powers.

Treatment of home building insurance in RG 000

ASIC's draft guidance RG 000 cites home building insurance in examples throughout the guidance.

At RG 000.20 – RG 000.21, ASIC says:

> *"For example, a lender may provide a home loan product to a customer and, under an arrangement, give the customer's contact details to an issuer of home building insurance. If the issuer of the insurance contacts the customer three weeks later, the offer will still be 'in connection with' the customer acquiring the principal product.*

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[2] https://treasury.gov.au/consultation/c2021-142813

[3] https://treasury.gov.au/consultation/c2021-142813

[4] COBA submission to Treasury consultation deferred sales model exemption by class (attached)

> *This is because the opportunity to sell the insurance arose because the customer acquired the home loan and the lender passed the customer's details on to the issuer of home building insurance. The issuer of home building insurance will commit an offence if they have not complied with the deferred sales model before selling the add-on insurance product."*[5]

ASIC also cites home building insurance at RG 000.80:

> *"At all times, a provider must limit the communication to the purpose for which the customer initiated the contact. For example, if a customer initiates contact to discuss home building insurance offered with a home loan, the provider cannot discuss another add-on insurance product (e.g. consumer credit insurance) unless the customer raises it."*[6]

ASIC's inclusion of these examples is unclear in that it appears that ASIC intends to treat home building insurance as a class of add-on insurance that is captured in the deferred sales model and by the anti-hawking regime.

This is confusing in the absence of Treasury responding to the broader consultation around classes of insurance products.

Interaction with the anti-hawking provisions

COBA understands that the deferred sales model for add-on insurance will interact with the expanded anti-hawking regime.

ASIC has endeavoured to explain the interaction of the two regimes in the draft regulatory guidance at parts RG 000.48 to RG 000.53.

However, in the absence of certainty around exempt classes of insurance product, and without revised regulatory guidance for the expanded anti-hawking regime, it is difficult for our members to fully understand the changes to their business operations that will need to occur to comply with both regimes.

In its current form, the anti-hawking regime will capture basic banking products, although COBA has been advised that an exemption for these products is likely to be provided via regulation before the regime commences.

COBA notes it has written to Treasury (attached) to request that home building insurance be exempt from the deferred sales model and for clarity on its treatment under the anti-hawking regime:

> *"Given that it is a requirement for ADI lenders to ensure that borrowers insure their house and that it is in the interests of the borrower to insure their house, it is undesirable and unreasonable to impose new barriers on offering such insurance.*
>
> *It is also unreasonable to impose conflicting regulatory obligations on ADIs. ADI lenders should not be restricted from acting in the interests of borrowers and meeting their prudential regulatory obligations."*[7]

COBA has urged Treasury to make a clear public statement, such as via ASIC guidance, that the anti-hawking regime does not prohibit an ADI from offering home building insurance during the process of arranging a home loan.

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[5] Consultation Paper 339: Regulatory Guide 000: The deferred sales model for add-on insurance

[6] Consultation Paper 339: Regulatory Guide 000: The deferred sales model for add-on insurance

[7] COBA submission to Treasury consultation deferred sales model exemption by class

Limited timeframe for implementation

Considerable detail for the deferred sales model for add-on insurance remains outstanding, in the absence of certainty around classes of exempt insurance products. There is also a lack of clarity around the full scope of regulatory change for the related anti-hawking regime.

COBA is concerned that the 5 October 2021 commencement date does not give our members adequate time to implement internal practices and procedures into order to comply with the new regimes.

COBA urges ASIC and Treasury to consider delaying the commencement date of the deferred sales model to allow a full six-month period after all regulations and regulatory guidance are finalised. This will allow members adequate time to implement the changes required to comply with the new regime.

Regulatory impact statement

These risks of the deferred sales model were not considered by a normal regulation impact statement process for the legislation. The Royal Commission Final Report was "certified as being informed by a process and analysis equivalent to a Regulation Impact Statement for the purposes of the Government decision to implement this reform."[8] However, the Final Report did not consider the consequences of imposing new barriers to offering home building insurance.

Thank you for the opportunity to provide these comments. If you wish to discuss any aspect of this submission, please contact ( ).

Yours sincerely,

Chief Executive Officer

ATTACHMENT: COBA submission to Treasury on deferred sales model for add on insurance

[8] Financial Sector Reform (Hayne Royal Commission Response) Bill 2020, Explanatory Memorandum

CUSTOMER OWNED BANKING ASSOCIATION

19 February 2021

Mr Luke Spear

Director

Insurance – Sales and Claims Unit

Financial System Division

The Treasury

By email: luke.spear@treasury.gov.au

Dear Luke

Home building insurance under deferred sales model & anti-hawking regimes

COBA is concerned that the deferred sales model regime for add-on insurance and the new anti-hawking regime could have unintended consequences for the distribution of home building insurance, resulting in consumer detriment.

COBA member banking institutions are concerned that their capacity to offer home building insurance to home loan borrowers will be hampered by these new laws. For most people, the family home is their most valuable asset. Destruction of this asset without insurance would be a financial catastrophe for most people. For borrowers, they would be without a home but still obliged to repay a loan.

These new laws flowing from the Financial Services Royal Commission are intended to protect consumers, particularly from "junk" products or from sales pressure in relation to products they don't really need. However, home building insurance is not a "junk" product. Home building insurance is a necessary product, not an optional product. These new laws raise barriers to offering home building insurance, exposing borrowers to significant financial risk and inconvenience and ADIs to conflicting regulatory obligations.

These risks were not considered by a normal regulation impact statement process for the legislation. The Royal Commission Final Report was "certified as being informed by a process and analysis equivalent to a Regulation Impact Statement for the purposes of the Government decision to implement this reform."[1] However, the Final Report did not consider the consequences of imposing new barriers to offering home building insurance.

We are requesting Government action to avoid the unintended outcome of raising barriers to ADIs offering home building insurance to borrowers by:

- **Exempting home building insurance from the deferred sales model regime, and**
- **Making a clear public statement, such as via ASIC guidance, that the anti-hawking regime does not prohibit an ADI from offering home building insurance during the process of arranging a home loan.**

[1] Financial Sector Reform (Hayne Royal Commission Response) Bill 2020, Explanatory Memorandum

COBA and COB sector

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has $144 billion in assets and more than 4 million customers.

Customer owned banking institutions account for around three quarters of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition, choice and market leading levels of customer satisfaction in the retail banking market.

COBA's members have a strong presence in regional Australia. The head offices of eight of the 10 largest customer owned banking institutions are outside Sydney and Melbourne, including in Brisbane, Adelaide and Perth and in regional centres such as Toowoomba, Newcastle and Wollongong.

Home lending is our sector's core business. Our sector's share of ADI housing lending is 5.6 per cent.

Home building insurance

Home building insurance provides coverage against damage or destruction and covers the cost of repairing or replacing a home.

The timing of securing home building insurance is an important consideration for a borrower to ensure adequate protection.

Financial comparison site Canstar advises consumers that each state and territory has its own standard position as to when the risk of damage to the property normally passes from the seller to the buyer:

> "In most parts of the country, this will either be when the buyer and seller exchange signed contracts or at settlement."[2]

APRA expects ADIs to ensure that homes that are security for a home loan are covered by insurance. Prudential Practice Guide APG 223 Residential Mortgage Lending says:

> "Good practice would be to ensure that claims against collateral are legally enforceable and could be realised in a reasonable period of time if necessary. This would include the ADI confirming that: a) the borrower has, or will have when the loan is extended, a clear title to the property; b) the characteristics of the property are as they have been represented; and c) the property serving as collateral is appropriately insured at the time of origination and is maintained under the contractual terms of the mortgage."

This APRA guidance will soon have the force of law, as it becomes part of a prudential standard. Prudential Standard APS 220 Credit Risk Management, which is due to commence on 1 January 2022 or earlier depending on passage of the Government consumer credit reform legislation, says:

> "An ADI must ensure that assets to be taken as security are accurately identified and documented in exposure documentation. An ADI must ensure that the relevant legal requirements are met to maintain the ADI's security position and to provide for its enforcement. This includes the ADI confirming that: (a) the borrower has, or will have when the exposure is extended, clear title to the assets; (b) the characteristics of the collateral are as they have been represented; and (c) assets serving as collateral, where relevant, are appropriately insured at the time of origination and this insurance is maintained under the contractual terms of the exposure."

Draft prudential practice guide APG 220 Credit Risk Management says:

> "APS 220 requires insurance of a property asset taken as security to be maintained under the contractual terms of the exposure. APRA expects an ADI to regularly review insurance arrangements. This does not mean an ADI would necessarily review the holding of insurance across the full term of the exposure for all types of exposures. For example, for residential mortgage

[2] https://www.canstar.com.au/home-insurance/need-home-insurance-settlement/

loans, an ADI would only be expected to confirm insurance in the first year and make it a contractual obligation for the term of the loan."

Given that it is a requirement for ADI lenders to ensure that borrowers insure their house and that it is in the interests of the borrower to insure their house, it is undesirable and unreasonable to impose new barriers on offering such insurance.

It is also unreasonable to impose conflicting regulatory obligations on ADIs. ADI lenders should not be restricted from acting in the interests of borrowers and meeting their prudential regulatory obligations.

This issue was specifically considered during the consultation process on the anti-hawking legislation and the draft bill's explanatory memorandum explicitly addressed the issue, providing clarity, i.e. that the ban on hawking would not prohibit an ADI offering home insurance during the process of arranging a home loan for a customer.

At paragraph 1.59, the draft bill's explanatory memorandum noted that it is expected that if a consumer requests a product (for example, a home loan) then a reasonable person would consider related financial products that provide cover for associated risks (for example, home insurance) to be within the scope of the request.

> "Example 1.14 Eleanor visited a bank and made a clear, positive and informed request to arrange a mortgage. During the process the bank offered home insurance. The home insurance would protect Eleanor's ability to repay the bank in the event of loss or damage to her property. A reasonable person would consider home insurance as covering risks directly associated with the mortgage, so the offer of the home insurance is reasonably within the scope of Eleanor's request."

However, and unfortunately, this explanation was not replicated in the final version of the explanatory memorandum. This should be remedied in guidance from ASIC or by whatever means necessary.

For a home loan borrower, home building insurance has a very high level of consumer value and therefore should not be captured by the deferred sales model.

Providing clarity and certainty about the legal position for ADIs offering home building insurance to home loan borrowers would have the following benefits:

- convenience for customers due to a reduced consumer time and effort needed to secure an important and highly-valued financial product
- reduced risk to borrowers due to the greater likelihood of borrowers obtaining home building insurance coverage in a timely way
- reduced costs on ADI lenders in meeting their prudential obligations, and
- reduced costs that ADI lenders would otherwise bear in terms of legal advice, changes to systems and processes and staff training.

Thank you for the opportunity to provide these comments. If you wish to discuss any aspect of this submission please contact ( ).

Yours sincerely

Chief Executive Officer