23 April 2021

Emma Curtis
Senior Executive Leader
Financial Services and Wealth
Australian Securities and Investments Commission

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

Dear Ms Curtis

ASIC Consultation Paper 339 – Implementing the Royal Commission recommendations: The deferred sales model for add-on insurance

The Australian Banking Association (**ABA**) welcomes the opportunity to provide our response to Australian Securities and Investments Commission (**ASIC**) Consultation Paper 339 on the implementation of a deferred sales model for add-on insurance (**DSM**).

General comments

The ABA supports the introduction of a DSM that is consistent with the recommendations of the Royal Commission and Productivity Commission. The focus of both the Royal Commission and Productivity Commission were on add-on insurance products that were considered to be of poor value to customers and were generally not well understood. Such insurance products included consumer credit insurance, GAP insurance and insurance sold at point of sale such as travel insurance and extended warranties.

The introduction of the DSM will enable consumers to make better informed decisions in relation to these product purchases by enabling and encouraging them to consider the merits of the insurance offered and to compare this insurance with alternative products.

Application of the DSM to credit providers

The ABA believes some clarification is needed to ensure that ASIC's regulatory guide clearly identifies which products are covered by the DSM and which are not.

The legislation to implement the DSM currently defines an add-on insurance product as an insurance product which is sold to cover risks associated with *the offer or sale of a principal product or service either by the provider of the principal product or service, or by a related party.* This definition ensures that the DSM applies to consumer credit insurance, GAP insurance and insurance sold at point of sale. However, the ABA does not believe that this definition applies to insurance products that are distributed by a credit provider which provide cover for *an asset purchased with a loan from that credit provider.* This is because the principal product or service is not the asset, but the loan.

In the context of a mortgage, a consumer will usually enter into an agreement to acquire two different principal products / services, the house and the mortgage. Where the house is considered to be the principal product, then home insurance which manages the financial risk of the value of a house decreasing due to the occurrence of certain insured events will only be captured by the DSM where it is being provided by the provider of that principal product or service, which in this case is the vendor.

Where the mortgage is considered the principal product or service, then the only insurance product which would be considered an add-on insurance product and captured by the DSM is consumer credit insurance as it is managing the financial risk of the principal product or service, the mortgage. In this regard, where a financial institution provides a loan and also offers the borrower a home insurance policy, that insurance cannot be considered to be an add-on insurance product and thus the DSM would not apply.

The same is applicable to the situation where a credit provider provides a personal loan for the purchase of a car. The loan in this regard is the principal product or service, not the vehicle, and the car insurance sold by a credit provider that protects the car would not be classified as an add-on insurance product (because it does not manage the financial risk of the principal product provided, being the loan). Car insurance sold with the sale of a car would only be captured by the DSM in situations where both the car and the car insurance are sold by the same provider. We are of the view that this distinction should be clearly expressed in ASIC's regulatory guide.

Purchasing property in Queensland

We note that under a Real Estate Institute of Queensland (**REIQ**) standard contract for the purchase of a property, the property is considered at the buyer's risk from 5pm on the first business day after the contract date. Imposing a four-day deferral sales period on the credit provider in offering home building and contents insurance with the provision of credit may result in the underinsurance of the customer, and would result in the credit provider having to refer a customer to other providers to ensure that the risk of underinsurance is mitigated, which is not commercially sensible.

Specific comments

The ABA's specific comments on the consultation paper are outlined in the attachment to this letter.

We thank you for the opportunity to provide comments on the implementation of the DSM and look forward to working with ASIC through this consultation process. Please contact me on or at if you have any questions.

Yours sincerely

Associate Director, Policy
Australian Banking Association

Australian Banking Association

Attachment – ABA feedback on consultation paper 339 – The deferred sales model for add-on insurance

Section B – Complying with the deferred sales model

Scope of the DSM

General insurance products provided by a credit provider

The ABA supports the application of a DSM to add-on insurance products that are considered to be of poor value and are generally not well understood by customers. The introduction of the DSM will enable consumers to make better informed decisions in relation to these product purchases.

The legislation to implement the DSM requires certain criteria to be met before a product is to be considered an add-on insurance product. In particular, s12DO(1)(b) of the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**), states that an insurance product will only fall within the remit of the DSM where the product is offered or sold by:

- The provider of the principal product or service; or
- Another person, in accordance with an arrangement to which the provider of the principal product or service is a party.

In respect of the purchase of a house or a car, in circumstances where a credit provider is offering an insurance product and is not the principal provider or in arrangement with the principal provider of the house or car, the credit provider's offer of that insurance product would not be captured by the DSM.

Further, s12DO(1)(c) of the ASIC Act, states that an insurance product must manage a financial risk relating to the principal product or service. Based upon this criteria, the ABA does not believe that the DSM would apply to insurance products that are distributed by a credit provider that provide cover for an asset purchased with a loan from that credit provider, since the principal product or service in this situation is the loan and not the asset purchased.

In the example of where a credit provider provides a home loan and offers home and contents insurance, the principal product or service being provided is the home loan. The insurance product in this case is not insuring against a financial risk related to that home loan. Rather, it is insuring against financial risk relating to damage of that property or its contents (i.e. the insured's repayment obligations to the financier are not assured by the cover). In this regard, the home and contents insurance would not be classified as an add-on insurance product. This interpretation of the definition of add-on insurance would also apply in the situation whereby the credit provider provides personal loans and also offers motor vehicle insurance. In these scenarios, the insurance product would not meet the definition of an add-on insurance product and thus the DSM would not be applicable. Applying the DSM in the above situations could result in serious financial loss particularly where the individual is underinsured while they were attempting to arrange insurance separately during the four-day deferral sales period.

We note that ASIC's regulatory guide sets out criteria that, if met, would result in a financial product being less likely to be considered as an add-on insurance product where the principal product is a loan. This criteria includes:

1. The insurance product benefits are not linked to the customer's financial obligations under the loan;
2. The insurance product pays the benefit to the insured or their beneficiaries and allows these benefits to be used in any manner (i.e. there is no requirement to use the benefits to pay any outstanding loan amount); and
3. The insurance product continues even if the loan has been repaid.

Taking the example of a credit provider offering home and contents insurance at the time of home lending and applying this criteria, 1) the potential claim outcome of the insurance policy is not directly linked to the financial repayment obligations of the customer for a home loan secured by residential property; 2) while a lender may be nominated as an interested party on an insurance policy, the lender does not have an insurable interest under the policy and the policy holder's financial obligations under a loan do not affect the insurer's acceptance of the risk or the insurer's assessment of any claim that may be payable under the policy. In many cases, any claim paid out for damage of the residential property would be paid out to the policy holder, with the responsibility falling on the policy holder to ensure their obligations under the home loan agreement are met e.g. in relation to notifying the lender of a claim and arranging repairs in order to maintain the value of the property; and 3) the home and contents insurance cover continues irrespective of the status of amounts owing under a home loan and will continue even after the loan has been repaid.

The same argument can also be applied to personal loans and any motor insurance purchased by a customer in relation to a vehicle, boat, caravan, or motorcycle, and small business loans with the purchase of commercial vehicle insurance or commercial property insurance.

Overall, we believe that applying this criteria to the scenarios outlined above further supports our conclusion that general insurance products offered by a credit provider in conjunction with the offering of a loan would not be considered add-on insurance products and the DSM would not be applicable.

To remove any ambiguity that currently exists, ASIC should clearly outline in its regulatory guide that where general insurance products are provided by a credit provider with the offering of a loan then these products would not be considered add-on insurance and would fall outside of the scope of the DSM. The regulatory guide should include examples to highlight this interpretation.

Complimentary insurance provided with a credit card

Banks provide different types of complimentary insurance with the offer of a credit card to customers (i.e. international travel insurance, extended warranty insurance, and purchase protection insurance). The ABA submits that complimentary insurance should not be captured by the DSM on the basis that it is not offered or sold to the customer. This is consistent with paragraph 3.29 of the Explanatory Memorandum to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020,* which provides:

> 'Insurance that is provided complimentary with a product or service (regardless of whether the insurance covers the risks associated with that product or service or another unrelated product or service) is generally not an add-on insurance product. Such insurance is unlikely to be caught by the deferred sales model as it is generally not offered nor sold to a customer.'

In line with the arguments above, we do not believe that such insurance products would be classified as add-on insurance products given that they are not managing a financial risk associated with the principal product being provided. Given this, the ABA suggests that the regulatory guide should expressly state that these types of complimentary insurance products fall outside the scope of the DSM and this should be supplemented by an example.

Lenders mortgage insurance

The ABA does not believe the DSM applies to the sale of lenders mortgage insurance (**LMI**) given that it is insurance that is purchased by the bank to insure against risks associated with the customer being unable to afford their mortgage repayments. We, however, consider it important for the regulatory guide to outline this through an example to ensure the necessary clarity for the industry.

Customer purchases insurance during the deferral period in a self-directed manner

The ABA has concerns that as currently proposed ASIC's regulatory guide is silent on the scenario where a customer, following an interaction with a provider of a principal product and add-on insurance, and during the four-day deferral period, in a proactive self-directed manner purchases the add-on insurance product from the provider (through attendance at another branch, by phone contact, or by online means). The ABA is of the view that in these circumstances, the insurance product would be considered to have been purchased on the standalone market given the customer has had the ability to consider all of their options prior to making this proactive purchase. In this regard, the regulatory guide should provide greater clarity on this scenario and clearly express that in these situations the provider would not have committed an offence.

Customer opt-out followed by subsequent proactive customer engagement

ASIC's regulatory guide provides guidance that where a customer communicates to the principal or third-party product provider that they no longer wish to receive offers, requests or invitations relating to add-on insurance products, then any subsequent contact by the provider would be an offence.

The ABA suggests that the regulatory guide should also include a scenario where the customer themselves chooses to engage with the principal or third-party product provider after opting-out of a discussion on the purchase of an insurance policy. To ensure clarity, the industry would benefit from the regulatory guide stating that where a customer engages with the product provider in a self-directed manner (i.e. not prompted by direct contact from the provider) following an opt-out by that customer, then this subsequent contact and discussion would not constitute an offence.

When a customer enters into a commitment

The regulatory guide outlines that a customer enters into a commitment when they are informed in writing of the approval of the credit facility. As currently proposed, this could be interpreted to be at the time conditional approval is provided in writing or at the point that unconditional approval is granted. If the deferral sales period begins at the time of unconditional approval, consumers would be at risk of underinsurance in jurisdictions where buyers are responsible for damages from the time of the contract exchange (i.e. Queensland) and when contracts are exchanged within four days of pre-approval. To ensure consistent application across the industry, given these differing state legislative requirements and to mitigate against underinsurance, we would suggest ASIC clarify the definition in its regulatory guide.

Section C – Exemptions from the deferred sales model

The legislation to implement the DSM provides ASIC with the power to exempt classes of products. The proposed guidance will outline the factors that are to be considered by ASIC when considering whether to exempt an add-on insurance product or class of product sold by a specific entity. Factors for consideration include evidence that the product or class have historically been good value for money and are well understood by customers.

To provide the industry with clarity, the ABA suggests that ASIC publish information for consultation where it is proposing to exempt a product or class of product in a manner similar to the information it publishes prior to exercising its product intervention powers.

In addition, we would support ASIC providing further guidance or examples in the regulatory guide as to its interpretation of the factors it would consider in granting an exemption. For example, we note that RG000.169(a) refers to low claim decline and withdrawal rates that may show that consumers are getting cover they expect under a product, and it would be useful for ASIC to provide greater clarity on what it considers low claim decline and withdrawal rates.

Section D – Customer Information

Australian Government logo

We understand that the Customer Information will include the Australian Government logo to signify authority and distinguish the Customer Information from marketing material or other paperwork that a provider may supply.

The ABA supports the inclusion of a logo within a fixed template only. We note, however, that the use of the Australian Government logo may be misleading to customers. It may be more appropriate to include ASIC and/or ASIC's MoneySmart logo given that a hyperlink reference to ASIC's MoneySmart website will be included in the Customer Information.

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Statements that the customer can say 'no' and insurance is not compulsory

While the ABA supports the Customer Information being provided to the customer to educate them on the application of the DSM, we believe the proposed language is too strong and could have a deterrent effect on the customer that could to lead to underinsurance.

As a requirement of securing a home loan, credit providers require customers to have home insurance or landlord insurance, and as currently proposed the Customer Information would create confusion for these customers as it would imply that the Australian Government is directing customers to not purchase insurance and that the purchase of this insurance is not compulsory.

To avoid this confusion and the risk of underinsurance, the ABA would recommend the Customer Information prioritise informing customers about the DSM and that a four-day deferral sales period exists rather than including a statement that the customer can say 'no' and that the insurance is not compulsory.