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Treasury Proposal Paper Submission – Reforms to the sale of add-on insurance products

1. As the representative body for Australia's major salary packaging providers, the National Automotive Leasing and Salary Packaging Association (**NALSPA**) welcomes the opportunity to make a submission on the *Treasury Proposal Paper: Reforms to the sale of add-on insurance products* dated 9 September 2019 (**Proposal Paper**).

About NALSPA and why we are submitting

2. NALSPA's members help over 800,000 Australian employees utilise their pre-tax salary to package a number of different employment-related benefits including products and services which may come within the scope of these reforms. As a result, NALSPA is committed to ensuring that these reforms achieve the intended customer benefits and protections without inadvertently resulting in poorer customer outcomes in other respects.

3. One of the key employer-provided benefits that employees' salary package under Australian taxation law is a motor vehicle via a novated lease arrangement. With a novated lease, the costs associated with the finance and operation of a vehicle, including insurances, can be packaged into a single, regular fixed, payroll deduction, comprising a mix of pre-tax and post-tax dollars.

4. Overall, vehicles that are the subject of a novated lease are a much younger and healthier carpark than the overall Australian carpark. NALSPA members currently administer over **180,000 novated leases** for Australian employees, equating to a total asset-value of around **$6.7B**, driving significant economic value through the Australian economy.

5. Over the last two decades novated leasing has become a popular method for employees in the health, charitable, public and private sectors to cost effectively finance and operate a motor vehicle. It is estimated that a novated lease structure is used for nearly 1 in 10 of all new annual car sales in Australia (PwC estimate).

6. In particular we note that novated leasing is utilised by many not-for-profit (NFP) organisations given the specific FBT concessions the Government has embedded in the tax legislation for the sector, as a means of competing for valued staff in view of their inability to provide wage parity.

7. Given the potential impact of the reforms outlined in the Proposal Paper to the many employers across Australia who provide a motor vehicle benefit and their employees who utilise the benefit to procure and tax effectively operate a vehicle, we have outlined our concerns and proposed solutions in this submission and we would welcome the opportunity to engage further with Treasury in relation to such matters.

Insurances sold via a salary packaging channel require a different approach

8. NALSPA is fully committed to ensuring that embedded selling processes and practices, in relation to insurance products offered in a salary packaging context, maximise the capacity of customers (employees) to make **rational and informed purchasing decisions**.

9. As is outlined in this submission, the sale of add-on insurance (AOI) products via salary packaging arrangements already contains natural pauses at various stages in the procurement process. In other words, a deferred sales mechanism is already embedded within the salary packaging context in which the customer is specifically considering a **'whole of life'** vehicle cost, thus achieving the desired outcome of giving the customer the opportunity to consider the appropriateness of the products for them away from a salesperson/consultant.

   The indicative flow chart included at **Annexure A** to this submission demonstrates the *typical* novated leasing sales process and the natural pauses embedded within that process. This helps to illustrate the number of interactions typically that customers have with a provider regarding an add-on insurance product and the length of the overall sales process.

10. We note that without exception, the packaging of add-on insurances through a novated lease product and their sale via a salary packaging channel is **fundamentally different** from the sale processes associated with add-on products that are solicited at the point-of-sale and in the 'pressure-selling' environments referred to by the Financial Services Royal Commission and other bodies such as Australian Securities and Investment Commission (ASIC).

11. Accordingly, the novated lease product and associated salary packaging channel warrant different consideration.

12. At the core of the difference is the fact that the customer's consideration of the product and ancillary products, such as insurances, already occurs over a significant period of time with key stages that support informed decision making.

13. Strictly applying the proposed deferral process on top of the existing novated leasing process would **create no further consumer protections than those already embedded within current practices** and may in fact produce unintended negative consequences as it would likely diminish the ability of the customer to determine a 'whole of life' cost relating to the vehicle and to assess vehicle affordability in the context of their 'after tax' remuneration.

14. The Government has previously recognised the need for differential treatment of novated leasing products - for example by including an exemption for 'employment-released leases' from the National Credit Code (section 171 of the Code).

NALSPA's primary submission/recommendation

15. NALSPA is of the view that add-on insurances sold through a salary packaging channel should **be categorically exempt** from the deferred sales model outlined in the Proposal Paper. Accordingly NALSPA seeks an exemption for the sale of add on insurance products included in the quotation of an employment-related lease from any consequent legislation.

NALSPA's secondary submission/recommendation

16. Should an exemption not be granted, then it is imperative that the definition of the 'trigger point' for the deferred sales period in the legislation specifically accommodate the salary packaging sales process by commencing from the time at which the novated lease **written quote** is provided to the salary packaging customer.

A. Overview of the sale of add-on insurance in the Salary Packaging Sector

Salary packaging and novated leasing explained – an employer provided benefit

17. As defined by the Australian Taxation Office (ATO), salary packaging is an arrangement between an employer and an employee, whereby the employee agrees to forgo part of their future entitlement to salary or wages, in return for the employer providing them with benefits of a similar cost (to the employer). By using pre-tax salary to pay for certain expenses, employees are able to increase their take home pay and decrease their taxable income.

18. A novated lease is a means of providing the benefit of the use of a motor vehicle for an employee via salary packaging, without the employer having to actually own the vehicle and also allowing the vehicle to move from employer to employer with the employee. The employee sacrifices a portion of his/her salary to cover the cost of the finance and running costs, ultimately resulting in tax savings to the employee.

19. Employees assess the benefits and costs associated with a novated lease against other means of financing and operating a vehicle. In this regard the novated lease product is one of many means available to employees.

20. We note that the ATO's acceptance of the concept of novated leasing and its position on the taxation laws applying to novated leases (and salary sacrificing) have been settled for a long period of time. To illustrate, the ATO's definitive **public ruling on novated leasing** was first released some 20 years ago, and, as such the laws and practices around the product and associated processes are very settled and established in terms of the taxation consequences – refer https://www.ato.gov.au/law/view/document?DocID=TXR/TR199915/NAT/ATO/00001&PiT=99991231235958.

21. The ATO publishes voluminous information which explains various concepts such as GST on novated leasing, and salary sacrificing in general. With the latter, the ATO gives specific examples of things that can be packaged – refer salary sacrificing: https://www.ato.gov.au/General/Fringe-benefits-tax-(FBT)/In-detail/Employees/Salary-sacrifice-arrangements-for-employees/. Refer novated leasing: https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Motor-vehicle-and-transport/GST-and-vehicles-purchased-under-novated-leases/.

22. The term ‘novated lease’ stems from the fact that as part of the arrangement with an employer, a lease is novated from an employee to an employer. The lease is a three-way agreement between:

  a. an employee;
  b. an employer; and
  c. a lease company (financier).

23. Using a combination of both pre-tax income and post-tax income, the employee pays for:
  a. lease payments to the lease company;
  b. insurances;
  c. vehicle repairs and maintenance;
  d. registration;
  e. petrol; and
  f. other related-vehicle operating costs.

24. Importantly, the products and services made available to employees via salary packaging are offered in accordance with the **contractual arrangements** negotiated between the salary packaging provider and the employer, for the benefit of the employee with the salary packaging provider. The provision of these products and services by salary packaging providers is therefore approved by the employer and delivered against a backdrop of service delivery performance requirements as defined and monitored by the employer pursuant to their contractual arrangement.

25. We note that some employers require certain add-on insurance products, such as lease protection insurance, to be offered with a novated lease as a risk mitigation strategy in the event of termination of employment of their employees who salary package.

26. Salary packaging service contracts between the salary packaging provider and the employer also provide significant benefits to employees utilising their employer’s salary packaging programs, including benefits arising from the purchasing collective of the employer and the purchasing power and industry relationships of the salary packaging provider.

An overview of the novated lease ‘process’ and whole of life vehicle cost

27. In broad terms the novated lease process begins with a fact finding activity and working with the customer to answer their questions and deepen their knowledge as necessary. This initial process may take days or weeks depending on the circumstances.

28. Importantly, we note that for a majority of customers, the salary packaging provider **does not** directly procure (find) the vehicle for the customer. Rather the customer is, or has already arranged to purchase the vehicle (either from a licensed motor vehicle dealer or privately) themselves, or are wanting to re-lease an existing vehicle or seeking a ‘sale and leaseback’ arrangement.

29. The novated lease establishment process will normally progress to providing the customer with an estimate (or vehicle quote). This is accompanied by detailed product <u>and</u> premium information in writing regarding add-on insurance products as appropriate. It is important to note that nearly all customers ask, over a period of time, for multiple quotes as they assess what is appropriate for them.

30. Vehicle quotes provide the employee with a **“whole of life”** cost relating to the vehicle, represented in increments aligned to the frequency of the employee’s salary payments. These quotes provide

product and pricing information for the employee and enable them to assess vehicle affordability in the context of their "take home" pay.

31. This process together with the quote and the related product information are important to enable the customer to digest and consider all aspects of their proposed financial commitment, the tax concepts and terms associated with a novated lease, how it compares with alternative funding sources, their insurance needs and, crucially, the overall impact on their take home pay. The customer is afforded the time to ask and discuss any questions, as the novated lease establishment and decision timeline is effectively determined **by them**.

The conflict with a mandated deferred sales process

32. Any regulatory change that diminishes an employee's ability to accurately assess, from the beginning, the true total monthly (or fortnightly) cost of the vehicle, including associated financing, operating and related costs, for their personal situation and in the context of their take home pay, will result in a significant disadvantage to the employee, limiting their understanding and ability to make a properly informed decision.

33. The role of the salary packaging provider is to consult with the employee to help them identify products they can beneficially salary package and the impact of salary packaging the desired product or products is estimated to have on their disposable income. Once the employee has elected to salary package one or more products, the salary packaging provider then facilitates the salary packaging process. The salary packaging provider works alongside the employee for the duration of the packaging arrangement.

34. We also note that whilst motor vehicles are a significant salary packaging item, salary packaging providers are normally required under their contractual arrangements with employer clients to offer a broad range of packaged items able to be accessed by employees.

35. This means that the employee communication and interaction processes designed by salary packaging providers need to be able to incorporate a number of different products and processes, often simultaneously, including non-motor vehicle benefits such as superannuation contributions and laptops.

36. NALSPA is **unsure** as to how its members would continue to provide services as required (contracted) by employers (for example, assisting an employee to understand their whole of life vehicle cost from an after tax perspective) if they were prohibited from speaking or engaging with that customer about important associated vehicle costs, such as insurances during a deferral period.

37. This ongoing relationship (with both the employee and the employer) can be materially contrasted to the 'one-off' nature of a transaction occurring within a retail outlet facility or via a quick on-line purchase. Salary packaging providers are incentivised by the nature of the relationship to create and maintain valuable, trusting and sustainable relationships with employees and employers alike.

38. For the benefit of this submission, we highlight that the "**novated lease commencement**" process is in most cases <u>not</u> a face-to-face process. Most salary packaging providers manage the "salary package or novated lease commencement" process either on-line or over the phone and it does not occur in a single interaction with the employee as outlined above and illustrated in Annexure A.

39. Therefore, as already outlined, the customer investigating a novated lease option has significant time to consume and understand information in their own time. We also wish to re-emphasise that the duration of the "package commencement" process, which includes the offer of insurance products, is driven by the customer.

40. For the information of Treasury, and whilst it does vary across the novated lease sector, NALSPA estimates that the average time frame from commencement of contact with a customer through to completion (settlement) of all documentation and financing is in the order of **37 days**. (This timing does not include delivery time which can be substantially longer in the case of new vehicles (i.e. months)).

41. Where the employee determines that they require add-on insurance products, they are generally subject to a minimum cooling off period of at least **14 days**, depending on the specific product chosen, whilst the customer is also able to opt out of the insurance/s at any point up until settlement of the vehicle.

B. First feedback request in the Proposal Paper – why a particular type of insurance product should reside in a particular tier

42. Further to the submission outlined above, if not exempted through primary legislation, NALSPA proposes that all add-on insurances sold through the novated lease/salary packaging process should reside in **tier three** for two primary reasons:

    a. the current sales process already contains embedded pauses that ensure informed decision making; and
    b. the introduction of a deferred sales process that creates separation between the vehicle lease costs and other associated costs is not in the best interest of customers – without the complete information they are unable to properly consider the additional running and operating costs and make an informed 'whole of vehicle cost' decision regarding a novated lease versus other forms of finance.

Further detail on the above two points is highlighted below

43. We note that the Proposal Paper references the findings of the Royal Commission which highlighted that the current sales process for add-on insurance products "*inhibits informed consumer decision making"*. The Proposal Paper refers to various reasons for this outcome including, *"the inherent complexity of insurance products, unfair sales tactics and weak competition in add-on insurance markets" and "*pressure selling" which *"inhibits consumers from assessing the suitability of add-on insurance sold in connection with vehicles or vehicle finance."*

44. We respectfully submit that the sales process in the salary packaging sector by its very nature protects against these mis-selling concerns raised in the Proposal Paper, with the following factors:
    a. average time from initial interest to settlement is approximately 37 days;
    b. average number of contacts (either initiated by the customer or the provider) with the customer during the process is approximately 15;

c. all customers are provided with clear written product information (including Product Disclosure Statements and Financial Services Guides) to help with informed choice.

45. Conversely, the imposition of a deferred sales model in the form proposed in the Proposal Paper may result in **significant and detrimental impacts** to both salary packaging customers and providers due to the following reasons:

    a) in most cases the cost of ancillary items such as insurances are repaid together with the financed amount on a monthly basis**–** the **ATO** expects the total monthly repayment in respect of the lease (including any ancillary items) to be met with pre-tax remuneration;

    b) therefore, in order to be included as part of the employee's salary packaging arrangements and to ensure that the employee obtains the maximum possible benefit, a decision in relation to the purchase of such products must occur as part of the over-arching novated lease decision process, otherwise the decision cannot be made on a fully informed basis;

    c) any disruption to the current sales process is likely to reduce choice, and affect the ability of the customer to realise the maximum benefit available through their salary package arrangement – at a minimum it will **confuse** customers in a salary packaging context; and

    d) as already outlined, preventing or delaying conversations in relation to insurance products associated with the lease would diminish the ability to determine a 'whole of life' cost relating to the vehicle and to assess vehicle affordability in the context of their 'after tax' pay.

46. The ability to clearly understand the total impact on take home pay, which is a unique benefit of the salary packaging process, is of critical importance – it is the **single most important factor** in enabling an employee to determine the affordability of selected products, in light of their personal circumstances. Any regulatory or legislative instrument that inhibits a salary packaging provider from fully disclosing all elements of the salary packaging arrangement **<u>at the same time</u>** is a disadvantage to the employee, limiting their understanding and ability to make informed decisions.

47. We note that some employers see significant value in certain add-on insurance products offered with a novated lease, so much so that some employers require insurances, such as lease protection insurance to be offered as a risk mitigation strategy in the event of termination of employment of their employees who are salary packaging.

48. NALSPA is firmly of the view that the method of **distribution** of an add-on insurance product should be taken into account by the Government in assessing its proposed three tier structure and that all add-on insurance products sold through the salary packaging channel should be exempt from the deferred sales model outlined in the Proposal Paper and therefore **we seek exemption from any consequent legislation (either through categorisation by ASIC as Tier 3 products or as an exemption mandated through primary legislation).**

C. Second feedback request in the Proposal Paper – how the proposed trigger would correspond to current business practices in selling add-on insurance products

49. Section 1.4 of the Proposal Paper states that the deferral period trigger should start from when the "consumer makes a financial commitment to purchase the primary good/service and/or arranges finance".

50. As noted above, NALSPA's **primary view is that the distribution of insurance products through the salary packaging channel should be exempt** from the requirements regarding a deferred sales model.

51. The proposed trigger in Tier 2 would not accord with the manner and timing in which decision making occurs under a salary packaging arrangement where customers make decisions based upon the total composition of each element of the cost and operation of a vehicle so that there is full understanding of the cost of ownership as a 'package' or 'bundle'.

52. We further submit that the inherent protections under an enduring salary packaging contract, which is relationship based, should satisfy Government with respect to the risks referred to by the Royal Commission associated with the on the spot sale of add-on insurance's .

53. However, for completeness, we will address how the proposed trigger would correspond to current business practices. As currently outlined, the proposed deferral period trigger, being the 'financial commitment', **does not** fit easily into the novated lease and salary packaging context.

54. This is because, in order to receive the full benefits of the salary packaging arrangement in the context of a novated lease, the financial commitment to the add-on insurances has to occur at the **same time** as the financial commitment to the lease.

55. Specifically, in the context of a novated lease, **<u>the only sensible deferral period trigger is the point at which a written quote is provided to a salary packaging customer.</u>**

56. Any other 'trigger point' would result in a less satisfactory customer experience (for example if they are unable to be provided with the total overall package cost at the outset, or if multiple finance applications are required because the total package changes as a result of add-on insurances being added after the initial application process had been completed) or the customer missing out on obtaining the maximum benefit to which they might otherwise have been entitled. None of these outcomes are the purpose of the amendments, and in fact are arguably part of what the deferred sales model is attempting to avoid.

57. Further to that outlined in this submission, current industry practices mean that in order to generate a written quote, a salary packaging provider will have most likely engaged in consultation with a customer and obtained extensive information from a customer, including the following:

    a. the desired make and model of their selected vehicle or the vehicle they already have acquired or are in the process of doing so;
    b. their employer, employment arrangements and current salary;
    c. estimated annual kilometers (for operating budget calculation purposes);
    d. any desired extras for the vehicle; and
    e. a selection of insurance products and other products (e.g. roadside assistance, maintenance and aftermarket vehicle accessories) that they would like to obtain more information about.

58. The consultant utilises this information to generate a written quote. The written quote includes the full lease costs associated with the vehicle and the estimated periodic deductions that would be made from the employees take home salary to service the lease. The consultant will also provide disclosure materials regarding the selected products at this point, including the PDS and FSG associated with the nominated insurance products, and the delineated cost of any insurance products included in the quote.

The novated leasing sales process would accommodate a deferred sales period commencing from provision of a written quote

59. As noted above, the only sensible deferral period trigger is the point at which a novated leasing quote is provided to the customer. At this point:

    - the add-on insurances information would be provided in the prescribed form (**a form which we note is to be determined by ASIC**);
    - insurances would only be included and the information supplied, should the customer desire to receive such information. In the quote, any add-on insurances included would continue to have the cost/premium clearly disclosed;
    - the prescribed information would be provided to the customer at the time of the quote; and
    - the **4 day** deferral period would then commence with no further opportunity to complete the sale of add-on insurances during that timeframe - unless the customer initiates a shorter deferral period.

60. In addition to the above, as is currently the case, the customer would be able to opt out of the insurance/s at any point up until settlement of the vehicle.

61. The **rationale for the above is clear** - the customer will be incapable of making a fully informed decision in relation to their novated lease unless the salary packaging consultant is able to include all running costs at the point of the initial quote.

62. If the salary packaging provider is required to wait until after the customer has applied for finance to be able to discuss the insurance arrangements that the customer would like to apply to the lease, we risk the customer being forced to make an incomplete decision on their lease and also potentially risk the customer losing the ability to include the insurance as part of their financed total monthly payment.

    This is not a good customer outcome as it impairs the customer's ability to make a responsible, informed decision about affordability in the context of their take home pay.

63. Although our primary position remains, should that not be accepted then we suggest that setting the trigger point for the deferral period as the time of the initial written quote would provide the desired temporal separation and not disadvantage salary packaging customers, whilst also ensuring that the customer has sufficient time to make a rational and informed decision regarding their purchase of the products and the overall servicing cost for their novated lease. We are confident this is in line with the Government's intent.

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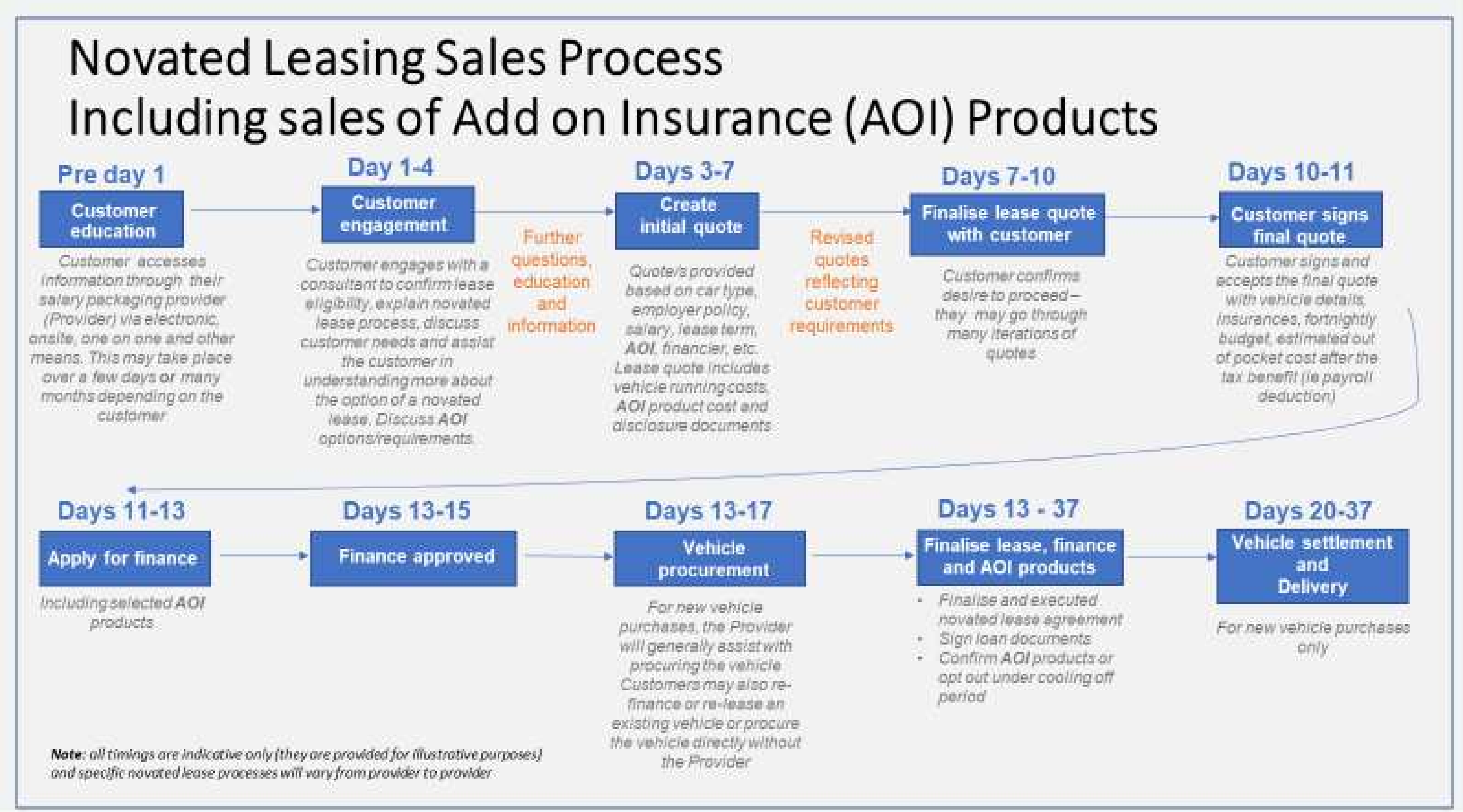
In summary, we again stipulate that NALSPA is of the view that add-on insurances sold through a salary packaging channel should **be categorically exempt** from the deferred sales model outlined in the Proposal Paper. Accordingly NALSPA seeks an exemption from any consequent legislation.

NALSPA would welcome the opportunity to provide further input throughout the consultation process, and would be pleased to discuss this letter with you in further detail. Should you have any questions whatsoever, please contact me on (03) 9097 3999 or at rmartin@nalspa.org.au.

Yours sincerely

Rohan Martin
Secretary

ANNEXURE A


Novated Leasing Sales Process
Including sales of Add on Insurance (AOI) Products
Pre day 1
Customer education
Customer accesses information through their salary packaging provider (Provider) via electronic, onsite, one on one and other means. This may take place over a few days or many months depending on the customer
Day 1-4
Customer engagement
Customer engages with a consultant to confirm lease eligibility, explain novated lease process, discuss customer needs and assist the customer in understanding more about the option of a novated lease. Discuss AOI options/requirements
Further questions, education and information
Days 3-7
Create initial quote
Quote/s provided based on car type, employer policy, salary, lease term, AOI, financier, etc. Lease quote includes vehicle running costs, AOI product cost and disclosure documents
Revised quotes reflecting customer requirements
Days 7-10
Finalise lease quote with customer
Customer confirms desire to proceed – they may go through many iterations of quotes
Days 10-11
Customer signs final quote
Customer signs and accepts the final quote with vehicle details, insurances, fortnightly budget, estimated out of pocket cost after the tax benefit (ie payroll deduction)
Days 11-13
Apply for finance
Including selected AOI products
Days 13-15
Finance approved
Days 13-17
Vehicle procurement
For new vehicle purchases, the Provider will generally assist with procuring the vehicle Customers may also re-finance or re-lease an existing vehicle or procure the vehicle directly without the Provider
Days 13 - 37
Finalise lease, finance and AOI products
Finalise and executed novated lease agreement
Sign loan documents
Confirm AOI products or opt out under cooling off period
Days 20-37
Vehicle settlement and Delivery
For new vehicle purchases only
Note: all timings are indicative only (they are provided for illustrative purposes) and specific novated lease processes will vary from provider to provider