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Dear Sir/Madam

EXTENDING UNFAIR CONTRACT TERMS (UCT) PROTECTIONS TO GENERAL INSURANCE CONTRACTS

The Insurance Council of Australia¹ (Insurance Council) appreciates the opportunity to comment on Treasury's Proposals Paper *Extending Unfair Contract Terms Protections to Insurance Contracts* (the Proposals Paper).

While still holding that Australian consumers already have rigorous and extensive protections when it comes to insurance², the Insurance Council and its members have taken account of the strong political and public concern regarding the exemption from UCT review within the Insurance Contracts Act and are willing to explore a solution that works in the interests of all stakeholders. Such an outcome would allow consumers to challenge insurance contracts for unfairness while not undermining the commercial certainty necessary for the stable and sustainable long term performance of the general insurance industry.

However, the Insurance Council and its members are seriously concerned that the key elements of the model proposed for insurance in the Proposals Paper would operate more severely, and create far more uncertainty, than the general UCT regime (in the ASIC Act and the equivalent provisions in the Australian Consumer Law) does for other sectors of the economy.

The Productivity Commission's recommendation in 2008 was that the national generic consumer law should address unfair terms in standard form contracts in order to prevent a

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. December 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$44.9 billion per annum and has total assets of \$118.6 billion. The industry employs approximately 60,000 people and on average pays out about \$132 million in claims each working day.

² This has been consistently argued in Insurance Council submissions since the Australian Consumer Law was first proposed in 2008. The most recent submission explaining this position is the Insurance Council's response of 9 December 2016 to the Interim Report on the Australian Consumer Law (available from the ICA website www.insurancecouncil.com.au).

significant imbalance in the parties' rights and obligations arising under the contract.³ The same goal should guide the current consultation on how to implement the Government's decision to apply UCT protections to insurance contracts. It should not seek to review the merits of the commercial bargain underlying the policy by applying a narrow interpretation of the exemption for terms which define the main subject matter or taking a restrictive view on the legitimate interests of the insurer.

Main Subject Matter

Under the proposal advocated in the Proposals Paper, the 'main subject matter of the contract' would be defined narrowly as terms that describe what is being insured.⁴ Under this approach, the terms of an insurance contract setting out the risks covered would be reviewable, with the insurer required to justify why they are necessary to protect their legitimate interests. This goes to the commercial bargain at the heart of the contract and is more onerous than what is applied to other sectors. For example, apart from it being accepted that the terms of a standard form contract for sale of a car relating to the make, model, and finish of the car being sold would not be reviewable for unfairness, no one is suggesting that terms which for the sake of certainty expressly exclude from the contract extras such as climatization and window tinting are reviewable and need to be justified on the basis of protecting the car dealer's legitimate interests vis a vis the consumer's detriment in not having them.

The impact of the uncertainty created by the proposed model on insurers will be significant. If insurers cannot rely on the terms forming the basis of their contracts, they will need to reprice the risks being underwritten and there will be significant implications for their reinsurance arrangements and the capital they need to hold. In turn, this will affect the scope of policy coverage and lead to higher premiums for consumers.

The Australian Consumer Law Review's Final Report proposed that applying UCT protections to insurance contracts would be consistent with the regulatory treatment in the UK and New Zealand. Legal advice received by the Insurance Council confirms that in the UK, application of the UCT provisions needs to take account of the European Council Directive (93/13/EEC) on the treatment of unfair terms in consumer contracts. This includes the following exemption for insurance contracts:

"...the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;"

The Insurance Council submits that adoption of the European approach to the main subject matter of the contract would allow insureds to challenge terms which unfairly prevent them from receiving the protection which they thought they had purchased, while giving insurers certainty that the commercial basis of the insurance contract would not be undermined. As highlighted in the proposals paper⁵, the European Commission's 2017 evaluation of its consumer directives concluded that the protections remain fit for purpose.

Productivity Commission, [Report into Australia's Consumer Policy Framework](#), Recommendation 7.1, volume 1, page 69.

⁴ Treasury Proposals Paper "[Extending Unfair Contract Terms Protections to Insurance Contracts](#)" June 2018 (at 34)

⁵ *Id.* at 28.

Meaning of Unfair

Treasury proposes that, when determining whether a term is unfair, a term will be reasonably necessary to protect the legitimate interests of an insurer if it reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and it does not disproportionately or unreasonably disadvantage the insured.⁶

While the need to manage underwriting risk is central to many terms of an insurance contract, it is not the only factor taken into account. For example, terms requiring the disclosure of relevant information would go to overall risk appetite. Furthermore, making the test for protection of legitimate commercial interests dependent on the impact on the particular insured, and not the whole class of insureds, would undermine the nature of insurance and create significant contractual uncertainty. It would often be the case that the theoretical cost to the insurer of providing cover to a particular consumer (say for example for termite damage) would be relatively modest but the impact to that consumer of rectifying the damage could be significant.

Consequently, the Insurance Council submits that it is unnecessary to tailor the definition of unfairness in relation to insurance contracts and the generic approach taken in the ASIC Act and Australian Consumer Law should apply.

Introduce the existing UCT laws into the Insurance Contracts (IC) Act

The Insurance Council's preferred option for extending UCT protections to insurance contracts is to introduce a stand-alone set of UCT protections in the IC Act which largely mirror those in the ASIC Act. If a Court is to have the ability to choose the most appropriate remedy for a term found to be unfair, it makes sense for the remedies to be found together in the IC Act. However, careful consideration would need to be given to how a UCT regime for insurance contracts would interact with the established UGF regime, particularly as a UCT regime for insurance contracts would introduce another, different concept of fairness into the IC Act. It would be helpful if the legislation clarified that not all terms found to be unfair would necessarily be breaches of the duty of UGF.

Need for the legislation to reflect how it is intended to be used

It has been put to the Insurance Council in stakeholder consultations that it shouldn't worry if the wording of any amendment applying UCT protections exposes key parts of an insurance contract to review. The rationale being that legal action would be expensive for both consumers and their advocates and ASIC, leaving enforcement to be implemented by ASIC through consultation with relevant insurers on the need to amend a term thought to be unfair.

The Insurance Council submits that such an approach to the law is deeply flawed; a law should be drafted as it is meant to be enforced. This view of how UCT protections would be applied to insurance contracts also ignores that most consumer disputes for general insurance don't involve legal action but are adjudicated by the Financial Ombudsman Service (FOS – soon to be the Australian Financial Complaints Authority (AFCA)). With the monetary limit on disputes coming before AFCA set at \$1 million⁷, Insurance Council members need to take account of the very real possibility that FOS will find an exclusion void

⁶ *Id.* at 38.

⁷ AFCA Draft Rules, c.1.2(e)

in order to reach a settlement that it considers to be fair in all the circumstances⁸; with this decision liable to be applied by FOS in all similar situations.

Examples of terms subject to UCT review under the industry's preferred approach

Under the approach advocated by Treasury, almost all terms of an insurance contract would be subject to UCT review. This is said to be justified by concerns that otherwise few terms would be reviewable. However, the Insurance Council has faith that Australian courts will be able, as their European counterparts have been able, to delineate between terms which define the risk which the insurer is willing to undertake and other ancillary terms.

Indeed, although there is limited Australian case law on UCT issues, the reasoning in *Abraham v Gogetta Equipment Funding Pty Ltd* [2017] NSWCATCD 22 is worth noting. In considering whether a term in a vehicle rental contract was unfair under the UCT laws, the NSW Civil & Administrative Tribunal interpreted the “main subject matter of the contract as follows:

“... the main subject matter ... is limited to those matters central to the consideration that passed between the parties when the contract was formed. This includes the total agreed price, the term of the contract and the monthly payments.”

Senior Member Shipp stated that the “main subject matter” of the contract did not extend to any “ancillary or subsidiary term”. The term in dispute was found to be ancillary because it did not go to the existence of the contract nor was it necessary to effect the supply of the rental vehicle.

In view of the above, the Insurance Council is confident that applying its preferred approach to the main subject matter exemption would expose for review those terms requiring attention for potential unfairness.

The following examples have been submitted by consumer advocate groups as examples of unfair terms which should be able to be addressed by UCT protections. For discussion purposes, the Insurance Council has considered how the UCT protections in the ASIC Act if mirrored in the IC Act but modified as described above, would operate.

For each of the examples, the Insurance Council considers that, if the clause concerned were thought to be unfair (as defined), redress could be sought by either consumers or ASIC as none of these terms would fall within the exemptions as formulated above. The Insurance Council does not however consider that such terms would necessarily be found to be unfair and it would be open to the insurer to argue that the term was necessary to protect its legitimate interests. For example, with respect to the Example B, the information is required to be able to recover the loss from the third party's insurer, especially given no premium is charged for this benefit.

⁸ FOS Terms of Reference 8.2 and AFCE Draft Rules A.14.2

Motor vehicle insurance⁹

Example A

“If You are responsible for damage to another person’s Vehicle, We will pay the reasonable costs of hiring a substitute Vehicle for that person at the lowest publicly available commercial rate, not exceeding \$100.00 per day. This benefit is limited to \$1500.00”

Example B

“Under Third Party, Fire and Theft or Third Party Property Only cover, up to \$5,000 or the car’s market value, whichever is the lesser, for accidental damage to the car, if there was an uninsured third party motorised vehicle involved and if:

... we agree that the third party was completely to blame for the accident; you provide us with the name, residential address, contact phone number and vehicle make and registration number of the other party;...”

Home building insurance

Example C

“When you make a claim we will choose whether to deduct the applicable excesses from the amount we pay you or direct you to pay the excesses to us or to the appointed repairer or supplier. We may require you to pay the excesses in full before we pay your claim or provide any benefits under your policy. The fact we have asked for payment of your excess does not of itself mean that your claim has or will be accepted by us either in whole or in part.”

The Insurance Council and its members remain prepared to explore options of applying UCT provisions to insurance contracts which are acceptable to all stakeholders and allow consumers to challenge insurance contracts for unfairness while protecting the commercial basis on which they are underwritten. The Insurance Council’s specific responses to the questions posed in the proposals paper are contained in **Attachment A**. I have included some specific drafting suggestions in **Attachment B**.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council’s General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely



Robert Whelan
Executive Director & CEO

APPLYING THE ASIC ACT TO INSURANCE CONTRACTS

Consultation Questions 1-6

The Insurance Council's preferred option for extending UCT protections to insurance contracts is to introduce a stand-alone set of UCT protections in the IC Act which largely mirror those in the ASIC Act. This approach has the benefit of keeping all the remedies together.

However, careful consideration would need to be given to how a UCT regime for insurance contracts would interact with the established UGF regime, particularly as a UCT regime for insurance contracts would introduce another, different concept of fairness into the IC Act. If not done with care the result could be confusion and unnecessary legal costs and potentially undermine the duty of UGF. Importantly, section 12 of the IC Act explicitly states that the effect of the UGF provisions is "not limited or restricted in any way by any other law"; that is, the UGF provisions would not to be read down in favour of UCT options if they were also available.

On this basis, a UCT regime and the UGF regime would need to operate in a mutually compatible manner to the benefit of all stakeholders, without undermining the aim of the IC Act to ensure that:

"... a fair balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and the practices of insurers in relation to such contracts, operate fairly, and for related purposes"

It would be helpful if the legislation clarified that not all terms found to be unfair would necessarily be breaches of the duty of UGF.

Treasury also asks "[w]hat costs will be incurred by insurers to comply with the proposed model? To the extent possible, identify the magnitude of the costs and a breakdown of the categories (for example, substantive and/or administrative compliance costs in reviewing contracts)"¹⁰. The Insurance Council and its members submit that the impact of the proposals are of an entirely different order of magnitude to "administrative compliance costs". Under the proposed model, for the reasons set out in relation to consultation questions 7-9 (Main Subject Matter) and 15-17 (Meaning of Unfair), insurers may not be able to rely on contractual terms that legitimately define the scope of the risk shared between the insurer and insured.

MAIN SUBJECT MATTER

Consultation Questions 7-9

Under the proposed narrow definition of the main subject matter, the terms of an insurance contract setting out the risks covered would be reviewable, and therefore there is uncertainty about whether such terms are unfair. If insurers cannot rely on the terms forming the basis of their contracts, they will need to reprice the risks being underwritten and there will be

¹⁰ *Id.* at 13.

significant implications for their reinsurance arrangements and the capital they need to hold. Indeed, some members observed that reinsurers are already expressing concern about the implications of the proposed model for their contracts. In turn, this will affect the scope of policy coverage and lead to higher premiums for consumers.

In addition, restricting the main subject matter to the thing being insured raises complications as to how it is to be interpreted for many insurance products. For example, what is the thing being insured in relation to management liability insurance or a travel insurance policy?

The Insurance Council strongly supports the approach taken in the European Union (including the UK) to the main subject matter of the contract. Under this approach, application of the UCT provisions needs to take account of the European Council Directive (93/13/EEC) on the treatment of unfair terms in consumer contracts, including the following exemption for insurance contracts:

“...the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;”

UPFRONT PRICE

Consultation Questions 10-12

The Insurance Council supports the proposal that terms setting the upfront price, and the excess payable, are excluded from review. In addition, deductibles should be excluded from review. We would also recommend it be confirmed that where an insurance contract is altered by way of an endorsement that any additional premium is also not able to be reviewed.

STANDARD FORM CONTRACTS

Consultation Questions 13-14

It is generally acceptable that contracts which allow a consumer or small business to select from different policy options should be considered standard form and so subject to review for UCT. However, the Insurance Council recommends where elements of a policy have been negotiated by a broker on behalf of a client, it should not be dealt with as a “standard form” contract.

MEANING OF UNFAIR

Consultations Question 15-17

The Insurance Council strongly disagrees with the proposed tailoring of the definition of unfairness in relation to insurance contracts. In particular, making the test for protection of legitimate commercial interests dependent on the impact on the particular insured, and not the whole class of insureds, would undermine the nature of insurance which is based upon the pooling of risk and create significant contractual uncertainty.

In addition, while the need to manage underwriting risk is central to many terms of an insurance contract, it is not the only factor taken into account. It would often be the case that the theoretical cost to the insurer of providing cover to a particular consumer (say for example for termite damage) would be relatively modest but the impact to that consumer of rectifying the damage could be significant.

Consequently, the Insurance Council submits that it is unnecessary to tailor the definition of unfairness in relation to insurance contracts and the generic approach taken in the ASIC Act and Australian Consumer Law should apply.

TERMS THAT MAY BE CONSIDERED UNFAIR

Consultation Questions 18-20

The Insurance Council and its members submit that the approach of including specific examples of potentially unfair terms in statute is too rigid, and would be difficult for Treasury to update as community expectations evolve. A better approach would be to include examples in a non-binding Explanatory Memorandum. If examples are to be included, they should be in so far as possible agreed with the industry and should not be binding on any court, as such terms should be read with the contract as a whole.

The first example cited in the paper as a potentially unfair term is one which permits the insurer to pay a claim based on the cost of repair or replacement that it could achieve but could not be reasonably achieved by the policyholder. Voiding this term would ignore how it works in practice. Insureds have the option to have the repair/replacement done by the insurer; to insist on cash settlements being paid at a higher amount negates the cost reductions that insurers can negotiate because of the scale of the work they undertake, and may lead to greater delays in repairs. The Insurance Council doubts it the Government's intention that insurers price their policies based on the reinstatement costs that could be obtained by a retail consumer.

REMEDIES FOR UNFAIR TERMS

Consultation Questions 21-23

The Insurance Council supports, in principle, the proposal for courts to be able to make orders for remedies other than voiding the term. However, further details are needed. For example, is the proposed discretion for courts to be able to make other orders limited to damages? What about non-contractual relief?

THIRD PARTY BENEFICIARIES

Consultation Questions 24-26

The Insurance Council supports, in principle, the proposal that UCT protections apply to third-party beneficiaries.

TAILORING FOR SPECIFIC INSURANCE CONTRACTS

Consultation Questions 27-28

Insurance contracts which would be subject to UCT

The ICA suggests that, rather than apply the definitions of consumer contract in the ASIC Act, it would be more appropriate, clearer and more certain to use the definition of 'eligible contract' that is already used for the purposes of the standard cover provisions (see regulation 2B(1) of the Insurance Contracts regulations).

It would also be reasonable to include contracts that are wholly personal and domestic property insurance as defined in regulation 7.1.17 of the Corporations Regulations.

The result would be to capture those types of insurance policies most commonly held by consumers, reflect existing and well understood approaches, and be similar to the definition in the ASIC Act for other financial products and services.

For the sake of certainty whichever category of contract was chosen, an insurance contract would be subject to UCT if it were wholly within the category.

Relief Making Power for ASIC

General insurers have been disadvantaged by the lack of relief powers which ASIC has under the Insurance Contracts Act, compared to the Corporations Act. This has manifested itself in insurers not having the same ability to communicate electronically with their customers as other financial services providers. The Insurance Council suggests that inserting the ability for ASIC to provide relief under the Insurance Contracts Act would not only guard against unintended consequences in relation to the UCT provisions but would also have benefits in relation to other insurance issues.

Exemption from review for terms required or expressly permitted by legislation

For the sake of clarity, the Insurance Council notes that the Standard Cover regulations in the Insurance Contract Regulations 1985 are the basis for the drafting of many retail insurance policies. Consequently, it is important that in the application of UCT provisions to insurance contracts remains subject to the exclusion from review in both the Australian Consumer Law and ASIC Acts for terms that are:

“... a term required, or expressly permitted, by a law of the Commonwealth or a State or Territory”.¹¹

The Insurance Council suggests that this be done by way of an explicit exclusions along the lines included in the model set out in Attachment B.

TRANSITIONAL ARRANGEMENTS

Consultation Questions 29-32

A 12 month transition period is inadequate given the work involved in reviewing affected contracts and considering the need not only to reword policies and reissue product documents but also what the new risk exposure is. Depending on the change in risk exposures, there may be a need to renegotiate reinsurance arrangements. Two years is the minimum that would be workable for the industry.

Reinsurance agreements vary between 12 months to 10 years. At the lower end, a 12 month reinsurance contract for catastrophes requires 6 months for renewal. Furthermore, reinsurance renewals typically involve international offices in cross-border negotiations.

Although extension of UCT provisions to insurance contracts has been mooted for some time, the variety of options being explored in the current consultation demonstrates the uncertainty of how it would be implemented. Consequently, insurers have not been able to undertake a focused review of contracts. It should be noted the extent of contract review and

¹¹ ASIC Act 2001, Section 12BI

subsequent action would be significantly limited if the Government adopted the EU approach to the main subject matter exemption, as advocated by the Insurance Council. This would be reflected in the time needed for transition.

Thought should also be given to the interaction between the proposed UCT changes and ASIC's powers under the proposed Product Design and Distribution Obligations and Product Intervention Power. There is considerable overlap in the improved consumer outcomes which both aim to achieve and insurers would appreciate being able to deal together with the introduction of both obligations.

The Insurance Council suggests that the below formulation would help achieve the objectives of those advocating the application of UCT provisions to insurance contracts. It would enable insureds, their representatives and regulatory bodies to challenge terms which unfairly prevent insureds from receiving the protection which they thought they had purchased, while giving insurers certainty that the commercial basis of the insurance contract would not be undermined.

Exemptions for certain terms of insurance contracts

STARTS

Section [x] does not apply to a term of a contract for insurance to the extent that the term:

defines the underwriting risk or the insurer's liability under the contract of insurance, and has been taken into account in the calculation of the premium; or

- (a) sets the premium payable in whole or part under the contract of insurance; or
- (b) sets the excess(es) or deductible(s) payable under the contract of insurance; or
- (c) is a term required, expressly permitted by, or otherwise regulated by a law of the Commonwealth or a State or Territory; or
- (d) is a term that is a prescribed term of standard cover under the regulations.

ENDS