



Law Council  
OF AUSTRALIA

# Unfair Contract Terms – Insurance Contracts

**The Treasury**

**27 August 2018**

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## About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2018 Executive as at 1 January 2018 are:

- Mr Morry Bailes, President
- Mr Arthur Moses SC, President-Elect
- Mr Konrad de Kerloy, Treasurer
- Mr Tass Liveris, Executive Member
- Ms Pauline Wright, Executive Member
- Mr Geoff Bowyer, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.

## About the Sections

### Business Law Section

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws passed pursuant to the Constitution of the Law Council of Australia and is constituted as a Section of Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, and enhance their professional skills.

The Section has a current membership of more than 1,000 members. The Section has 15 specialist Committees, all of which are active across Australia.

Current Office Holders on the Business Law Section's Executive Committee are:

- Ms Rebecca Maslen-Stannage, Chair;
- Mr Greg Rodgers, Deputy Chair; and
- Mark Friezer, Treasurer.

### Legal Practice Section

The Legal Practice Section of the Law Council of Australia was established in March 1980, initially as the 'Legal Practice Management Section', with a focus principally on legal practice management issues. In September 1986 the Section's name was changed to the 'General Practice Section', and its focus broadened to include areas of specialist practices including Superannuation, Property Law, and Consumer Law.

On 7 December 2002 the Section's name was again changed, to 'Legal Practice Section', to reflect the Section's focus on a broad range of areas of specialist legal practices, as well as practice management.

The Section's objectives are to:

- Contribute to the development of the legal profession;
- Maintain high standards in the legal profession;
- Offer assistance in the development of legal and management expertise in its members through training, conferences, publications, meetings, and other activities; and
- Provide policy advice to the Law Council, and prepare submissions on behalf of the Law Council, in the areas relating to its specialist committees.

Members of the Section Executive are:

- Mr Philip Jackson SC, Chair;
- Ms Maureen Peatman, Deputy Chair; and
- Mr Michael James, Treasurer.

## Acknowledgement

The Law Council is grateful to the following committees for their assistance with the preparation of this submission:

- Small and Medium Enterprise Committee of the Business Law Section; and
- Consumer Law Committee of the Legal Practice Section.

## Part A – SME Business Law Committee

1. The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) makes this submission in response to a Proposals Paper from Treasury dated June 2018 on *Extending Unfair Contract Term Protections to Insurance Contracts* (**Proposals Paper**).
2. The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs.
3. Please note that the SME Committee's submission may differ from that of the Consumer Law Committee later in this document because of the SME Committee members' perspectives and experiences as advisers to SMEs.

### Response

4. The SME Committee have sought to respond below to each of the questions listed in the Proposals Paper.
5. The SME Committee considers it is important to recognise that both consumers and small businesses use insurance cover to manage risk. The SME Committee's responses below are made in light of the use by small businesses particularly of general insurance cover as a risk treatment for their business activities. The SME Committee also provides responses in light of the use by small businesses and consumers of life insurance cover as a treatment for the risk costs of the death, trauma to, permanent disability or temporary disability (so as not to be able to be employed) of individuals upon whom others, or the business, relies. The benefit payable under such an insurance policy is compensation for what would otherwise have been the loss suffered by the insured for an untreated risk event.
6. The SME Committee notes that because insurance cover is used as a risk treatment, it is imperative that the terms of the cover and the benefit payable under the insurance policy are clear and indisputable so that the policyholder as an insured consumer or small business does not find that the insurance cover taken out fails to provide sufficient and certain risk cover.

### Proposed Model

**Question 1: Do you support the proposal to amend section 15 of the IC Act to allow the current UCT laws in the ASIC Act to apply to insurance contracts regulated by the IC Act?**

7. The SME Committee acknowledges that the simplest drafting exercise to include insurance contract terms under the Unfair Contract Terms laws (**UCT**) in the *Australian Securities Investment Commission Act 2001* (Cth) (**ASIC Act**) is to amend section 15 of the *Insurance Contracts Act 1984* (Cth) (**IC Act**) by removing the word 'unfair'.
8. The SME Committee notes that each of the recent reviews<sup>1</sup> that have recommended including insurance contracts in the UCT regime, have referred to insureds not having

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<sup>1</sup> Report dated 27/3/2018 from the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Life Insurance Industry: symmetrical good faith duty under IC Act is incompatible with the

the same level of consumer protections under the IC Act as the UCT law in the ASIC Act provides for consumers and small businesses under other financial services contracts. The Proposals Paper recommends three options for catering for the imposition of the UCT law to contracts of insurance to which the IC Act applies, the second two of which (firstly by enhancing the existing IC Act by adding in additional definitions and requirements, and secondly by duplicating the UCT in the ASIC Act into the IC Act, although varied to cater for insurance specific requirements) both only provide for UCT.

9. The SME Committee considers that if it is proposed that the changes to section 15 of the IC Act, being the preferred recommendation under the Proposals Paper, are anticipated to also remove the words 'hard, oppressive, unconscionable, unjust or inequitable' from the section to accord with the position in the recent reviews, this should also be included in the Proposal Paper.

### **Question 2: What are the advantages and disadvantages of this proposal?**

10. The recommended proposal of removing the word 'unfair' in section 15 of the IC Act is the simplest drafting exercise as it requires no other amendments to the IC Act. The additional required changes to the UCT law in the ASIC Act to cater for specific requirements of insurance are an easier exercise to undertake than either of the other two options looked at (see above answer for a description of the two other options).
11. This option, under which the UCT law in the ASIC Act would apply also has the advantage of clearly having Australian Securities and Investment Commission (**ASIC**) as the regulator for the UCT laws as applicable to insurers.
12. The SME Committee notes that the IC Act is regulated by Australian Prudential Regulation Authority (**APRA**). Under the other two options, the SME Committee would prefer to have the changed UCT law regulated by ASIC, which may require a further amendment to the IC Act.

### **Question 3: What costs will be incurred by insurers to comply with the proposed model? To the extent possible, identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs in reviewing contracts).**

13. Adherence to the proposed model by insurers should not incur substantial initiation or ongoing monitoring costs because the existing 'utmost good faith' obligation under the IC Act requires insurers not to include unfair terms of a general nature. However, this is subject to the comments below by the SME Committee on the proposed narrowness of exclusion for 'subject matter' under an insurance contract. If the proposed narrowness is implemented, there will be a considerable amount of uncertainty that would need to be dealt with in both calculating premiums and when claims are made, that would substantially increase the administration cost of many insurance policies. See answer to Question 8 below.

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highly asymmetrical nature of the relationship between an individual or small business dealing with large and powerful life insurance companies.

- Senate Economic References Committee report of August 2017 into the general insurance industry: general insurance plays an important role in maintaining the stability of consumers in the Australian economy. Exemption from the UCT in the ASIC Act is unwarranted and is a significant gap in consumer protections.
- The 2017 ACL Review: while the IC Act has its own protections, these are not the same as the UCT protections and haven't been shown to provide equal or better consumer protection. Insurance contract consumers do not have access to the same rights and remedies as consumers of other financial services/products standard form contracts.

**Question 4: Do you support either of the other options for extending UCT protections to insurance contracts?**

14. The SME Committee would support both the other options if it were considered more appropriate to implement either of them. Whichever option is decided upon, the SME Committee prefers that ASIC be the regulator of the proposed extensions of UCT to insurers given that the reason for the extension is to align the UCT obligations of insurers with those that apply to other financial service providers, who are regulated on this issue by ASIC.

**Question 5: What are the advantages and disadvantages of these options?**

15. The two other options both require more complex amendments to the IC Act than the proposed option, the first additional option by enhancing the existing IC Act by adding in additional definitions and requirements, and the second additional option by duplicating the UCT in the ASIC Act into the IC Act, although varied to cater for insurance specific requirements are both options that require substantial amendments to the IC Act that could then be construed as complex and debatable with regard to how the legislation, as amended, would apply. In addition, both additional options would require an amendment to have ASIC regulate the UCT for insurers because the IC Act is currently regulated only by APRA.

**Question 6: What costs would be incurred by insurers to comply with these options? To the extent possible please identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs).**

16. Please see the answer to Question 3 as the implementation costs to the insurer should not differ whichever of the three options are required to be adhered to as the effective outcomes are the same. The only difference is the way the law is drafted.
17. The main initial cost is to review the contracts to identify any UCT's in the standard form contracts and to propose amendments. From the experience of SME Committee members, the legal review and amendment of each agreement would average out at between two to three hours work. Therefore, assuming an hourly charge of \$750 for a partner in a top tier, that would mean between \$1500 to \$2250 per agreement. If you assume 20 agreements (which is roughly what the banks had) the total cost would be between \$30,000 to \$45,000 per insurer. That would be an upper estimate based on a partner doing all the work. If they had a senior associate or special counsel to do the work the cost would be between \$20,000 and \$30,000.

## **Excluded Terms - Main Subject Matter**

**Question 7: Do you consider that a tailored 'main subject matter' exclusion is necessary?**

18. The SME Committee considers a tailored 'main subject matter' exclusion is necessary to ensure that the subject matter of what the insurance policy provides cover for is very clear and consistent and not subject to later debate around whether or not the description of the subject itself was 'unfair'. This is because insurance cover is used by both consumers and small businesses as a risk treatment, and it is imperative that what is covered, when a benefit is payable and how much benefit is payable under the insurance policy are clear and indisputable so that the policyholder as an insured consumer or small business does not find that the insurance cover taken out fails to provide the expected risk cost compensation such that the insured suffers a loss that would otherwise have occurred for the risk event if left untreated.

**Question 8: If yes, do you support this proposal or should an alternative definition be considered?**

19. The SME Committee does not support the proposal to have excluded main subject matter based on a generic description as, for example, car insurance, house or house and contents insurance, travel insurance life insurance or disability insurance. The SME Committee considers it is important that any specific terms and/or conditions that reasonably reflect the underwriting risk accepted by the insurer in relation to the contract and thereby give rise to a change to what would otherwise be covered, or paid out if a generic description was used, including a change from a basic premium, should be acknowledged in the main subject matter description. As mentioned above, this is to ensure there is no debate between the parties as to what is covered, when a benefit is payable, and how much benefit is payable because the insured should be able to rely with certainty on the subject matter description in the policy.

**Question 9: Should tailoring specific to either general or life insurance contracts also be considered?**

20. The SME Committee is of the view that specific tailoring should be included for the main subject matter exemption description for both general and life insurance policies.

### **Excluded Terms - Upfront Price**

**Question 10: Do you support this proposal or should an alternative proposal be considered?**

21. The SME Committee supports the proposal that both premium and the excess payable should be included in the 'upfront price' and not be subject to the unfair contract term legislation. The SME Committee notes that this proposal is a logical complement to the SME Committee's suggested expansion of the main subject matter exemption because the premium calculation made by the insurer will be reflective of the specific terms and conditions that the SME Committee considers it is important to include in an expanded description of the main subject matter and will not be calculated at generic level.

**Question 11: Do you agree that the quantum of the excess payable under an insurance contract should be considered part of the upfront price and, therefore, excluded from review?**

22. The SME Committee agrees that the excess payable under an insurance contract should be considered as part of the upfront price and excluded from review because the value of the excess is directly reflected in the calculation of the premium by the insurer as based on the benefit payable under the policy and, as such, should be dealt with in the same way as the premium for the purposes of the exclusion of 'upfront price'.

**Question 12: Should additional tailoring specific to either general or life insurance contracts also be considered?**

23. In the SME Committee's view, so long as the definition of 'upfront price' includes the premium and excess (or deductible) there is no need for further tailoring specific to either general or life insurance policies.

## Standard Form Contracts

**Question 13: Is it necessary to clarify that insurance contracts that allow a consumer or small business to select from different policy options should still be considered standard form?**

24. The SME Committee considers it is necessary to clarify that insurance contracts that allow a consumer or small business to select from different prescribed policy options and thereby tailor their policy to their particular insurance needs should still be considered standard 'user friendly' form and not one that has definitions and exclusions set out in annexures or otherwise in a document where they are difficult to identify or find. The SME Committee notes that this position should not change if the description of 'main subject matter' is expanded as suggested in the SME Committee's responses above.
25. The reason for clarification is to ensure that the unfair contract provisions apply to insurance policies that are by their nature drafted in 'standard form', meaning the same version of the policy with pre-formulated content is issued by the insurer to a number of policyholders who have chosen the same options, despite there being different options available for a consumer or small business to choose from with regard to cover, benefits, terms and conditions including, as proposed, but not limited to, excess amounts, riders, sum insured amounts, and policy exclusions.

**Question 14: If yes, do you support this proposal or should an alternative definition be considered?**

26. The SME Committee supports the proposal and does not consider an alternative definition needs to be considered.

## Meaning of Unfair

**Question 15: Do you consider that it is necessary to tailor the definition of unfairness in relation to insurance contracts?**

27. As mentioned in the Proposals Paper, a term will be unfair if certain criteria are met, including because the term is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by it. The Proposals Paper includes a suggestion that the legislation should provide guidance to insurers and consumers, so as to provide clarity about when a term is reasonably necessary to protect the legitimate interests of a party, and that one way of providing clarity is to make clear that a term is reasonably necessary to protect the insurer's legitimate interests when the insurer proves the term reasonably reflects the underwriting risk accepted by them in relation to the contract and does not disproportionately or unreasonably disadvantage the insured. The Proposals Paper notes that this approach would provide that terms defining the insured risk and that are taken into account in the calculation of the premium should not be considered unfair.
28. The SME Committee notes that this guidance may not be necessary if the SME Committee's suggestion of broadening the description of 'main subject matter' is accepted because the consideration of whether a term or condition is reflected in the underwriting risk, which in turn is reflected in the calculation by the insurer of the premium under the policy, would already have been excluded from the unfair term provisions so that it would not be necessary to assess whether these terms and conditions should be excluded at a later point in time when a court is considering a claim that a policy term or condition is unfair.

**Question 16: Do you support the above proposal or should an alternative proposal be considered? For example, should the approach taken in New Zealand's Fair Trading Act be considered?**

29. Despite the position the SME Committee has taken in its responses above with regard to having an expanded description of 'main subject matter', the SME Committee considers the alternative approach taken in New Zealand's *Fair Trading Act 1986* to be appropriate and acceptable to be included in the proposed changes to extend unfair contract terms legislation to insurers in Australia.

30. This could, as in New Zealand, list fundamental terms that under insurance policies should not be considered as unfair because they are taken to be terms that are reasonably necessary in order to protect the legitimate interests of the insurer, being terms which:

- identify the uncertain event or that otherwise specify the subject matter insured or the risk insured against;
- specify the sum or sums insured or assured;
- exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances;
- describe the basis on which claims may be settled or that specify any contributory sum due from, or amount to be borne by, an insured in the event of a claim under the contract of insurance;
- provide for the payment of the premium;
- relate to the duty of utmost good faith that applies to parties to a contract of insurance; and
- specify the requirements for disclosure, or relating to the effect of non-disclosure or misrepresentation, by the insured.

31. The SME Committee notes that these suggested excluded terms (as in New Zealand), potentially proposed to be stated not to be considered as unfair, could already be excluded as suggested above by broadening the description of 'main subject matter', including as proposed the exclusion for 'upfront price' and continuing to apply the current provisions of the ICA with regard to the insurer's duty of 'utmost good faith' and the provisions around the insured's obligation with regard to disclosure and the consequences of non-disclosure or misrepresentation.

**Question 17: Should tailoring specific to either general or life insurance contracts also be considered?**

32. The SME Committee notes that the Proposals Paper already includes considerable tailoring to accommodate general and life insurers in its approach to the definition of 'unfair'.

### **Terms that may be considered Unfair**

**Question 18: Do you consider that it is necessary to add specific examples of potentially unfair terms in insurance contracts?**

33. In the SME Committee's view, given that the current UCT laws provide a non-exhaustive list of examples of kinds of terms that may be unfair and which provide guidance, but do not prohibit the use of these terms or create a legal presumption that they are unfair, it should be acceptable for specific examples of potentially unfair terms for insurance contracts be added in on the same basis.

**Question 19: Do you support the kinds of terms described in the proposal or should other examples be considered?**

34. The SME Committee supports the kinds of terms described in the Proposals Paper, although notes that the first example should be clarified to apply only where the insured is required to organise their own repairs which the insurer funds by paying the insured a benefit under the contract, and not where the insurer organises and pays for the repairs.

**Question 20: Should tailoring specific to either general or life insurance contracts also be considered?**

35. The Committee recognises that tailoring of examples of terms that may be unfair specific to life insurance contracts, in particular, would be appropriate given that life insurance contracts are automatically renewable and are not replaced each year with a new contract.

36. Such tailoring is not, so far as the SME Committee is concerned, necessary for general insurance contracts as these are contractually replaced each year and the replacement contract can be updated to remove potentially unfair terms.

## **Remedies for Unfair Terms**

**Question 21: Do you support the remedy for an unfair term being that the term will be void? Is a different remedy more appropriate (for example, that the term cannot be relied on)?**

37. The SME Committee supports the remedy for an unfair term in an insurance contract to be that the term is prima facie void, consistent with the current UCT regime.

38. The SME Committee notes, as set out in the Proposals Paper that the consequence of a term being void in insurance contracts may include:

- a declaration that a term is unfair will apply to contracts and parties on a case-by-case basis, acknowledging, however, that as the declaration will apply to a standard form contract, there is the potential that it could be considered unfair for a number of other consumers and small businesses;
- ASIC may seek court orders to prevent or redress any disadvantage to a class of consumers or small businesses who are not a party to the contract but are impacted by the unfair term; and an insurer that attempts to enforce or rely on an unfair term may be contravening the prohibitions against unconscionable and/or misleading or deceptive conduct under the ASIC Act. If this is the case, ASIC will be able to seek other orders in relation to the unfair term, including an injunction, compensation or declarations covering a class of consumers not party to the proceeding, but at risk of being disadvantaged by the unfair term.

39. The Proposals Paper notes that a declaration that a term in an insurance contract is unfair would not automatically lead to a conclusion that the insurer had breached provisions of the ASIC Act or had breached its duty of utmost good faith. However, courts would have the discretion to draw those conclusions if the circumstances of the case warranted it.

40. The SME Committee agrees with the Proposals Paper which notes that, for insurance contracts, there may be circumstances where the remedy of voiding a term may not be the preferred outcome for a policyholder. For example, a particular term may unfairly

limit the amount paid to a policyholder under a claim, but to have the term made void may remove the basis for the claim entirely.

41. The SME Committee therefore agrees with the Proposal Paper that as an alternative to the term being void, it is proposed for insurance contracts that a court should also be able to make other orders if it thinks the order will provide a more appropriate and just outcome in all of the circumstances, including rewriting or varying any unfair term.

**Question 22: Do you consider it is appropriate for a court to be able to make other orders?**

42. The SME Committee considers it is appropriate for a court to be able to make other orders with regard to UCT in insurance contracts if other orders are required to alleviate the disadvantage suffered from the unfair term by the policy holder or third party.

**Question 23: Should tailoring specific to either general or life insurance contracts also be considered?**

43. The SME Committee notes that as the Proposals Paper already includes considerable tailoring to accommodate general and life insurers in its approach to the definition of 'unfair', there should be no need to consider any further specific tailoring for either general or life insurance contracts.

## **Third Party Beneficiaries**

**Question 24: Do you consider that UCT protections should apply to third-party beneficiaries?**

44. The SME Committee considers that the UCT protections should apply to third party beneficiaries in the case of individual life insurance contracts for death cover, and in the case of group life insurance contracts for death cover, disability (permanent or temporary), trauma and income protection because under these contracts the benefits can be payable, and in the case of group contracts are always payable, to a person other than the policyholder with whom the insurer enters into the contract.
45. It is not necessary for the UCT protections to apply for general insurance contracts or for individual life insurance contracts for cover for disability (permanent or temporary), trauma and income protection because benefits under these contracts are not paid to third parties and are paid under them to the policyholder with whom the insurer enters into the contract, who is or are also the insured.

**Question 25: Do you support the above proposal or should an alternative proposal be considered?**

46. The SME Committee agrees with the proposal that the UCT laws should apply to consumers and small businesses who are third-party beneficiaries under the insurance contracts set out above and that specifically:
- the definitions of 'consumer contracts' and 'small business contracts' should include contracts that are expressed to be for the benefit of an individual or small business who is not a party to the contract; and
  - third-party beneficiaries should be able seek declarations that a term of such a contract is unfair.

47. The SME Committee concurs with the rationale for this approach being that access to UCT protections by consumers and small businesses should be based on the actual risk or incidence of unfairness in contractual terms and not be affected by how the insurance arrangements entered into for their benefit are structured or the nature of the group or master policyholder.

**Question 26: Superannuation fund trustees may have substantial negotiating power and owe statutory and common law obligations to act in the best interest of fund members. Do these market and regulatory factors already provide protections comparable to UCT protections such that it would not be necessary to apply the UCT regime to such products?**

48. The SME Committee is of the view that the market and regulatory factors that require superannuation fund trustees to act in the best interests of members serve a different purpose and do not provide protections comparable to the UCT protections. The obligations of superannuation fund trustees, who are the policyholders of group life insurance contracts on the lives insured of fund members are owed by the trustees to their fund members.

49. The UCT protections would be provided for in group life contracts made between life insurers and superannuation fund trustees and which for contract purposes the members of the superannuation fund are not parties.

50. Albeit the lives insured under such group life contracts are the members of the superannuation fund for which the policyholder acts as trustee, without the application of UCT protections to third party beneficiaries in group life insurance, the UCT protections would not apply to the relationship between the third party beneficiaries and the life insurer.

51. The SME Committee is therefore of the view that the UCT protections should be applied to third party beneficiaries, including superannuation fund members, as set out in the SME Committee's answer to Question 24.

## **Tailoring for Specific Insurance Contracts**

**Question 27: Do you consider that any other tailoring of the UCT laws is necessary to take into account specific features of general and/or life insurance contracts?**

52. Aside from the issue mentioned in Question 28 below, and other specific tailoring described in the Proposals paper and in the SME Committee's responses to the questions posed in the Proposals Paper, the SME Committee is not aware of any other tailoring of the UCT laws necessary to take into account specific features of general and/or life insurance contracts.

**Question 28: Do you agree that unilateral premium adjustments by life insurers should not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy?**

53. The SME Committee agrees that for life insurance contracts, it should be made clear that where a term provides a life insurer with the ability to unilaterally increase premiums, this will be considered to be fair where the premium increase is related to the management of the insurer's risk. The SME Committee notes that such ability should be clearly described in the contract so that the insured, whether a consumer or small business, and any impacted third party, would be aware of and be able to plan for such premium increases.

## Transitional Arrangements

### **Question 29: Is a 12-month transition period adequate? If not, what transition period would be appropriate?**

54. The SME Committee, from experience, does not consider that a transition period of 12 months will be adequate. The SME Committee considers a transition period of at least 18 months will be required. This is because general insurance contracts are for a 12-month period, and life insurance contracts are renewable annually and insurers will require longer than the annual period to implement the changes.

### **Question 30: Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered?**

55. The SME Committee considers that once the UCT laws apply to insurance, the timing proposals for new contracts, renewed contracts and contract variations, which are the same as the application under the current UCT law, are also appropriate for insurance contracts.

### **Question 31: What will insurers need to do during the transition period to be ready to comply with the new UCT laws?**

56. During the transition period, insurers will need to review and delete potential unfair terms from their insurance contracts, which will require re-drafting of those contracts, may require re-drafting of Product Disclosure Statements for the products the changed contracts support, variations to compliance and risk items to cater for the changes and education and training of both employees of the insurer, and those who distribute and advise on the products the changed contracts support.

### **Question 32: Should tailoring specific to either general and/or life insurance contracts be considered?**

57. The SME Committee notes that with regard to transition, tailoring to accommodate general and life insurers should be considered for general and in particular for life insurance contracts, compared with what transition was for implementation of the current UCT law.

## Contact – SME Committee

58. For further comment or clarification on any of the matters raised in Part A, please contact Coralie Kenny, member of the SME Committee, on (T) 0409 919 082 or at (E) [Coralie.kenny@gmail.com](mailto:Coralie.kenny@gmail.com).

## Part B - Consumer Law Committee

59. This submission, prepared by the Australian Consumer Law Committee of the Legal Practice Section of the Law Council of Australia (**the ACL Committee**), responds to the proposal paper entitled *Unfair contract terms – insurance contracts (Proposals Paper)*. The Committee welcomes the opportunity to participate in the consultation through this submission.

### Applying the ASIC Act to insurance contracts

**Question 1: Do you support the proposal to amend section 15 of the IC Act to allow the current UCT laws in the ASIC Act to apply to insurance contracts regulated by the IC Act?**

60. The ACL Committee supports this proposal.
61. In the ACL Committee's view, the insurance sector should not have received an exemption from the 2010 UCT reforms.
62. The reliance on either the common law Duty of Utmost Good Faith (**DUGF**) or statutory interpretation sections 13 and 14 of the IC Act have not succeeded as an adequate consumer protection against unfair contract terms.
63. DUGF is not generally known or understood by consumers seeking redress by themselves. Generally, only lawyers understand the term and argue on the basis of DUGF. Consumers subsequently do not argue on the basis of good faith in the Financial Ombudsman Service (**FOS**). DUGF is not therefore relied upon unless FOS itself identifies it, if at all, as a basis for relief from an unfair term. Their track record on identifying DUGF with respect to an unfair contract term is minimal and mixed at best. Consumers rarely have the financial capacity to take any action in forums such as Courts.
64. DUGF is applied on a case by case basis and is therefore ill-fitted and addressing systemic unfair contract terms nor will it (or ever has) incentivised insurers to pre-emptively draft their terms mindful of not being unfair.
65. Unlike DUGF, the UCT regime explicitly acknowledges the inherent imbalance of power between the contracting powers and reverses the onus on this basis.
66. Parliament introduced section 14A to the IC Act to provide ASIC the powers to take action against an insurer for breach of the duty of utmost good faith in relation to handling or settlement of claims. This was an explicit acknowledgement that DUGF does not provide solutions to systemic breaches.

**Question 2: What are the advantages and disadvantages of this proposal?**

67. Key advantages include:

- consistency across the economy;
- consistency of precedent and jurisprudence;
- will not create uncertainty; and
- sends a message that the insurance sector is not unique or some special case understanding by consumers and a consistency in jurisprudence.

**Question 3: What costs will be incurred by insurers to comply with the proposed model? To the extent possible, identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs in reviewing contracts).**

68. There will be cost to insurers to:

- (a) examine their contracts to identify any potential unfair contract terms; and
- (b) once identified, rectify those terms that are pre-emptively deemed by insurers to be potential found to be unfair.

69. This is the entire point of the regime and therefore are intended costs.

70. There may be costs for reinsurers. Reinsurers are, however, well used to unfair contract terms from their implementation in other jurisdictions. The inability of reinsurers to cope with the impact of a UCT regime should be used as a 'strawman' to argue against the introduction of UCTs.

71. Insurers (and reinsurers) should be monitored subsequent to the introduction of the UCT regime to ensure they do not exploit the opportunity to unreasonably raise premiums. This should be modelled on the Victorian Fire Services Insurance Levy Monitor or the NSW Emergency Services Insurance Levy Monitor.

## **Other options for extending UCT protections**

**Question 4: Do you support either of the other options for extending UCT protections to insurance contracts?**

**Question 5: What are the advantages and disadvantages of these options?**

**Question 6: What costs would be incurred by insurers to comply with these options? To the extent possible please identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs).**

72. The ACL Committee does not support extending unfair contract term protections to insurance contracts by either enhancing existing IC Act remedies or introducing the existing unfair contract laws into the IC Act.

73. Insurance contracts should not be treated as unique, special or in any way different to other financial services contracts or any other non-financial service contract.

## **Proposed Tailoring of UCT Laws for Insurance Contracts**

### **Main Subject Matter**

**Question 7: Do you consider that a tailored 'main subject matter' exclusion is necessary?**

**Question 8: If yes, do you support this proposal or should an alternative definition be considered?**

74. The main subject matter of an insurance contract has been defined at common law and in legislation in narrow and precise terms as the thing being insured. This should remain the case for the purposes of the UCT regime.

75. The terms of an insurance contract setting out the risks covered ought to be reviewable under any UCT regime.
76. Any other broad definition would only serve to maintain the exclusion of insurance that currently exists and all efforts to expand upon the definition should be resisted. Insurers will simply use any expansion to avoid the rigours of the regime.
77. It is also not within the spirit or intent of the original Unfair Contract Terms.

**Question 9: Should tailoring specific to either general or life insurance contracts also be considered?**

78. Life Insurance should naturally cover the *life* of a person who is being insured. Otherwise, the ACL Committee is not of the view that Life Insurance contracts should receive any special consideration or carve out.

**Upfront Price**

**Question 10: Do you support this proposal or should an alternative proposal be considered?**

79. The ACL Committee supports excluding upfront price including the premium paid, or to be paid, by the insured.

**Question 11: Do you agree that the quantum of the excess payable under an insurance contract should be considered part of the upfront price and, therefore, excluded from review?**

80. The quantum of the excess payable under an insurance contract should not be excluded from review where such an excess is non-transparent, that is hidden in complex multiple excesses or hidden in confusing fine print and not highlighted upfront. Such an excess is not 'upfront'.

**Question 12: Should additional tailoring specific to either general or life insurance contracts also be considered?**

81. No. There is no difference between a general insurance contract and life insurance contract that is material in this regard.

**Standard Form Contracts**

**Question 13: Is it necessary to clarify that insurance contracts that allow a consumer or small business to select from different policy options should still be considered standard form?**

**Question 14: If yes, do you support this proposal or should an alternative definition be considered?**

82. Insurance contracts that allow a consumer or small business to select from different policy options, including but not limited to excess amounts, riders, sum insured amounts and policy exclusions, should be considered standard form.

## Meaning of Unfair

**Question 15: Do you consider that it is necessary to tailor the definition of unfairness in relation to insurance contracts?**

**Question 16: Do you support the above proposal or should an alternative proposal be considered? For example, should the approach taken in New Zealand's Fair Trading Act be considered?**

83. The ACL Committee supports the proposal to define an insurer's legitimate interest as being when the term reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and it does not disproportionately or unreasonably disadvantage the insured.
84. The first step will naturally arise and appropriate limits the insurers legitimate interests. The second part is an important anti-avoidance measure to limit the insurer's ability to claim all terms are required for underwriting purposes.
85. Most consumer groups are basing their support of the above on the following principles:
- consistency of jurisprudence and application in order that insurers are not treated any differently;
  - onus of proof should be on the insurer not the insured - at all points of any test (be it in one step or two step);
  - the definition must incentivise insurers to ensure that contract terms accurately and transparently reflect risk as has been the case for other industries;
  - terms that disproportionately or unreasonably disadvantage the insured are unfair (be it implicitly or expressed explicitly in any legislation); and
  - common industry practice cannot be deemed a legitimate business interest.

**Question 17: Should tailoring specific to either general or life insurance contracts also be considered?**

86. No.

## Terms that may be considered unfair

**Question 18: Do you consider that it is necessary to add specific examples of potentially unfair terms in insurance contracts?**

**Question 19: Do you support the kinds of terms described in the proposal or should other examples be considered?**

87. Yes, it will provide guidance to industry, consumers and lawyers as to the types of terms to be on the lookout for.

**Question 20: Should tailoring specific to either general or life insurance contracts also be considered?**

88. Examples should be provided specific to both life and general insurance.

## Remedies for unfair terms

**Question 21: Do you support the remedy for an unfair term being that the term will be void? Is a different remedy more appropriate (for example, that the term cannot be relied on)?**

**Question 22: Do you consider it is appropriate for a court to be able to make other orders?**

89. The remedy for an insurance contract term being declared unfair should be that the insurer cannot rely on the term. Voiding an unfair contract term can lead to unfair outcomes where the voiding undermines the effect of a contract in part or in whole.

**Question 23: Should tailoring specific to either general or life insurance contracts also be considered?**

90. No.

## Third-party beneficiaries

**Question 24: Do you consider that UCT protections should apply to third-party beneficiaries?**

**Question 25: Do you support the above proposal or should an alternative proposal be considered?**

91. UCT laws should apply to consumer and small business who are third party beneficiaries under the contract.

**Question 26: Superannuation fund trustees may have substantial negotiating power and owe statutory and common law obligations to act in the best interest of fund members. Do these market and regulatory factors already provide protections comparable to UCT protections such that it would not be necessary to apply the UCT regime to such products?**

92. Group insurance should be subject to the unfair contract terms regime. Despite a best interests duty, superannuation fund trustees are conflicted in negotiating with an insurer (by benefitting financially from decreased coverage as detailed in the PJC Life Insurance Inquiry).

## Tailoring for specific insurance contracts

**Question 27: Do you consider that any other tailoring of the UCT laws is necessary to take into account specific features of general and/or life insurance contracts?**

**Question 28: Do you agree that unilateral premium adjustments by life insurers should not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy?**

93. If unilateral premium adjustments by life insurers are not to be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy, then:

- (a) an onus should be placed on the life insurer to back such increases with proper assessments of risk including real health, actuarial or statistical data that are reasonable to rely on; and

- (b) such premium increases and the circumstances specified should be clearly explained to the consumer in a transparent manner, explicitly and specifically highlighted at purchase, renewal and at the time of any variations or premium increases.

## **Transitional Arrangements**

**Question 29: Is a 12 month transition period adequate? If not, what transition period would be appropriate?**

**Question 30: Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered?**

94. The 12-month transition period is more than reasonable, as is the proposal to apply UCT provisions to new contracts, renewed contracts and contract variations.

**Question 31: What will insurers need to do during the transition period to be ready to comply with the new UCT laws?**

95. Insurers need to review every contract and PDS to ensure that they meet the laws.

**Question 32: Should tailoring specific to either general and/or life insurance contracts be considered?**

96. No.

## **Contact – ACL Committee**

97. For further comment or clarification on any of the matters raised in Part B please contact Ben Slade, Chair, Australian Consumer Law Committee on (T) 02 8267 0914 or at (E) [bslade@mbc.aus.net](mailto:bslade@mbc.aus.net).