



Australian Government  
The Treasury

**TSY/AU**

# EXTENDING UNFAIR CONTRACT TERMS PROTECTIONS TO INSURANCE CONTRACTS

PROPOSALS PAPER

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# CONSULTATION PROCESS

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## Request for feedback and comments

Interested parties are invited to comment on this Proposals Paper. While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

## Closing date for submissions: 24 August 2018

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# INTRODUCTION

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Insurance plays an important role in maintaining the financial stability of both individuals and the Australian economy.<sup>1</sup> As a result, it is important that the insurance market functions appropriately and protects consumers and small businesses from the unfairness which can result from contractual arrangements which are developed in the absence of negotiation and provided on a ‘take it or leave it’ basis.

Consumers and small businesses entering into standard form insurance contracts should have confidence that the contract accurately reflects the cover agreed with the insurer. They should also have appropriate remedies when they suffer detriment as a result of terms in the contract which are unfair.

In 2010, unfair contract terms (UCT) laws were introduced which apply to all sectors of the economy and to all businesses operating in those sectors who use standard form contracts in their dealings with consumers. In 2016, these laws were extended to provide protections to small businesses from unfair contract terms. While the UCT laws apply to most financial products and services, they do not currently apply to insurance contracts regulated under the *Insurance Contracts Act 1984* (IC Act).

To address this, on 18 December 2017, the Minister for Revenue and Financial Services announced, in the Government’s response to the Senate Economics References Committee report into the general insurance industry, that the Government will extend the unfair contract term provisions to contracts of insurance with proposals to be released in early 2018.<sup>2</sup>

This Proposals Paper follows from this announcement and seeks stakeholder views on a proposed model which will extend the UCT protections to insurance contracts regulated by the IC Act. This proposed model involves:

- amending section 15 of the IC Act to allow the UCT laws in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to apply to insurance contracts regulated by the IC Act, which includes both general and life insurance contracts; and
- tailoring the UCT laws in the ASIC Act to accommodate specific features of insurance contracts (see Box 1).

The objectives of this proposed model are to:

- ensure that consumers and small businesses who purchase insurance have the same access to protection from unfair terms in insurance contracts as they do for other contracts for financial products and services;

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1 Senate Economics References Committee (2017), *Australia's general insurance industry: Sapping consumers of the will to compare*, page 65.

2 See Minister for Revenue and Financial Services, Media Release of 18 December 2017, available at <http://kmo.ministers.treasury.gov.au/media-release/120-2017/>.

- increase incentives for insurers to improve the clarity and transparency of contract terms, and remove potentially unfair terms from their contracts; and
- provide appropriate remedies for consumers and enforcement powers for the Australian Securities and Investments Commission (ASIC).

Extending the UCT laws to insurance contracts will also bring Australia into line with comparable jurisdictions, including the United Kingdom, the European Union and New Zealand, where insurance contracts are not excluded from those jurisdictions' UCT laws.

### **BOX 1: SUMMARY OF THE PROPOSED MODEL**

The proposed model seeks to ensure that insureds are provided with the same UCT protections already available to consumers in relation to other financial products and services, while ensuring the laws are appropriate in light of the specific features of insurance contracts.

It is proposed that the existing UCT regime in the ASIC Act apply to insurance contracts regulated by the IC Act. The key elements of the model are:

- Amending 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.
- The UCT provisions in the ASIC Act being tailored in their application to contracts of insurance to accommodate specific features of these contracts, in particular:
  - the 'main subject matter' of an insurance contract will be defined narrowly as terms that describe what is being insured, for example, a house, a person or a motor vehicle;
  - clarification will be provided that the 'upfront price' will include the premium and the excess payable and that these will not be subject to review;
  - a contract will be considered as standard form even if the consumer or small business can choose from various options of policy coverage;
  - 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;
  - examples specific to insurance will be added to the list of examples of kinds of terms that may be unfair, which could include terms that permit the insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policyholder;
  - where a term is found to be unfair, as an alternative to the term being declared void, a court will be able to make other orders if it deems that more appropriate;
  - the definition of 'consumer contract' and 'small business contract' will include contracts that are expressed to be for the benefit of an individual or small business, but who are not a party to the contract;
  - for life policies, as defined by the Life Insurance Act 1995, which are guaranteed renewable, it will be made clear that a term which provides a life insurer with the ability to unilaterally increase premiums will not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy.

# CURRENT REGULATORY FRAMEWORK

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## UCT LAWS FOR FINANCIAL PRODUCTS AND SERVICES

In 2008, the Productivity Commission recommended that a new national consumer law should apply in all sectors of the economy and that this law should include protections against UCT.<sup>3</sup> The Australian Government accepted this recommendation, which was implemented through the Australian Consumer Law and related reforms.

The UCT laws are expressed to apply to all sectors of the economy, and to all businesses operating in those sectors in Australia which use standard form contracts in their dealings with consumers and small businesses.<sup>4</sup> The UCT laws apply to most financial products and financial services through the ASIC Act.

The effect of the legislation is to make void a term in a consumer or small business contract which is unfair. A term will be unfair if:

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.<sup>5</sup>

In determining whether a term is unfair, a court may take into account such matters as it thinks relevant, but must take into account:

- the extent to which the term is transparent (that is, expressed in reasonably clear language, legible, presented clearly and readily available to any party affected by the term); and
- the contract as a whole.

In terms of their scope of operation, the UCT laws do not apply to terms in consumer or small business contracts which define the main subject matter of the contract, set the upfront price payable under the contract, or are required or expressly permitted by law.<sup>6</sup>

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3 Productivity Commission (2008), Review of Australia's Consumer Policy Framework.

4 The UCT laws were extended to small business with effect from 12 November 2016.

5 Section 12BG of the *Australian Securities and Investments Commission Act 2001* sets out the meaning of 'unfair' and the matters a court may take into account in determining whether a term is unfair, and section 12BH of the *Australian Securities and Investments Commission Act 2001* provides examples of unfair terms.

6 Section 12BI of the *Australian Securities and Investments Commission Act 2001*.

Despite the UCT laws applying to most financial products and services, they do not apply to insurance contracts covered by the IC Act. This is because section 15 of the IC Act precludes the ASIC Act's UCT laws from applying to insurance contracts. Specifically, section 15 provides that a contract of insurance is not capable of being made the subject of relief under any other Act, a State Act, or an Act or Ordinance of a Territory. Relief, relevantly, means relief in the form of judicial review of a contract on the ground that it is harsh, oppressive, unconscionable, unjust, unfair or inequitable.

The rationale for this exclusion has been that the IC Act has its own protections for standard insurance contracts and that insurance contracts may have special characteristics due to the nature of the risk involved which make them unsuitable for UCT protections.<sup>7</sup>

However, not all insurance contracts are excluded from the UCT laws as they are not covered by the IC Act. For example, private health insurance contracts and state and Commonwealth government insurance contracts are subject to the UCT laws.

## EXISTING PROTECTIONS FOR INSURANCE POLICYHOLDERS

The IC Act provides a number of protections for insurance policyholders to ensure they are not negatively impacted by contract terms in certain circumstances. These protections can be categorised into three groups:

- **Pre-contractual disclosure:** Informs policyholders about the terms of the policy before it is entered into. It also includes a standard cover regime for certain policies and unusual terms rules for other contracts.
- **Duty of utmost good faith:** Prevents parties from relying on terms if to do so would be inconsistent with the principle of utmost good faith.
- **Rules limiting insurers from relying on certain contract terms:** Prevents an insurer from varying terms to the prejudice of another person or relying on terms requiring an insured to do (or not do) some act after the contract is entered into.

### Pre-contractual disclosure

One of the most common situations in which dissatisfaction and perceived unfairness arises in the context of insurance contracts is when an insurer seeks to deny a claim based on an exclusion or limitation on cover that the insured argues was not, until the time of the claim, fully known or understood by the insured.

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<sup>7</sup> Australian Government (2017), *Australian Consumer Law Review*, Final Report, page 52.



The key current laws governing pre-contractual disclosure for insurance are:

- the 'standard cover' rules in the IC Act for certain types of prescribed household/personal contracts, and the 'unusual terms' rules for other contracts in the IC Act;<sup>8</sup> and
- Product Disclosure Statement (PDS) requirements for retail clients under the *Corporations Act 2001* (Corporations Act).<sup>9</sup>

### Standard cover and unusual terms

The IC Act provides that standard cover (that is, minimum levels of cover for prescribed events) will be deemed to be included in certain classes of prescribed insurance policy, including home buildings insurance and home contents insurance (other than cover notes and renewals). The standard cover terms and conditions are set out in the *Insurance Contracts Regulations 2017*.

If an insurer seeks to limit or exclude its liability in respect of the standard cover, then the insurer must prove that:

- it 'clearly informed' the consumer of the limitation or exclusion in writing before the contract was entered into;
- the consumer knew of the limitation or exclusion; or
- a reasonable consumer in the circumstances could be expected to have known of the limitation or exclusion.<sup>10</sup>

For other non-prescribed types of contracts (which would include, for example, funeral insurance), there is no standard cover regime. However, insurers still need to 'clearly inform' insureds in writing, before a contract is entered into, of the effect of any terms 'of a kind that are not usually included in insurance contracts that provide similar insurance cover [to standard cover]'. A failure to clearly inform an insured of such a clause (for example, an unusual exclusion or limitation) means the insurer is not permitted to rely on it later.<sup>11</sup>

### Product Disclosure Statement requirements

In addition to the pre-contractual disclosure requirements in the IC Act, the Corporations Act also imposes a number of disclosure requirements on insurers. These requirements include the provision of a PDS to consumers, which must contain information about the features of the policy, including its terms, conditions, limits and exclusions. For certain insurance products, such as home building and contents insurance, insurers must also provide consumers with a key fact sheet which sets out the policy's key features.<sup>12</sup>

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8 Sections 35 and 37 of the *Insurance Contracts Act 1984*.

9 The rule in section 14 of the *Insurance Contracts Act 1984* which prevents reliance on a term if to do so would not be in the 'utmost good faith' indirectly addresses pre-contractual disclosure because it takes into account whether notification of the term was given.

10 *Insurance Contracts Regulations 2017*.

11 *Insurance Contracts Regulations 2017*.

12 Senate Economics References Committee (2017), *Australia's general insurance industry: Sapping consumers of the will to compare*, page 28.

## Duty of utmost good faith

Both insurers and their customers owe a duty of good faith in all of their dealings with each other. The IC Act provides that neither party may rely on a term in a contract if to do so will be to fail to act with the utmost good faith.<sup>13</sup>

It is up to a policyholder whose claim is denied to bring an action alleging that reliance on a term is a breach of the duty of utmost good faith. A successful challenge to reliance on a term in dispute will normally affect only the contract (and policyholder(s)) that are the subject of the dispute. The impact will usually be that the insurer will not be permitted to rely on the term in question for the purposes of denying an insurance claim.

## Rules limiting insurers from relying on certain contract terms

The IC Act contains provisions that have the effect of rendering void specific terms, and preventing reliance by insurers on certain types of terms in identified situations.

Under the IC Act, for example, if a policy term allows the insurer to vary an insurance contract to the prejudice of a person other than the insurer themselves, the term is void.<sup>14</sup> Regulations may be made to exempt certain classes of policy from the scope of the rule and a number of exemptions have been made in relation to life insurance and superannuation contracts, and certain types of commercial insurance contracts.<sup>15</sup>

The IC Act also restricts an insurer from relying on terms of the policy that require an insured to do (or not do) some act after the contract was entered into.<sup>16</sup>

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13 Section 14 of the *Insurance Contracts Act 1984*.

14 Section 53 of the *Insurance Contracts Act 1984*.

15 *Insurance Contracts Regulations 2017*.

16 Section 54 of the *Insurance Contracts Act 1984*.

# THE CASE FOR EXTENDING UCT LAWS TO INSURANCE CONTRACTS

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## REVIEWS RECOMMENDING EXTENDING UCT LAWS TO INSURANCE CONTRACTS

The appropriateness of exempting insurance contracts regulated by the IC Act from the UCT laws has been considered recently by a number of inquiries, with these inquiries supporting the removal of the insurance contract exemption. These reviews are considered below along with the position in comparable overseas jurisdictions which have UCT laws.

### **2018 Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the life insurance industry**

On 27 March 2018, the Parliamentary Joint Committee on Corporations and Financial Services released its report into the life insurance industry. The Committee made 49 recommendations aimed at improving the transparency, accountability and effectiveness of the life insurance industry. The report focuses on areas where the Committee considers 'substantial changes are required to ensure the life insurance industry is held to account'.<sup>17</sup>

The Committee found that the symmetrical nature of the good faith duty is incompatible with the highly asymmetrical nature of the relationship between an individual or small business dealing with large powerful life insurance companies. It also found that it was no longer reasonable to exempt the life insurance industry from the application of consumer protection provisions.<sup>18</sup>

The Committee recommended that section 15 of the IC Act be reformed to enable consumer protections, including UCT laws, to apply to general and life insurance contracts, with appropriate transitional and other arrangements.<sup>19</sup>

### **2017 Senate Economics References Committee's inquiry into the general insurance industry**

The Senate Economics References Committee released its report into the general insurance industry in August 2017. The report made 15 recommendations on a range of issues, including the transparency of pricing, disclosure and competition in the general insurance industry.

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17 Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page ix.

18 Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page 47.

19 Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page 47.

The Committee concluded that general insurance plays an important role in maintaining the financial stability of consumers and the Australian economy. Given this, effective protections are essential during all stages of a consumer's relationship with an insurer. The Committee was of the view that the exemption of general insurers from the UCT provisions contained in the ASIC Act was unwarranted and created a significant gap in consumer protections.<sup>20</sup>

## 2017 Australian Consumer Law Review

Consumer Affairs Australia and New Zealand delivered its final report on the Australian Consumer Law Review to Commonwealth, State and Territory Consumer Affairs Ministers in March 2017. The report identified a package of reforms to strengthen and clarify the Australian Consumer Law, in order to improve consumer wellbeing.

The report found that while the IC Act contains its own protection for consumers, they are not the same as the UCT protections and have not been shown to provide equal or greater consumer protection. The current exclusion means that consumers who are party to insurance contracts do not have access to the same rights and remedies as consumers of all other standard form contracts. The Review stated this was inconsistent with the underlying intention that the Australian Consumer Law operate as a generic, economy-wide law that minimises exemptions where possible, particularly where those exemptions are no longer considered appropriate or in the public interest.<sup>21</sup>

### TERMS WHICH HAVE BEEN RAISED AS PROBLEMATIC

The type of terms that have been raised by stakeholders in the context of these reviews as being problematic and potentially disadvantaging consumers include:

- Home building insurance: terms that provide that the most the insurer will pay in the event of loss or damage to a building is the cost to the insurer for rebuilding or repairing the building (as opposed to the actual cost of the repair, which may be higher for the insured);
- Home building insurance: terms that allow the insurer to require the insured to pay an excess before paying the claim;
- Car insurance: terms that require the insured to provide the name, registration and contact details of an uninsured at-fault driver when making a claim;
- Consumer credit insurance: terms that prevent an insured from making a disability claim if they were not diagnosed with the disability prior to leaving work; and
- Travel insurance: terms that allow a claim to be denied on the basis of a blanket mental health exclusion.

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20 Senate Economics References Committee (2017), *Australia's general insurance industry: Sapping consumers of the will to compare*, page 65.

21 Australian Government (2017), *Australian Consumer Law Review*, Final Report, page 53.

## INTERNATIONAL APPROACHES TO UNFAIR INSURANCE CONTRACT TERMS

Several comparable overseas jurisdictions have longstanding UCT laws that apply to consumer contracts, including insurance contracts. The main aspects of these laws are broadly similar to Australia's UCT framework. For example, they:

- apply to non-negotiated consumer contracts;
- contain an unfairness test centred on an imbalance between the rights of the parties; and
- provide exemptions from the regime for terms relating to price and the contract's main subject matter.

### United Kingdom

In the United Kingdom, UCT protections were introduced in 1999 under the *Unfair Terms in Consumer Contracts Regulations 1999* and, subsequently, the *Consumer Rights Act 2015*. These laws provide that unfair terms will not be binding upon a party and provides a mechanism for individuals, as well as fair trading agencies, to deal with unfair terms.

In addition to an unfairness test, the United Kingdom laws require terms in contracts to be prominent and transparent. Where terms are not prominent and transparent, the UCT exemptions do not apply and such terms are subject to a full assessment for fairness.<sup>22</sup>

### European Union

Within the European Union (EU), UCT protections were introduced in 1993 under European Council Directive 93/13/EEC on *Unfair Terms in Consumer Contracts* (ECD 93/13).<sup>23</sup> This is a minimum harmonisation instrument allowing variations within EU Member States through national legislation and judicial interpretation. For example, in some EU Member States, the unfairness test extends to the adequacy of the price and the definition of the main subject matter.<sup>24</sup> In 2017, the European Commission released an evaluation of its consumer directives concluding that the protections remain fit for purpose and recommending enhanced enforcement and redress measures.<sup>25</sup>

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22 Competition and Markets Authority (2015), *Unfair Contracts Terms Explained*, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/450410/Unfair\\_Terms\\_Explained.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/450410/Unfair_Terms_Explained.pdf).

23 Council Directive 93/13/EEC of 5 April 1993, *Unfair Terms in Consumer Contracts*, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31993L0013>.

24 European Commission (2017), *Report on the Fitness Check of consumer and marketing law*, page 94.

25 European Commission (2017), *Results of the Fitness Check of consumer and marketing law and of the evaluation of the Consumer Rights Directive*, [http://ec.europa.eu/newsroom/just/item-detail.cfm?item\\_id=59332](http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=59332).

## New Zealand

In New Zealand, UCT protections were introduced in 2013 via amendments to the *Fair Trading Act 1986*. The UCT provisions apply to all standard form insurance contracts, entered into on or after 17 March 2015. The key differences to the Australian UCT regime include:

- if a price term is not transparent, the term is not exempt from the regime and is subject to the fairness assessment; and
- only the New Zealand regulator, and not consumers, may apply for a declaration that a term is unfair.<sup>26</sup>

Under the New Zealand laws, there are particular provisions which apply to insurance contracts. Specifically, the following terms must be taken to be terms that are reasonably necessary in order to protect the legitimate interests of the insurer. 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.<sup>27</sup>

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26 Commerce Commission of New Zealand (2015), *Unfair Contract Terms Guidelines*.

27 Section 46L(4) of the *Fair Trading Act 1986* (NZ).

# PROPOSED MODEL

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## SUMMARY OF THE PROPOSED MODEL

The proposed model seeks to ensure that insureds are provided with the same UCT protections already available to consumers in relation to other financial products and services, while ensuring the laws are appropriate in light of the specific features of insurance contracts.

It is proposed that the existing UCT regime in the ASIC Act apply to insurance contracts regulated by the IC Act. The key elements of the model are:

- Amending 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.
- The UCT provisions in the ASIC Act being tailored in their application to contracts of insurance to accommodate specific features of these contracts, in particular:
  - the ‘main subject matter’ of an insurance contract will be defined narrowly as terms that describe what is being insured, for example, a house, a person or a motor vehicle;
  - clarification will be provided that the ‘upfront price’ will include the premium and the excess payable and that these will not be subject to review;
  - a contract will be considered as standard form even if the consumer or small business can choose from various options of policy coverage;
  - 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;
  - examples specific to insurance will be added to the list of examples of kinds of terms that may be unfair which could include terms that permit the insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policyholder;
  - where a term is found to be unfair, as an alternative to the term being declared void, a court will be able to make other orders if it deems that more appropriate;
  - the definition of ‘consumer contract’ and ‘small business contract’ will include contracts that are expressed to be for the benefit of an individual or small business, but who are not a party to the contract;
  - for life policies, as defined by the Life Insurance Act 1995, which are guaranteed renewable, it will be made clear that a term which provides a life insurer with the ability to unilaterally increase premiums will not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy.

## APPLYING THE ASIC ACT TO INSURANCE CONTRACTS

The key element of the proposed model is the amendment of 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, which includes both standard form general and life insurance contracts.

The benefits of this proposed model include:

- it will ensure that insureds are provided with protection under the same UCT laws which are already available to consumers in relation to other financial products and services. This will enable the courts, consumers, external dispute resolution schemes, and the regulator to take a consistent approach;
- it is consistent with the objective of the Australian Consumer Law that the UCT protections should be applied economy wide; and
- it will not negatively affect or create uncertainty regarding the judicial interpretation of the IC Act and its existing legal principles and consumer protections.

In addition to this proposed model, other options also exist for extending the UCT laws to insurance contracts regulated by the IC Act. These options include enhancing the existing IC Act remedies and introducing the existing UCT laws into the IC Act.

### Other options for extending UCT protections

#### Enhance existing IC Act remedies

Under this option, the existing remedies in the IC Act, particularly the duty of utmost good faith, would be enhanced to improve their effectiveness to provide UCT protections in relation to standard form insurance contracts.

Specifically, the possible changes could include the following elements:

- introduce a definition of an unfair term, with the definition reflecting the ASIC Act definition, with appropriate exemptions (for example, relating to the 'main subject matter' of the contract);
- an unfair term will be a breach of the duty of utmost good faith and consistent with the existing remedy for this breach, an unfair term must not be relied on;
- reversing the onus of proof, so where an insurer is relying on a term in the contract that a policyholder or third-party beneficiary considers is unfair, the insurer will be required to demonstrate that reliance on the term is not a breach of the duty of utmost good faith; and
- enabling consumers or ASIC to seek court orders to remedy any disadvantage arising from an unfair term.

Section 15 of the IC Act would continue to operate so that the UCT provisions of the ASIC Act would not apply.



## Introduce the existing UCT laws into the IC Act

Under this option, the IC Act would be amended to introduce a stand-alone set of UCT protections in the IC Act which largely mirror those in the ASIC Act, but with tailoring to take account of the specific features of insurance contracts and the existing regulatory framework of the IC Act.

Again, section 15 of the IC Act would continue to operate so that the unfair contract terms provisions of the ASIC Act would not apply.

### QUESTIONS

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?
2. What are the advantages and disadvantages of this proposal?
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).
4. Do you support either of the other options for extending UCT protections to insurance contracts?
5. What are the advantages and disadvantages of these options?
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).

## PROPOSED TAILORING OF UCT LAWS FOR INSURANCE CONTRACTS

The UCT laws in the ASIC Act will be tailored in their application to insurance contracts to take account of the specific features of insurance where necessary.

### Terms excluded from the UCT laws

The UCT laws provide that the following terms are excluded from review:

- terms that define the main subject matter of the contract (the ‘main subject matter’ exclusion);
- terms that set the upfront price payable under the contract; or
- terms that are required or expressly permitted by law.<sup>28</sup>

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<sup>28</sup> Section 12BI of the *Australian Securities and Investments Commission Act 2001*.

## Main Subject Matter

The interpretation of the main subject matter of a contract significantly affects the scope of the contractual terms to which the UCT laws will apply. Under the current UCT laws, the main subject matter of a contract is not defined in legislation and is a matter for the courts to decide on a case-by-case basis.<sup>29</sup> A similar position is adopted in New Zealand and the United Kingdom where the unfair contract terms provisions do not apply to the 'main subject matter of the contract' and no statutory definition is provided for what constitutes the main subject matter of the contract.<sup>30</sup>

For many standard form contracts, the main subject matter of the contract and the contract itself are clearly distinguished. This means the definition of the contract's main subject matter is relatively straightforward. However, the definition is less clear in the context of insurance contracts; in particular, it could be possible for the main subject matter of the contract and the contract to be construed as effectively being the same thing. This interpretation would be inconsistent with the intention behind of the UCT laws. Because of this uncertainty, it is proposed that the main subject matter will be given a tailored definition for insurance contracts.

One approach is to provide a narrow definition which excludes from review terms that describe what is being insured, for example, a house, a person or a motor vehicle. A narrow definition would provide the most comprehensive scope for UCT protections. For example, policy limitations, conditions precedent to cover and exclusions that affect the scope of cover would not be considered part of the 'main subject matter' and would be open to review.

A narrow approach has been favoured by consumer group representatives on the basis that the broadest possible terms in insurance contracts should meet the fairness test.<sup>31</sup> General insurance industry participants have previously not supported this approach for different reasons, including that it may impact insurers' certainty of contract and have implications for the way insurers calculate risk.<sup>32</sup>

An alternative approach is to provide a broader definition which would exempt from review terms that define the scope of cover. The approach adopted in the EU provides an example of such a definition via ECD 93/13 which exempts from the UCT regime terms which 'clearly define or circumscribe the insured risk and the insurer's liability'.

General insurance industry participants have advocated that should government consider it necessary to apply UCT protections to general insurance, a definition of 'main subject matter' analogous to the EU approach is necessary.<sup>33</sup>

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29 The Explanatory Memorandum of the *Competition and Consumer Act 2010* provides some guidance in referring to the 'main subject matter' as being the 'basis for the existence of the contract'.

30 Section 46K of the *Fair Trading Act 1986* (NZ); section 64 of the *Consumer Rights Act 2015* (UK).

31 For example, see Consumer Action Law Centre (2018), *Denied: Levelling the playing field to make insurance fair*, pages 27-28.

32 For example, see Insurance Council of Australia (2012), Submission to the Unfair Terms in Insurance Contracts Draft Regulation Impact Statement For Consultation.

33 For example, see Insurance Council of Australia (2012), Submission to the Unfair Terms in Insurance Contracts Draft Regulation Impact Statement For Consultation.

It is proposed that the main subject matter of the contract will be defined narrowly as terms that describe what is being insured. For example, under a home and contents policy, terms excluded from review would include those which detail the insured property, such as the location and type of dwelling.

The rationale for this proposal includes:

- the objective of the UCT regime is to address the power imbalance that arises from contracts being offered to consumers on a take-it-or-leave-it basis. Therefore, the 'main subject matter' exclusion should be defined in a way that best serves this consumer protection objective;
- it is consistent with the objective of the Australian Consumer Law that UCT protections should be given a broad application; and
- it reduces the risk that UCT protections will be diminished by contractual drafting techniques or consumers being uncertain about which terms are subject to review.

The proposed main subject matter exclusion only relates to defining which terms are open to review, it does not relate to whether or not the term is unfair. To determine this, the court will apply the test of unfairness. This approach seeks to strike an appropriate balance between the interests of both policyholders and insurers.

## QUESTIONS

7. Do you consider that a tailored 'main subject matter' exclusion is necessary?
8. If yes, do you support this proposal or should an alternative definition be considered?
9. Should tailoring specific to either general or life insurance contracts also be considered?

## Upfront Price

The UCT laws provide that terms setting the contract's upfront price are excluded from review. The upfront price includes consideration paid for the supply under the contract, but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.<sup>34</sup>

The exclusion of upfront price means that a term concerning the upfront price cannot be challenged on the basis that it is unfair. This means that after having agreed to provide a particular amount of consideration when the contract was offered, which was disclosed at or before the time the contract was entered into, an insured cannot then argue that that consideration is unfair.

Consistent with the existing UCT laws, it is proposed that for insurance contracts, the upfront price will include the premium paid, or to be paid, by the insured and therefore excluded from review.

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34 Section 12BI of the *Australian Securities and Investments Commission Act 2001*.

It is also proposed that the quantum of the excess payable under an insurance contract should be considered part of the upfront price and, therefore, excluded from review. This approach is consistent with that adopted for other financial products or services. For example, under a consumer credit agreement, the upfront price includes the amount borrowed, the interest payable and any fees disclosed at the time the contract is entered into.<sup>35</sup>

## QUESTIONS

10. Do you support this proposal or should an alternative proposal be considered?
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?
12. Should additional tailoring specific to either general or life insurance contracts also be considered?

## Standard form contracts

The UCT laws apply to standard form contracts. In determining whether a contract is a standard form contract, a court may take into account such matters as it thinks relevant, but must take into account a number of factors, including whether:

- one of the parties has all or most of the bargaining power relating to the transaction;
- another party was, in effect, required either to accept or reject the terms of the contract in the form in which they were presented; and
- the terms of the contract take into account the specific characteristics of another party or the particular transaction.<sup>36</sup>

Some types of insurance allow consumers to choose between different policy options and levels of coverage before the contract is entered into. This does not suggest that consumers actively negotiate the terms of such policy options with the insurer, rather consumers are selecting amongst prescribed options to tailor their policy to their insurance needs.

It is proposed that, for insurance contracts, a contract can be considered as standard form even if the consumer or small business can choose from various options of policy coverage (including, but not limited to, excess amounts, riders, sum insured amounts, and policy exclusions).

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35 Australian Consumer Law (2016), Unfair contract terms, A Guide for Businesses and Legal Practitioners, page 10.

36 Section 12BK of the *Australian Securities and Investments Commission Act 2001*.

This is analogous to the operation of the UCT laws in the European Union which provides that individually negotiated terms shall not exclude the contract from being considered standard form if an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract.<sup>37</sup>

## QUESTIONS

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

## Meaning of unfair

The UCT laws provides that 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.<sup>38</sup>

To provide guidance to insurers and consumers, it is proposed to provide clarity about when a term is reasonably necessary to protect the legitimate interests of a party.

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. This approach would provide that terms defining the insured risk and are taken into account in the calculation of the premium should not be considered unfair.

It may be preferable, however, to allow a court to consider factors beyond whether a term is taken into account in the calculation of the premium. For example, a term may only incidentally relate to the insurer's risk, or may have a relatively minor effect on an insurer's premium rating structure, but have a disproportionate effect on the policyholder. This could be addressed by providing that 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.

It is, therefore, proposed 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.

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37 See Article 3 of the European Council Directive 93/13/EEC on unfair terms in consumer contracts.

38 See section 12BG of the *Australian Securities and Investments Commission Act 2001*.

The rationale for this includes:

- it encourages appropriate risk bearing between insurers and consumers by incentivising insurers to ensure their contract terms accurately and transparently reflect their underwriting risk; and
- it is consistent with the objective of the Australian Consumer Law that UCT laws should be given a broad application by reducing the risk for an insurer changing their premium rating structures to exclude terms from reviewability.

### QUESTIONS

15. Do you consider that it is necessary to tailor the definition of unfairness in relation to insurance contracts?
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?
17. Should tailoring specific to either general or life insurance contracts also be considered?

### Terms that may be considered unfair

The UCT laws provide a non-exhaustive list of examples of kinds of terms that may be unfair.<sup>39</sup> These examples provide guidance, but do not prohibit the use of these terms or create a legal presumption that they are unfair.

It is proposed that examples specific to insurance contracts will be added to this list. For example, the following kinds of terms could be added:

- terms that permit the insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policyholder;
- terms which make the insured's ability to make a claim conditional on the conduct of a third-party over which the insured has no control; and
- terms in a contract that is linked to another contract (for example, a credit contract) which limit the insured's ability to obtain a premium rebate on cancellation of the linked contract.

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<sup>39</sup> Section 12BH of the *Australian Securities and Investments Commission Act 2001*.

## QUESTIONS

18. Do you consider that it is necessary to add specific examples of potentially unfair terms in insurance contracts?
19. Do you support the kinds of terms described in the proposal or should other examples be considered?
20. Should tailoring specific to either general or life insurance contracts also be considered?

## Remedies for unfair terms

The UCT laws provide that if a term is declared unfair, it is void.<sup>40</sup> This approach is consistent with other UCT laws internationally and ensures a counterbalancing in the rights of the parties.

In relation to what UCT remedy should apply to unfair terms in insurance contracts, options include:

- the existing remedy of 'voidance'; or
- that the insurer cannot rely on the term.

It is proposed that, consistent with the current UCT regime, the consequence of a term being found to be unfair will be that the term will be void. This will have consequences that 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.

A declaration that a term was 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 be free to draw those conclusions if the circumstances of the case compelled them to.

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<sup>40</sup> Section 12BF of the *Australian Securities and Investments Commission Act 2001*.

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.

Therefore, as an alternative to the term being void, it is proposed 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.

### QUESTIONS

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)?
22. Do you consider it is appropriate for a court to be able to make other orders?
23. Should tailoring specific to either general or life insurance contracts also be considered?

### Third-party beneficiaries

The UCT laws apply to certain 'consumer contracts' and 'small business contracts'.<sup>41</sup> These definitions require a consumer or small business to be a party to the contract in order to be covered by UCT protections. For standard form contracts used throughout the economy, it will usually be the case that a person affected by an unfair term is a party to the contract.

In the insurance context, many types of insurance contracts operate in the same way, with the party to the contract being the person affected by potential contractual unfairness. Examples of this include home and contents insurance, motor vehicle insurance and income protection insurance.

Certain types of insurance policies, however, extend benefits to third-party beneficiaries (either individually or as part of a class) who are not parties to the contract.<sup>42</sup> For such contracts, it will be the third-party beneficiary, rather than the party to the contract that may potentially be affected by an unfair term. Examples of this include:

- life insurance policies providing benefits to nominated beneficiaries. These can be entered into either directly by a consumer or by an entity such as a superannuation fund or employer under a group life policy; and
- insurance taken out by a group purchasing body, such as a sporting association covering members of their club.

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41 Section 12BF of the *Australian Securities and Investments Commission Act 2001*.

42 See section 11 of the *Insurance Contracts Act 1984* for the definition of third-party beneficiary.



It is proposed that the UCT laws will apply to consumers and small businesses who are third-party beneficiaries under the contract. Specifically:

- the definitions of 'consumer contracts' and 'small business contracts' will include contracts that are expressed to be for the benefit of an individual or small business but who are not a party to the contract; and
- third-party beneficiaries would be able seek declarations that a term of a contract is unfair.

The rationale for this approach is 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 affected by how the insurance arrangements entered into for their benefit are structured or the nature of the group or master policyholder.

### QUESTIONS

24. Do you consider that UCT protections should apply to third-party beneficiaries?
25. Do you support the above proposal or should an alternative proposal be considered?
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?

### Tailoring for specific insurance contracts

General and life insurance contracts are similar in many contractual and regulatory aspects but there are also differences. For example, general insurance contracts are typically of limited duration (for example, 12 months), with yearly renewal, whereas life insurance contracts can be for a longer, or indeterminate, duration with no renewal (for example, lifetime cover).

The Parliamentary Joint Committee on Corporations and Financial Services in its recent report on the life insurance industry identified that overseas experience may necessitate specific life insurance provisions deeming unilateral premium adjustments by an insurer as 'fair' for the purposes of unfair contract term provisions where clear motive is given to the insured that premiums may increase and how.<sup>43</sup> The Committee was not, however, more broadly swayed by arguments from the life insurance industry that it needs special provisions due to the nature of the risk involved in the industry, or the potentially high value of transactions.<sup>44</sup>

It is proposed that for life insurance contracts, it will 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.

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43 Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page 38.

44 Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page 47.

## QUESTIONS

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?
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?

## Transitional Arrangements

A 12 month transitional period will be provided before the new provisions take effect. After the transition, it is proposed that the UCT provisions will apply as follows:

- **New contracts:** New provisions will apply to all new contracts originally entered into on or after the commencement.
- **Renewed contracts:** If a contract that was originally entered into before the commencement is renewed, the new provisions will apply to the contract as renewed, on or after the day on which the renewal takes effect.
- **Contract variations:** If a contract was originally entered into before the commencement is varied on or after the day, the new provisions apply to the term as varied, on or after the day the variation takes effect. Other terms of that contract will not be made subject to the UCT provisions because of the variation, until such time as the contract is renewed.

## QUESTIONS

29. Is a 12 month transition period adequate? If not, what transition period would be appropriate?
30. Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered?
31. What will insurers need to do during the transition period to be ready to comply with the new UCT laws?
32. Should tailoring specific to either general and/or life insurance contracts be considered?