



THE LAW SOCIETY
OF NEW SOUTH WALES

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24 August 2018

Manager, Insurance and Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: UCTinsurance@treasury.gov.au

Dear Sir/Madam,

Extending Unfair Contract Terms Protections to Insurance Contracts

Introduction

The Law Society of NSW appreciates the opportunity to comment on the proposal to extend the unfair contract terms ("UCT") provisions to contracts of insurance.

The Law Society's Business Law Committee contributed to this submission.

General

The Law Society agrees that as insurance cover is used by both consumers and small businesses as a common risk management strategy, it is imperative that the terms of the cover and the benefit payable under the insurance policy are clear. The policyholder as an insured consumer or small business entering into a standard form contract should have the confidence that the contract accurately reflects the agreed cover with the insurer.¹ We also recognise the importance of balancing the rights of all parties and for insurance to be readily available at a reasonable cost.

Proposed Model

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?

Yes. The Law Society considers that applying the existing UCT regime under the *Australian Securities and Investments Act 2001* ("ASIC Act") to insurance contracts by amending s 15 of the *Insurance Contracts Act 1984* ("IC Act") achieves the objectives set out in the Proposal Paper.² The proposed model will ensure that insureds are provided with the same UCT protections already available to consumers in relation to other

¹ Treasury (Cth) 'Extending Unfair Contract Terms Protections to Insurance Contracts, 1.

² Ibid 1-2.

financial products and services, subject to tailoring those provisions in light of the specific features of insurance contracts. Under the proposed model the same regulator, the Australian Securities and Investments Commission ("ASIC"), will be responsible for regulating the UCT laws in relation to all financial services products.

We note that each of the recent reviews³ that has recommended applying the UCT regime to insurance contracts, has referred to insureds not having 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.

2. What are the advantages and disadvantages of this proposal?

Incorporating the UCT law in the ASIC Act into the IC Act has the advantage of ASIC becoming the regulator for the UCT laws as applicable to insurers. The Law Society considers this to be appropriate given that the reason for the proposed extension of the UCT laws to contracts of insurance is to ensure insureds have the same level of consumer protections under the IC Act as is currently provided in respect of other financial products in the ASIC Act. ASIC will remain the sole regulator to enforce the UCT laws for consumers and small businesses under all financial services contracts.

We note that the IC Act is otherwise regulated by the Australian Prudential Regulation Authority ("APRA"). Under the other two options, ASIC would be the regulator under the UCT regime for all financial products except insurance contracts.

The advantage of adopting either of the other two options, instead of the proposed model, would be to have all of the provisions regulating insurance contracts contained in the one Act, the IC Act, and regulated by a single regulator.

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).

We consider that insurers should not incur substantial initiation or ongoing monitoring costs under the proposed model. Insurers have an existing duty of utmost good faith under the IC Act and as a result should not require major amendments to their current contracts.

However, this is subject to the comments below on the proposed narrow exclusion for 'subject matter' under an insurance contract. If the proposed narrow definition of 'main subject matter' is implemented, there will be a considerable amount of uncertainty in both calculating premiums and when claims are made that may substantially increase the administration cost of many insurance policies. See our comments in response to question 8 below.

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

The Law Society does not support either of the other options as they do not attract the benefits of the proposed model as set out on page 12 of the Proposals Paper.

³ Treasury (Cth) 'Extending Unfair Contract Terms Protections to Insurance Contracts, 7-8.

5. What are the advantages and disadvantages of these options?

The other two options require more complex amendments to the IC Act than the proposed model, first by having to enhance protections under the IC Act by adding in additional definitions and requirements, and second by having to duplicate the UCT law in the ASIC Act into the IC Act, although tailored to cater for insurance specific requirements.

An advantage of these options is that all provisions regulating insurance contracts would be contained in one Act, the IC Act.

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).

Please see the answer to question 3, as the implementation costs to the insurer should not differ whichever of the three options are implemented, as the effective outcomes are the same. The only difference is the way the law is drafted.

Excluded Terms - Main Subject Matter

7. Do you consider that a tailored 'main subject matter' exclusion is necessary?

Yes. The Law Society considers a tailored 'main subject matter' exclusion is necessary to ensure that the subject matter covered by the insurance policy is clear and not subject to later debate as to whether or not the description of the subject matter itself was 'unfair'. Insurance cover is used by both consumers and small businesses as a common risk management strategy, 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.

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

The Law Society considers it is crucial that there is clarity around the key terms of an insurance contract, that is, what is covered, the premium payable, and the benefit payable when the relevant conditions are met. While appreciating the benefits of a narrow definition of 'main subject matter', this must not lead to a situation where neither the insurer nor the insured are clear about the key terms of the contract.

It may be that the 'main subject matter' should extend to any specific terms and/or conditions that differentiate the underwriting risk accepted by the insurer in relation to the contract (and that thereby impact the calculation of the premium, and/or benefits payable). The insured and the insurer should be able to rely with certainty on the subject matter description in the policy: the insurer in its premium calculations and provisions for benefit payments, and the insured so as to have comfort the risk intended to be mitigated is properly covered by the policy.

9. Should tailoring specific to either general or life insurance contracts also be considered?

Yes. The Law Society is of the view that specific tailoring should be included for the main subject matter exemption description for both general and life insurance policies to provide clarity.

Excluded Terms - Upfront Price

10. Do you support this proposal or should an alternative proposal be considered?

The Law Society supports the proposal that both premium and the excess payable should be included in the 'upfront price' and not be subject to the UCT legislation. We note that this proposal is a logical corollary of our position in relation to the main subject matter exemption. We consider that it is important to include the premium calculation made by the insurer in the description of the main subject matter.

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?

Yes. The Law Society agrees that the excess payable under an insurance contract should be considered as part of the upfront price. As such, it should be 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.

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

No. In our 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

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?

Yes. The reason for this clarification is to ensure that the UCT laws 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, excess amounts, riders, sum insured amounts, and policy exclusions, these contracts should be considered 'standard'.

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

The Law Society supports the proposal and does not consider an alternative definition needs to be considered.

Meaning of Unfair

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

Yes. As mentioned in the Proposals Paper⁴ a term will be unfair if certain criteria are met, including because the term is not reasonably necessary to protect the legitimate interests

⁴ Ibid, 17.

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. One way of providing clarity is to stipulate that a term is reasonably necessary to protect the insurer's legitimate interests. The insurer should be able to prove 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.⁵

The Law Society notes that this guidance may not be necessary if our position regarding the description of 'main subject matter' is accepted. This is 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 UCT provisions. In this event, 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.

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?

We consider the approach taken in New Zealand's *Fair Trading Act 1986* to be a viable alternative to the proposed changes to extend UCT laws to insurance contracts in Australia, subject to our comments below.

Under the New Zealand Act, a list of 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, include 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.

We note that these suggested excluded terms could also be excluded under the proposed model, as suggested above, by including them in the description of 'main subject matter'. We note that under the proposed model, the current provisions of the IC Act with regard to the insurer's duty of 'utmost good faith' and the provisions dealing with the insured's obligation with regard to disclosure and the consequences of non-disclosure or misrepresentation will continue to apply.

⁵ Ibid.

We note, however, that under the New Zealand model, only the regulator and not consumers may apply for a declaration that a term is unfair. We would not recommend adoption of this provision of the New Zealand model.

17. Should tailoring specific to either general or life insurance contracts also be considered?

The Law Society notes that the Proposals Paper already proposes considerable tailoring to accommodate general and life insurers in its approach to the definition of 'unfair'.

Terms that may be considered unfair

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

Yes. In the Law Society'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 on the same basis.

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

The Law Society supports the kinds of terms described in the Proposals Paper.⁶

20. Should tailoring specific to either general or life insurance contracts also be considered?

The Law Society 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.

Such tailoring is not, so far as we are 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

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)?

The Law Society supports the remedy for an unfair term in an insurance contract to be that the term is void, consistent with the current UCT regime.

We note, 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

⁶ Ibid 18.

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.⁷

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 the provisions of the ASIC Act or had breached its duty of utmost good faith. However, courts would be free to draw those conclusions if compelled to do so by the circumstances of the case.

We agree with the statement in the Proposals Paper that, for insurance contracts, there may be circumstances where the remedy of voiding a term may not be the preferred outcome for a policyholder.⁸ 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.

We therefore agree with the Proposals Paper⁹ that as an alternative to the term being void, a court should also be able to make other orders if it thinks the orders in relation to insurance contracts will provide a more appropriate and just outcome in all of the circumstances.

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

Yes. The Law Society 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.

23. Should tailoring specific to either general or life insurance contracts also be considered?

The Law Society notes that the Proposals Paper already includes considerable tailoring to accommodate general and life insurance contracts in its approach to the definition of 'unfair'. As a result, we consider there should be no need to consider any further specific tailoring for either general or life insurance contracts.

Third party beneficiaries

24. Do you consider that UCT protections should apply to third-party beneficiaries?

Yes. We consider that the UCT protections should apply to third party beneficiaries in the case of individual insurance contracts for death cover, and in the case of group insurance contracts for death cover, disability (permanent or temporary), trauma and income protection. Under these contracts the benefits can be payable, and in the case of

⁷ Ibid 19.

⁸ Ibid 20.

⁹ Ibid.

group contracts are always payable, to a person other than the policyholder with whom the insurer enters into the contract.

25. Do you support the above proposal or should an alternative proposal be considered?

The Law Society 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.¹⁰

The Law Society agrees 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.

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?

The Law Society 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.

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

Although 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.

The Law Society is therefore of the view that the UCT protections should be applied to third party beneficiaries, including superannuation fund members, as set out in our answer to question 24.

¹⁰ Ibid 21.

Tailoring for specific insurance contracts

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?

Aside from the issue mentioned in question 28 below, and the other specific tailoring described in the Proposals Paper and in our responses to the questions posed in the Proposals Paper, the Committee is not aware of any other tailoring of the UCT laws that 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?

We agree 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. We note that the ability to unilaterally increase premiums in this way 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

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

The Law Society, based on the experience of our members, considers that a transition period of 12 months may not be adequate. We consider a transition period in excess of 12 months, for example 18 months, will be required. This is because general insurance contracts are usually for a 12 month period, and life insurance contracts are often annually renewable and insurers will require longer than the annual period to implement the changes.

30. Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered?

We consider that the proposed application of the provisions to new contracts, renewed contracts and contract variations, are appropriate.

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

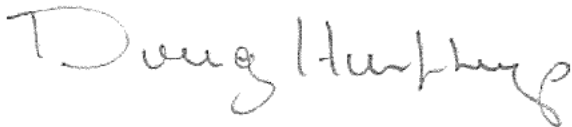
During the transition period, insurers will need to review and delete potential unfair terms from their insurance contracts, which may require re-drafting of those contracts and of Product Disclosure Statements for the products the changed contracts support. Variations to compliance and risk items to 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, will also be required.

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

It is our view that tailoring to accommodate general and life insurance contracts should be considered in developing transitional arrangements for implementation of the current UCT law.

Please contact Liza Booth, Principal Policy Lawyer, on [REDACTED] if you would like to discuss this submission.

Yours faithfully,

A handwritten signature in cursive script that reads "Doug Humphreys".

Doug Humphreys OAM
President