

# UNFAIR TERMS IN INSURANCE CONTRACTS DRAFT REGULATION IMPACT STATEMENT FOR CONSULTATION

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## ***Chapter 1 Background***

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### **UNFAIR CONTRACT TERMS LAWS**

1.1 The Productivity Commission, in its 2008 *Review of Australia's Consumer Policy Framework*, recommended that a new generic, national consumer law should apply in all sectors of the economy. It further recommended that this generic law include national unfair contract terms (UCT) laws. The Productivity Commission broadly defined 'unfair contract terms' as terms '*that disadvantage consumers, but ... are not reasonably necessary for the protection of the legitimate interests of suppliers*'.<sup>1</sup>

1.2 The Productivity Commission's recommendations have been implemented through the Australian Consumer Law (ACL) and related reforms. The final form of the UCT laws in the ACL draws on the previous Victorian UCT laws, the Productivity Commission's recommendation and the experience of the enforcement of UCT laws in Victoria and the United Kingdom.

1.3 The UCT laws were implemented as laws of the Commonwealth and of Victoria and New South Wales on 1 July 2010 and then extended to apply in all other States and Territories on 1 January 2011. 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. The UCT laws apply to most

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<sup>1</sup> Productivity Commission Inquiry Report, Volume 2 – Chapters and Appendixes, p 403, 30 April 2008, [http://www.pc.gov.au/data/assets/pdf\\_file/0008/79172/consumer2.pdf](http://www.pc.gov.au/data/assets/pdf_file/0008/79172/consumer2.pdf)

financial products and financial services through the *Australian Securities and Investments Act 2001* (ASIC Act). **Chapter 2** provides an overview of how the UCT laws are currently framed under the ASIC Act.

1.4 Since the introduction of the UCT laws, Australia's consumer agencies have worked to inform businesses about their obligations under the ACL, and have worked with them to improve terms and conditions in standard form consumer contracts. On 1 July 2010, a national guide to the UCT laws was issued by all national, State and Territory consumer agencies, and a revised edition was published on 20 January 2011.

## **EXCLUSION FOR INSURANCE CONTRACTS**

1.5 The UCT laws do not apply to standard form contracts covered by the *Insurance Contracts Act 1984* (IC Act).

1.6 The operation of the UCT laws in the ASIC Act is affected by section 15 of the IC Act, which provides that:

*(1) A contract of insurance is not capable of being made the subject of relief under:*

- (a) any other Act; or*
- (b) a State Act; or*
- (c) an Act or Ordinance of a Territory.*

*(2) Relief to which subsection (1) applies means relief in the form of:*

- (a) the judicial review of a contract on the ground that it is harsh, oppressive, unconscionable, unjust, unfair or inequitable; or*
- (b) relief for insured from the consequences in law of making a misrepresentation;*

*but does not include relief in the form of compensatory damages.*

1.7 An exclusion for insurance contracts from State and Territory laws regarding judicial review laws was recommended by the Australian Law Reform Commission (ALRC) in its 1982 report on insurance contracts. The reasons cited by the ALRC were:

- to avoid difficulties of distinguishing between business and non-business contracts in the insurance context;
- to avoid insurance contracts being subject to judicial review in some jurisdictions and not others; and
- the doctrine of utmost good faith, especially when elevated to a contractual term, ‘*should provide sufficient inducement to insurers and their advisers to be careful in drafting their policies and to act fairly in relying on their strict terms.*’

1.8 The version of section 15 that was included in the 1984 Act went beyond the ALRC recommendation, and excluded relief under Commonwealth law (as well as State and Territory laws) regarding “*harsh, oppressive, unconscionable, unjust, unfair or inequitable contracts*”. The relief that was excluded encompassed, but was not limited to, “*relief by way of variation, avoidance or termination of a contract*”.

1.9 A 1992 report on consumer credit insurance by a Government Working Party noted that there was a great deal of confusion about the scope of the 1984 version of section 15. In response, the section was amended in 1994 through the *Insurance Laws Amendment Act (No 2) 1994*, to reflect the wording outlined in section 1.6 above. In its Consumer Credit Insurance Review of July 1998, the Australian Competition and Consumer Commission (ACCC) noted that the 1994 changes to section 15, among other things, “*clarified the position of making a claim under other legislation for compensatory damages*” so that consumers should be more willing to exercise their rights.

## Consideration of the exclusion

1.10 In a 2009 inquiry by the Senate Economics Legislation Committee (the Committee) into the *Trade Practices Amendment (Australian Consumer Law) Bill 2009*, one issue that was considered was that section 15 of the IC Act would operate to prevent some or all of the UCT provisions proposed to be inserted in the ASIC Act (which mirror those in the ACL in respect of financial services) applying to terms in insurance contracts.

1.11 Views differed on whether the inclusion of insurance contracts under the UCT provisions of the ASIC Act was appropriate. Submissions from consumer representatives argued that the UCT provisions should apply to insurance contracts. Submissions from insurance industry

representatives argued that there was no justification to have the UCT provisions apply to insurance contracts.

1.12 In September 2009, the Committee stated in its report that:

- The Committee is of the view that consumers are not provided with adequate protection in insurance contracts under existing law.
- The Committee recommends that the Government address insurance contract legislation to ensure that the IC Act provides an equivalent level of protection for consumers to that provided by the ACL.
- Consideration by the Government of the 2004 review of the IC Act should determine whether this will be achieved by amending the IC Act to achieve a harmonisation with the amendments proposed in the ACL, or by amending the ACL to apply to insurance contracts.

1.13 In March 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, introduced the *Insurance Contracts Amendment Bill 2010* (ICA Bill) into the Parliament. The ICA Bill did not pass the Senate before the calling of the federal election in July 2010, and the Bill lapsed.

1.14 The Bill did not deal with unfair contract terms. At the same time as the ICA Bill was introduced into Parliament, the Minister released a paper seeking comments on options to address unfair terms in insurance contracts. The paper described a number of options to deal with the potential for unfair terms in insurance contracts. In the latter part of 2010, the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP, discussed the issue of UCT and insurance at various meetings with stakeholders. In March 2011, the Parliamentary Secretary convened a roundtable discussion of key stakeholders at which various options were discussed.

1.15 The consultative processes undertaken by the Government in 2010 and 2011 have largely informed the formulation of options and their assessment in this Regulatory Impact Statement. Further details about those processes are set out in Chapter 6 (Consultation) below.

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## Chapter 2 The problem

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### SUMMARY

2.1 The problem sought to be addressed is the current imbalance between protections offered under the existing regulation of insurance contracts and that which currently applies to other financial products and services, which may result in actual or potential disadvantage or loss to consumers due to insurance contracts containing terms that are harsh and/or unfair.

### SCALE AND SCOPE

#### Statistics

2.2 At the end of 2008-09 there were 30,972,178 retail insurance policies in force.<sup>2</sup> In that year 3,020,082 claims were lodged against personal lines of general insurance and 2,952,011 of those claims (or 98 per cent) were paid. Motor and pleasure-craft insurance had the lowest rate of rejected claims (1 per cent or less) and consumer credit the highest (12 per cent), followed by travel (9 per cent).<sup>3</sup> In that year, there were 15,591 disputes arising from claims.<sup>4</sup>

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<sup>2</sup> Financial Ombudsman Service, General Insurance Code of Practice Overview of the 2008-2009 Financial Year, p8, viewed 28 April 2011, [http://www.fos.org.au/centric/home\\_page/about\\_us/codes\\_of\\_practice/general\\_insurance\\_code\\_of\\_practice.jsp](http://www.fos.org.au/centric/home_page/about_us/codes_of_practice/general_insurance_code_of_practice.jsp)

<sup>3</sup> Financial Ombudsman Service, General Insurance Code of Practice Overview of the 2008-2009 Financial Year, p20, viewed 28 April 2011, [http://www.fos.org.au/centric/home\\_page/about\\_us/codes\\_of\\_practice/general\\_insurance\\_code\\_of\\_practice.jsp](http://www.fos.org.au/centric/home_page/about_us/codes_of_practice/general_insurance_code_of_practice.jsp)

<sup>4</sup> Financial Ombudsman Service, General Insurance Code of Practice Overview of the 2008-2009 Financial Year, p20, viewed 28 April 2011, [http://www.fos.org.au/centric/home\\_page/about\\_us/codes\\_of\\_practice/general\\_insurance\\_code\\_of\\_practice.jsp](http://www.fos.org.au/centric/home_page/about_us/codes_of_practice/general_insurance_code_of_practice.jsp)

2.3 According to the 2009-10 Annual Review of the Financial Ombudsman Service, in that year the service dealt with 5,684 insurance disputes. Approximately 4,320 (76 per cent) of the disputes related to a decision by the financial services provider, most commonly a decision to deny an insurance claim.<sup>5</sup>

2.4 The above statistics, although they provide some perspective on unfair contract terms in insurance, are of limited utility in assessing the scale and scope of loss or damage for policyholders caused by such terms:

- Although the number of disputes is a very small proportion of the number of claims made, the statistics do not include instances of policyholders whose claim may have been affected by an unfair contract term but chose not to challenge the decision<sup>6</sup>.
- It is possible that persons have not challenged terms that may be unfair because of the exclusion for insurance contracts.
- The statistics do not reveal how many disputes are related to alleged unfair contract terms. Nor do they reveal whether a claim based on UCT laws would have succeeded, if such laws had been in place.

2.5 As stated in Chapter 1, a paper seeking comments on options to address unfair terms in insurance contracts was released in March 2010. The paper asked stakeholders to provide any data / information that would assist in determining the extent to which unfair contract terms in insurance contracts are causing consumers actual or potential loss or damage. Submissions from various stakeholders indicated that:

- The Consumer Action Law Centre (CALC) strongly believes that unfair terms exist in Australian insurance contracts and that they are causing Australian consumers harm. The CALC noted that quantitative complaint numbers are not particularly helpful in terms of determining the extent of consumer problems with a product or service, although the qualitative nature of complaints received does provide some indication of trends in consumer markets.

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<sup>5</sup> Financial Ombudsman Service, *2009-10 Annual Review*, p49, viewed 28 April 2011, [http://www.fos.org.au/annualreview/2009-2010/PDF/FOS\\_AR2009-10.pdf](http://www.fos.org.au/annualreview/2009-2010/PDF/FOS_AR2009-10.pdf)

<sup>6</sup> In their submission, the Consumer Action Law Centre cited a 2006 report on consumer detriment in Victoria, which found that only 4% of revealed consumer detriment is reported to it and smaller percentages are reported to other nominated parties, including police or an ombudsman, while 26% of people do not make any complaint at all upon experiencing detriment, even directly to the supplier.

- The Insurance Council of Australia was not aware of any data that would support the contention that there are unfair terms in general insurance contracts which are causing consumers actual or potential loss or damage<sup>7</sup>. This statement is generally supported by Suncorp-Metway Ltd, who stated that due to the lack of disputes alleging a breach of the Duty of Utmost Good Faith, this is not a serious issue for consumers<sup>8</sup>.
- The Insurance Australia Group was not aware of any statistical study done on unfair terms and insurance contracts. However statistics provided in Financial Ombudsman Service Annual Reports in relation to disputes generally do not support any additional consumer legislative remedies in the retail insurance sector<sup>9</sup>.
- National Legal Aid (NLA) stated that there is overwhelming evidence which documents in clear and unambiguous terms the detriment that consumers have suffered due to harsh or unfair terms in insurance policies. The NLA acknowledges that it is difficult to gauge what percentage of refused claims would be caught by unfair terms legislation, but it would expect such reforms to have a ‘modest impact’ on the number of claims refused<sup>10</sup>.

## Case examples

2.6 One submission to the Committee in 2009 stated that there was ‘*considerable public reporting over the last two decades on what might be described, in one form or another, as examples of systemic unfairness in the drafting of terms in insurance policies.*’ Several specific examples of terms in insurance contracts that were said to be harsh and/or unfair to consumers were presented to the Committee. Particular examples included:

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<sup>7</sup> Insurance Council of Australia submission, available at:

[http://icareview.treasury.gov.au/content/insurance\\_options\\_submissions.asp?NavID=23](http://icareview.treasury.gov.au/content/insurance_options_submissions.asp?NavID=23)

<sup>8</sup> Suncorp-Metway Ltd submission, available at:

[http://icareview.treasury.gov.au/content/insurance\\_options\\_submissions.asp?NavID=23](http://icareview.treasury.gov.au/content/insurance_options_submissions.asp?NavID=23).

<sup>9</sup> Insurance Australia Group submission, available at:

[http://icareview.treasury.gov.au/content/insurance\\_options\\_submissions.asp?NavID=23](http://icareview.treasury.gov.au/content/insurance_options_submissions.asp?NavID=23).

<sup>10</sup> NLA submission, available at:

[http://icareview.treasury.gov.au/content/insurance\\_options\\_submissions.asp?NavID=23](http://icareview.treasury.gov.au/content/insurance_options_submissions.asp?NavID=23)

- A claim for stolen luggage was denied after the insured left his baggage 'unattended' where the stolen baggage was within reach, but the insured was distracted at the time of the theft, asking for directions.
- A mature-aged traveller was denied cover for cancellation of a trip due to undergoing coronary surgery, on the basis that heart problems experienced 20 years earlier were a pre-existing condition.
- A comprehensive motor vehicle insurance policy contained an exclusion so that the main driver of the vehicle (who had a poor driving record) was not covered. The exclusion was not highlighted at the time of purchase.
- A claim was refused under a no-fault comprehensive motor vehicle policy due to a failure to take 'all precautions to avoid the incident'.
- A motor vehicle policyholder was required to satisfy the insurer that the owner or driver of another vehicle was not insured, in order for an uninsured motorist extension to apply.
- A landlord was not covered by his home buildings insurance policy when the tenant burned down the home, because of an exclusion in the contract for damage caused by an invitee.

2.7 Whether these particular examples cited would be 'unfair' for the purposes of a statutory formulation is a matter involving a degree of legal analysis. No implication should be drawn that the examples cited above would, if the matter was argued, necessarily be in breach of UCT laws.

- See **Protections offered by unfair contract terms provisions under the ASIC Act** for further detail.

2.8 A consumer representative organisation has suggested that UCT laws were likely to be utilised most in relation to travel insurance and consumer credit insurance.<sup>11</sup> As noted above, those classes of insurance have the highest rate of denied claims and have been the subject of

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<sup>11</sup> National Legal Aid, submission on the *Unfair Terms in Insurance Contracts: Options paper Options Paper* (2010), p7, viewed 28 April 2011, [http://www.icareview.treasury.gov.au/content/download/submissions\\_options\\_paper/NLA\\_Submission.pdf](http://www.icareview.treasury.gov.au/content/download/submissions_options_paper/NLA_Submission.pdf)

commentary about the inclusion of ‘rubbery’ terms, which effectively give insurers a significant discretion over the application of an exclusion.<sup>12</sup>

2.9 The case examples illustrate that the magnitude of the loss or damage for the affected individuals ranges from a relatively minor impact (such as denial of a travel insurance claim for a lost suitcase) to loss that is potentially life-changing for a policyholder and their family/associates, such as denial of a claim under a home building/contents policy. The potentially catastrophic impact for the individuals concerned, as well as the likelihood of such a loss occurring, is an important element in assessing of the scale and scope of the problem.

## EXISTING REGULATION AND PROTECTIONS PROVIDED UNDER INSURANCE AND CORPORATIONS LAW

2.10 There are a range of existing rules that are directed at offering protection to policyholders from being negatively impacted by policy terms in certain circumstances. Some of the rules might operate in circumstances that unfair contract terms laws would apply. The rules can be categorised into three groups:

- *Pre-contractual disclosure*: rules directed at informing policyholders about the terms of the policy before it is entered into;
- *Utmost good faith*: rules preventing parties from relying on terms if to do so would be inconsistent with the doctrine of utmost good faith; and
- *Rules on reliance on specific terms*: rules directed at preventing reliance by insurers on specific types of policy terms in certain circumstances.

### Pre-contractual disclosure

2.11 One of the most common situations in which dissatisfaction and perceived unfairness arises in the context of insurance contracts is when

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<sup>12</sup> See, for example, 2006-2007 Insurance Ombudsman Service Annual Review, p19, viewed 28 April 2011, [http://www.fos.org.au/centric/home\\_page/publications/annual\\_reports\\_archive.jsp](http://www.fos.org.au/centric/home_page/publications/annual_reports_archive.jsp)

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.

2.12 The issue of protecting insureds from unusual and unexpected limitations on cover was examined by the ALRC in its 1982 report on insurance contracts. This led to the enactment of the ‘standard cover’ and ‘unusual terms’ provisions in the IC Act (discussed further below). The legislative history of those provisions, particularly those relating to standard cover, is described in the judgement of Einstein J of the NSW Supreme Court in the decision of *Hams & Ors v CGU Insurance Limited* [2002] NSWSC 273 (Hams) from paragraph 208.

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

- the ‘standard cover’ rules in section 35 for certain types of prescribed household/personal contracts, and the ‘unusual terms’ rules for other contracts in section 37; and
- Product Disclosure Statement (PDS) rules for retail customers (under the Corporations Act).<sup>13</sup>

### **Section 35 IC Act – standard cover**

2.14 Section 35 of 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.

2.15 By way of example, the Regulations state that standard cover in respect of home contents insurance includes loss that is:

“... caused by or results from - ... storm, tempest, flood, the action of the sea, high water, tsunami, erosion or landslide or subsidence ...”.

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

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<sup>13</sup> The rule in section 14 of the IC Act 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. That rule is discussed below.

- it ‘clearly informed’ the consumer of the limitation or exclusion in writing before the contract was entered into (or within 14 days if provision before the contract was not reasonably practicable, e.g. telephone sales); or
- 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.

2.17 If the insurer is unable to prove one of these three cases, then the insurer will be liable to make good any losses suffered by a consumer that were caused by, or resulted from, any of the standard events (construed in accordance with their ordinary meanings) up to a maximum limit (usually \$2 million).

2.18 There have been a number of court and dispute resolution cases in relation to interpretation of ‘clearly inform’, which illustrate that although there could be various means to inform, provision to the insured of a policy document containing exclusions is sufficient, unless there are exceptional circumstances (for example, if the provisions in the policy are particularly confusing or complex). The court decision most cited on this issue (*Hams*) includes the following passage:

“... a fair reading of s35(2) does not warrant the conclusion that the result need go further than provide for the relevant exclusion in the policy wording in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding if that person reads the policy in question.”

2.19 In practice, the standard cover regulations are very often rendered non-applicable by the provision to the insured of a policy document (usually contained within a PDS), thereby satisfying the requirement to ‘clearly inform’ the consumer. In a case where such a policy document was provided, the protection offered by section 35 would only be available if the terms in the policy were particularly complex or confusing.

2.20 A common view is that a large proportion of insureds do not read in detail the policy documents they receive from their insurers, so the protection offered by section 35 is not, in practice, an effective tool to ensure that consumers are informed about their cover.

## **Section 37 IC Act – notification of unusual terms**

2.21 For other ‘non-prescribed’ types of contracts (which would include, for example, commercial buildings and contents), 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*’. 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.

2.22 The scope for misunderstanding in relation to non-prescribed classes of contracts may be less likely, due to many commercial insureds using the services of brokers and thus tailoring terms to the insured’s needs. A contrary consideration is that many commercial policies are purchased by small businesspeople (e.g. retailers, farmers) who may not approach the procurement of their business insurance coverage very differently to consumers of household insurance contracts.

2.23 The use of section 37 may also be limited as it only applies to provisions ‘not usually included in contracts of insurance that provide similar cover’. So, if an exclusion or limitation is generally used in relation to the type of cover concerned, section 37 offers no protection, even if the insured was not clearly informed of the term.

## **Product Disclosure Statement (PDS) requirements under the Corporations Act**

2.24 Pre-contractual disclosure requirements under the IC Act are commonly overlaid with requirements under the Corporations Act to provide clients with a PDS. The key criterion for this obligation to apply in relation to general insurance products is that the client is a ‘retail client’, as defined in Corporations Act and Regulations. This requires that:

- the acquirer of the product must be either an individual or a small business (fewer than 20 employees or 100 for manufacturing businesses); and
- the insurance product is within one of the following classes of insurance prescribed by the legislation and as defined in the regulations:
  - motor vehicle insurance;
  - home building insurance;

- home contents insurance;
- sickness and accident insurance;
- consumer credit insurance;
- travel insurance;
- personal and domestic property insurance; or
- another kind of general insurance product prescribed in the regulations (currently including medical indemnity insurance).

2.25 Accordingly, in general terms the PDS requirements apply to contracts prescribed for standard cover purposes under the IC Act, and some other classes of insurance. They do not apply, for example, to policies covering commercial buildings and contents.

2.26 Corporations Regulation 7.9.15E requires a PDS for a retail insurance product to contain both the policy terms (other than the policy schedule), and any information that would be required under sections 35 and 37 of the IC Act.

2.27 A consequence of this requirement is that, for those general insurance products subject to PDS requirements, the ‘clearly inform’ requirements in sections 35 and 37 of the IC Act are supplemented by a ‘clear, concise and effective’ requirement which applies generally under the Corporations Act to material in PDS documents.

### **Future changes to disclosure rules**

2.28 The current rules on pre-contractual disclosure have been considered in another context. On 5 April 2011, the Government released a paper seeking comment on a proposal to introduce a ‘key facts statement’ (KFS), which is intended to allow consumers to:

‘... quickly and easily check the basic terms of the insurance policy, including the nature of cover and any key exclusions.’<sup>14</sup>

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<sup>14</sup> Australian Government, *Reforming flood insurance: Clearing the waters*, p10, viewed on 28 April 2011, <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1995>

2.29 This proposal was introduced into the Parliament on 25 November 2011. The scope of the KFS has been limited to home buildings and home contents policies.

2.30 The introduction of a KFS will only seek to provide consumers with a high-level overview of what their insurance policy does and does not cover. As such, the KFS, in itself, will not address the issue of unfair contract terms in insurance, as it will not prevent potentially unfair terms from being included in an insurance contract.

## **Section 14 IC Act – Utmost good faith**

2.31 Section 14 of the IC Act provides that neither party may rely on a term in a contract if to do so would be to fail to act with the utmost good faith. This section is linked to pre-contractual disclosure, as subsection 14(3) provides that a court must have regard to whether any notification was given to the other party when deciding whether reliance by an insurer on a provision would breach the duty of utmost good faith.

2.32 Under section 14, it is up to a policyholder whose claim is denied to bring an action (in a court or, more commonly, through the Financial Ombudsman Service) alleging the reliance on a term was in breach of section 14. A successful challenge to reliance on a term in dispute under section 14 would normally affect only the contract (and policyholder(s)) that were the subject of the case. The impact would usually be that the insurer would not be permitted to rely on the term in question for the purposes of denying an insurance claim.

2.33 Section 14 is rarely used by insureds to challenge reliance by an insurer on a provision in a court. One possible explanation is that the provision requires the insured, who is almost always a weaker and more vulnerable party than the insurer, to take pro-active steps to enforce it.<sup>15</sup>

2.34 Section 14 has been referred to in decisions by the Financial Ombudsman Service and its predecessor, the Insurance Ombudsman Service. Nevertheless, consumer advocates have submitted that it is rarely

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<sup>15</sup> National Legal Aid, submission on the *Unfair Terms in Insurance Contracts: Options paper Options Paper* (2010), p10, viewed 28 April 2011, [http://www.icareview.treasury.gov.au/content/download/submissions\\_options\\_paper/NLA\\_Submission.pdf](http://www.icareview.treasury.gov.au/content/download/submissions_options_paper/NLA_Submission.pdf)

used by consumers as a basis for relief, possibly because consumers do not understand their rights under that provision to make a claim.<sup>16</sup>

2.35 By contrast, under the UCT laws in the ASIC Act (and the ACL), in addition to the consumer, ASIC is able to bring actions for injunctions, damages and declarations that terms are unfair. However, under changes proposed in the 2010 ICA Bill, ASIC would have power to bring a 'public interest' action on behalf of one or more insureds (with their consent) under section 55A of the IC Act for a breach of section 14.

### Sections 53 and 54 IC Act – Rules on specific terms

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

2.37 Under section 53 of the IC Act, 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. 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>17</sup>

2.38 Section 54 of the IC Act 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. There are a number of elements to section 54:

- If the act or omission could not be reasonably regarded as being capable of causing or contributing to the loss, the insurer cannot rely on a clause in the policy to refuse the claim on the basis of that act or omission unless it can prove actual prejudice (subsection 54(2)).
- If the act or omission could be reasonably regarded as being capable of causing or contributing to the loss, but the insured proves that no part of the loss was caused by the act or

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<sup>16</sup> National Legal Aid, submission on the *Unfair Terms in Insurance Contracts: Options paper Options Paper* (2010), p11, viewed 28 April 2011, [http://www.icareview.treasury.gov.au/content/download/submissions\\_options\\_paper/NLA\\_Submission.pdf](http://www.icareview.treasury.gov.au/content/download/submissions_options_paper/NLA_Submission.pdf)

<sup>17</sup> Regulation 31, Insurance Contracts Regulations 1985.

omission, then the insurer can still not rely on the act or omission to deny the claim (subsection 54(3)). If the insured proves that some part of the loss was not caused by the act or omission, the insured may not refuse to pay that part of the claim (subsection 54(4)).

- If the act was necessary in order to protect the safety of a person or to preserve property, or if it was not reasonably possible to do the act, the insurer may not refuse the claim by reason only of the act (subsection 54(5)).

2.39 Sections 53 and 54 would potentially operate in similar fact situations to when unfair contract terms laws may be sought to be applied. For example, a clause that required a policyholder to provide information about the circumstances of a claim that was not reasonably possible for the policyholder to obtain might be challenged as an unfair term. Alternatively, section 54 might be used to prevent the insurer from relying on the same term to refuse a claim.

## **Do the current laws deal effectively with the problem?**

2.40 In prior consultations, there has been a divergence of views expressed about whether the current laws deal effectively with the problem. Insurance industry representatives have argued that, to the extent there are unfair contract terms in insurance, they could be addressed by the existing laws. Consumer advocates have argued that the existing laws are insufficient.

2.41 The requirements for pre-contractual disclosure should help to prevent policyholders being ‘surprised’ by exclusions or conditions, which is a common situation in which a term in a contract is said to be unfair. There is, however, a significant practical limitation to reliance on pre-contractual disclosure to lessen the risk of ‘surprises’ emerging. The Chair of the Claims Review Panel of the then Insurance Industry Ombudsman Service remarked that:

“The fundamental principle relevant to all insurance disputation on which all parties agree is that no-one ever reads the policy before a claim is made.”<sup>18</sup>

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<sup>18</sup> Insurance Ombudsman Service Limited, *Annual Review 2005*, Addendum, p2, viewed 29 April 2011, [http://www.fos.org.au/centric/home\\_page/publications/annual\\_reports\\_archive.jsp](http://www.fos.org.au/centric/home_page/publications/annual_reports_archive.jsp)

2.42 As policy documents can be relatively long and / or complex, it cannot be assumed that consumers will read and fully understand these documents either before or after purchase. While the Government is introducing a simple, streamlined one-page disclosure for home building and home contents insurance policies, it does not necessarily mean that every exclusion or limitation, in respect to those policies are highlighted.

2.43 Insurer representatives have argued that the statutory duty of utmost good faith in the IC Act and, in particular, section 14, which prevents reliance on a term in a contract if to do so would be in breach of the duty, could be utilised to prevent policyholders from being disadvantaged by any unfair contract terms. However, as noted above, consumer representatives have pointed out that it is rarely used to challenge terms in court.

2.44 Sections 53 and 54 would overlap to some degree with laws on unfair contract terms. However, they are limited in scope to specific types of terms (in the case of section 53, terms which allow the insurer to vary a contract, and in the case of section 54, terms that require the policy holder to act (or not to act) after the contract is entered into).

## PROTECTIONS OFFERED BY UNFAIR CONTRACT TERMS PROVISIONS UNDER THE ASIC ACT

2.45 *Subdivision BA--Unfair contract terms* of the *Australian Securities and Investments Act 2001* (ASIC Act) outlines how UCT laws currently apply to most financial products and financial services. Under s12BF, a term in a consumer contract<sup>19</sup> is void if:

- (a) the term is unfair; and
- (b) the contract is a standard form contract<sup>20</sup>; and
- (c) the contract is:
  - (i) a financial product; or

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<sup>19</sup> Section 12BF defines a consumer contract as ‘*a contract at least one of the parties to which is an individual whose acquisition of what is supplied under the contract is wholly or predominantly an acquisition for personal, domestic or household use or consumption*’.

<sup>20</sup> As defined at s12BK of the ASIC Act.

(ii) a contract for the supply, or possible supply, of services that are financial services.

2.46 Under Section 12BG, a term in a consumer contract could be considered 'unfair' if:

- (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term<sup>21</sup>; and
- (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

2.47 Importantly, only a court can decide as to whether a term in a consumer contract could be considered 'unfair'<sup>22</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 (i.e., is expressed in reasonably plain language; legible; presented clearly; and readily available to any party affected by the term), and the contract as a whole.

2.48 Under Section 12BK, a contract is considered to be a standard form contract if a party to a proceeding alleges that a contract is a standard form unless another party to the proceeding proves otherwise. In determining if a contract is a standard form contract a court may take a number of matters into consideration as it thinks relevant but must take into consideration:

- (a) whether one of the parties has all or most of the bargaining power relating to the transaction;

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<sup>21</sup> Under s12BG(4), a term of a consumer contract is presumed not to be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise.

<sup>22</sup> However, In a publication developed by Australian Capital Territory Office of Regulatory Services, Australian Competition and Consumer Commission, ASIC, Consumer Affairs and Fair Trading Tasmania, Consumer Affairs Victoria, New South Wales Fair Trading, Northern Territory Consumer Affairs, Office of Consumer and Business Affairs South Australia , Queensland Office of Fair Trading and Western Australia Department of Commerce, Consumer "A guide to the unfair contract terms law" examples of the types of terms in a standard form consumer contract that may be unfair are provided.

- (b) whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;
- (c) whether another party was, in effect, required either to accept or reject the terms of the contract in the form in which they were presented;
- (d) whether another party was given an effective opportunity to negotiate the terms of the contract;
- (e) whether the terms of the contract take into account the specific characteristics of another party or the particular transaction; and
- (f) any other matter prescribed by the regulations.

2.49 If a court finds a contract to be a standard form contract and that a term in that standard form contract is unfair, the term is void (i.e. the term is treated as if it never existed). However, the contract will continue to bind parties if it is capable of operating without the unfair term<sup>23</sup>.

2.50 Under Section 12BI, terms that define the main subject matter<sup>24</sup> of a consumer contract, or otherwise relate the upfront price payable under the contract, are not subject to UCT provisions.

- See **Chapter 5** for how ‘main subject matter’ could be treated in the context of insurance.

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<sup>23</sup> *Australian consumer law – unfair contract terms*, <http://www.asic.gov.au/asic/asic.nsf/byHeadline/Unfair-contract-terms-law?opendocument>

<sup>24</sup> Note that ‘main subject matter’ is not explicitly defined in either the ASIC Act or the *Competition and Consumer Act 2010 (CCA)*. ‘Main subject matter’ is however referred to as the ‘basis for the existence of the contract’ in the Explanatory Memorandum of the CCA. Further, the main subject matter of the contract ‘*may include the decision to purchase a particular type of good, service, financial service or financial product*’ and ‘*may also encompass a term that is necessary to give effect to the supply or grant, or without which, the supply or grant could not occur*’.

## **KEY POINTS**

- 2.51 Key points to note about the problem are that:
- there is a risk of unfair terms in standard form insurance contracts causing loss or damage to policyholders and third party beneficiaries which, in some situations, could be significant;
  - there are existing laws that might help to prevent loss or damage to policyholders due to reliance on unfair contract terms; and
  - the extent to which those laws are effective, or potentially effective, to address situations of unfair contract terms is debateable, but the existing laws:
    - do not cover the same breadth of circumstances as UCT laws;
    - are directed at providing remedies in individual cases where an objectionable term is sought to be relied upon, whereas UCT laws are directed at eliminating objectionable terms from standard form contracts; and
    - have been identified by the Senate Economics Legislation Committee and the Natural Disaster Insurance Review as not providing adequate protection to consumers.

**Consultation Question 1**

*A. In practical terms, is the current consumer protection provided in relation to the use of unfair terms in the Insurance Contract Act 1984 adequate?*

*B. Besides the provision of an additional legal avenue for consumers to explore if they are a party to a contract that has potentially unfair terms (if UCT provisions are introduced), are there any practical benefits for consumers?*

*C. Is there a reason for treating contracts of insurance different from other contracts relating to other financial products?*

*D. Will equivalent protection in respect to unfair contract terms lead to beneficial outcomes for consumers? If possible can you outline any situations where these benefits can be clearly identified?*

*E. What percentage of insurance contracts and types of insurance contracts are likely to be standard form contracts in accordance with section 12BK of the ASIC Act?*

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## **Chapter 3 Objectives of government action**

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3.1 The Government's objective is to ensure that consumers who purchase insurance have an equivalent level of protection as that which currently applies to other financial products and financial services, and are thus, insofar as is reasonably possible, protected from actual or potential disadvantage or loss as a result of insurance contracts containing terms that are harsh and/or unfair.

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## **Chapter 4 Options that may achieve the objectives**

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4.1 In previous consultations with stakeholders, a number of options and variations have been proposed and debated. These options have been refined to the set listed below, which are most likely to meet the Government's objectives.

- 4.2 For the purpose of this consultation RIS, we will consider:
- (a) whether UCT laws should apply in some form to insurance contracts; and
  - (b) if UCT laws are to apply to insurance how should the main subject matter be defined; and if the main subject matter is defined narrowly whether the regulator should only have standing to challenge the terms in the contract.
- 4.3 A preferred overall option that may achieve the Government's object may therefore be Option C or D with Option 1, 2(a) or 2(b).

## **Should UCT laws be applied to insurance contracts?**

- 4.4 The first question that needs to be considered is whether UCT laws should be applied to insurance:
- If the answer is no, options that may still meet the Government's objectives are:
    - ***Option A – Status Quo:*** The problem would continue to be addressed through the operation of section 14 of the IC Act.
    - ***Option B – Enhance existing IC Act remedies:*** Existing remedies in the IC Act, particularly section 14, would be modified to improve their effectiveness to prevent the use of unfair contract terms in standard insurance contracts with consumers. Section 15 would continue in operation so that the UCT provisions of the ASIC Act would not apply.
  - If the answer is yes, options that may meet the Government's objectives are:
    - ***Option C – Permit the unfair contract terms provisions of the ASIC Act to apply to insurance contracts:*** Changes to the operation of section 15 would be made to permit the UCT provisions in the ASIC Act to operate in addition to, and alongside, the IC Act remedies.
    - ***Option D – Extend IC Act remedies to include unfair contract terms provisions:*** The IC Act would be

amended to include remedies relating to unfair contract terms similar to that in the ASIC Act. Section 15 would continue in operation so that the unfair contract terms provisions of the ASIC Act would not apply.

- **Option E – Encourage industry self-regulation to better prevent use of unfair terms by insurers:** Use of unfair terms by insurers would be addressed through self-regulatory means, such as a specific section dealing with the issue in, for example, the General Insurance Code of Practice.

### **If UCT laws were to apply to insurance, should existing UCT provisions be modified or otherwise clarified?**

4.5 The second question that needs to be considered is if UCT laws were to apply to insurance, should existing UCT provisions be modified or otherwise clarified to recognise the unique nature of insurance.

- Should the ‘main subject matter’ of an insurance contract be clarified to make explicit whether terms that sought to limit liability in an insurance contract are either:
  - considered to be within the ‘main subject matter’ of an insurance contract, and hence would not be subject to UCT provisions (**Option 1 – a broad definition of main subject matter**); or
  - not considered to be within the ‘main subject matter’ of a contract, and hence would be subject to UCT provisions (**Option 2(a) – a narrow definition of main subject matter**).
- Given the potential impact on insurers in the event that a policy exclusion may be declared void, should remedies be restricted to exercise by a regulatory authority (**Option 2(b) – remedies are restricted to exercise by a regulatory authority**)?

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## **Chapter 5 Other option considered**

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### **Consumer Education Program/campaign**

5.1 Consideration was initially given to an education program/campaign to inform consumers of the insurance related issues including their rights regarding UCT.

5.2 There may be a number of benefits to consumers from an education program/campaign including encouraging consumers to:

- ask questions about their insurance policies;
- seek advice when they fail to understand particular jargon/terminology; and
- become more active in the decision making process.

5.3 Although an educational program/campaign may have a number of benefits, it was considered that it would not meet the Commonwealth's objective to ensure that consumers who purchase insurance have an equivalent level of protection as that which currently applies to other financial products and financial services, and are thus, insofar as is reasonably possible, protected from actual or potential disadvantage or loss as a result of insurance contracts containing terms that are harsh and/or unfair. Therefore, this option was not considered further.

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## **Chapter 6 Assessment of options**

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### **Affected stakeholder groups**

6.1 In the case of all the options examined, the affected groups are, in order of potential impact from highest to lowest:

- parties to insurance contracts, being policyholders (part of the 'consumer' group) and insurers (part of the 'industry' group);
- third party beneficiaries of insurance contracts (consumer);

- dispute resolution facilities, including industry-based systems and courts (for this purpose, included in the ‘government’ group);
- the insurance regulators (government).

## **PART 1 – OPTIONS THAT MAY ACHIEVE THE GOVERNMENT’S OBJECTIVES**

### **Option A – Status quo**

6.2 The status quo is described in some detail in the ‘Problem’ section of this regulatory impact statement. The following key features are noted:

- there is a concern that the status quo is not dealing effectively with all cases of unfair terms in insurance contracts. This was accepted by the Committee as a valid concern<sup>25</sup>, and is also reflected in the recommendations of the recent Natural Disaster Insurance Review; and
- dispute resolution bodies have noted that sometimes a reliance on a term that is ‘unfair’ does not represent a breach of the duty of utmost good faith.

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<sup>25</sup> The Committee noted that the use of section 14 by consumers is rare, possibly because it is ‘costly and cumbersome’.

**Table 6.1 Status quo impact assessment**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	No increase in premiums under a status quo arrangement	Some policyholders / third party beneficiaries may continue to be denied otherwise valid claims due to unfair/harsh policy terms
<b>Industry</b>	Commercial certainty under a status quo arrangement	
<b>Government</b>	No implementation costs	

**Consultation Question 2**

*A. Please provide details of any additional costs or benefits of the status quo - if possible, please state the magnitude (either in dollars or qualitatively) of the costs and benefits?*

## Option B – Enhance existing IC Act remedies

6.3 Under **Option B - Enhance existing IC Act remedies**, the problem of unfair terms could be addressed by modifying the existing section 14 remedy of the IC Act to reduce its disadvantages (from a consumer perspective). This would eliminate the need for significant changes to the current regulatory framework for insurance contracts (as proposed in **Options C and D**). Section 15 of the IC Act would continue in operation which would mean that the UCT provisions of the ASIC Act would not apply to insurance.

6.4 Changes to section 14 that might be considered to address the disadvantages referred to in the ‘Problem’ section could include:

- The extension of the duty of utmost good faith to third party beneficiaries, as proposed in the 2010 ICA Bill;
- A proposed facility for ASIC to bring a public interest action for a breach of section 14, as proposed in the 2010 ICA Bill.
- Reversing the onus of proof, so where an insurer is relying on a term in the contract that is the subject of an allegation by a policyholder / third party beneficiary that it is in breach of the duty of utmost good faith, the insurer would be required

to demonstrate that reliance on the term is not in breach of section 14<sup>26</sup>.

- Implementing a blanket ban on terms found to be in breach of the duty of utmost good faith under section 14.

**Table 6.2 Option B preliminary impact assessment summary**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	<p>Onus of proof changes would reduce the costs and difficulties for insureds / third party beneficiaries in bringing actions relating to alleged unfair terms</p> <p>Use of representative actions and / or powers to address breaches of section 14 could be used to prevent future disadvantage to other consumers</p>	<p>May still not provide equivalent level of protection to current UCT regime as applied to other financial products and services under the ASIC Act.</p>
<b>Industry</b>		<p>Onus of proof changes would result in increased costs of defending against 'unfairness' claims</p>
<b>Government</b>	<p>Increased flexibility of remedies for ASIC</p>	<p>Legislative amendments will be required</p>

<sup>26</sup>Some safeguards to discourage frivolous or vexatious allegations might also be considered in that context.

**Consultation Question 3**

- A. Would you support changes to section 14 of the IC Act as a viable means to address the issue of unfair contract terms in insurance?
- B. Are there any other changes to section 14 that would increase consumer protection from unfair contract terms?
- C. What are the potential benefits to consumers (both monetary and non-monetary) - if possible, please state the magnitude (either in dollars or qualitatively) of the benefits?
- E. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option – if possible please provide the magnitude of the costs and a breakdown of categories?
- E. If this option is adopted will insurers:
- (i) be likely to increase insurance premiums?
  - (ii) revisit some of their current contract offerings?
- F. If this option is adopted, are there any:
- (i) additional costs or benefits?
  - (ii) factors that impact on the options feasibility?
  - (iii) practical limitations on insurers that would impede their ability to comply with the changes?

**Option C – Permit the unfair contract terms provisions of the ASIC Act to apply to insurance contracts**

6.5 Consumer representatives have argued that there would be a number of benefits, relative to the status quo, of permitting the unfair contract terms provisions to apply to insurance contracts. Insurers have disputed those arguments and identified a range of costs that would be associated with such a reform.

- An overview of these arguments is at **Attachment A**.

6.6 The most significant consideration, in terms of possibly justifying an exemption from UCT laws for insurance contracts, is the potential impact of having an exclusion declared void. The arguments of the insurance industry in that regard are, in summary, that:

- Insurers use exclusions as a tool to define the risk that they are willing to bear. Policies are priced on the basis that the exclusions will operate, factoring in the cost of the extent of cover in the relevant reinsurance treaties.
- Declaring void an exclusion that was important in the context of an event of widespread loss and damage (such as a natural disaster) means insurers would be required to pay for losses arising from a risk for which they have not collected any premiums. Depending on the number and size of the claims, this could have major ramifications for an insurer's balance sheet and capital requirements.
- Actions by reinsurers potentially have immediate and longer term impacts on the price and availability of policies, which will affect even insurers that are not directly affected by a UCT declaration.

6.7 For the above reasons, application of UCT laws in an insurance context have potentially more impact than in other industries, where the possible adjustment of non-core contractual terms are not as central to business finances and operations.

6.8 In response to those points, it could be argued that:

- As potential losses incurred by policyholders can be devastating, consumers should have access to an equivalent level of protection and remedies as that which currently apply to other financial products and services in the event that exclusions are shown to be unfair;
- Insurers may currently be relying on poorly drafted contracts, being potentially in breach of both IC Act and Corporations Act requirements; and
- Insurers may be able to mitigate increased risk through the periodic vetting of contracts (eg. at time of renewal) and an appropriate timeline for implementation of revised contracts.

**Table 6.3 Option C impact assessment**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	<p>Access by retail policyholders to additional remedies to prevent reliance on unfair terms in standard contracts</p> <p>Use of 'blanket' banning of unfair terms would serve to prevent future disadvantage to other consumers</p> <p>Access to more appropriate level of cover</p>	<p>Increase in premiums if insurers pass on increased costs</p>
<b>Industry</b>	<p>Enhancement to reputation</p>	<p>Relatively high commercial uncertainty arising from potential 'blanket' banning, leading to higher costs (including reinsurance)</p> <p>Increased complexity of regulation due to difference in coverage between ASIC Act and IC Act, and costs associated with dual pleadings</p>
<b>Government</b>	<p>Wider range of remedies for regulator</p>	<p>Legislative amendments will be required. ASIC will administer UCT in line with its current responsibilities under the ASIC Act.</p>

**Consultation Question 4**

A. *What are the potential benefits to consumers (both monetary and non-monetary) of adopting this option - if possible, please state the magnitude (either in dollars or qualitatively) of the benefits?*

B. *From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?*

C. *If this option is adopted will insurers:*

(i) *be likely to increase insurance premiums?*

(ii) *revisit some of their contract offerings?*

D. *If this option is adopted, are there any:*

(i) *additional costs or benefits?*

(ii) *factors that impact on the options feasibility?*

(iii) *practical limitations on insurers that would impede their ability to comply with the changes?*

**Option D – Extend IC Act remedies to include unfair contract terms provisions**

6.9 Rather than have the UCT provisions of the ASIC Act apply to insurance contracts (as per **Option C**), the IC Act could be amended to expressly include the sorts of remedies that are currently available to consumers in relation to unfair contract terms as provided under the ASIC Act.

- This would maintain the position that the IC Act is the only legislation that would deal with judicial review of insurance contracts, including for unfair contract terms. Section 15 of the IC Act would therefore continue to apply in its current form.

6.10 This approach recognises the Commonwealth's exclusive power to regulate insurance matters (apart from State insurance) under section 51(xiv) of the Constitution.

- This means that UCT provisions will be contained in the ACL (for non-financial services); the ASIC Act (for financial services other than insurance contracts); and the IC Act (for insurance contracts).

6.11 While less than ideal, from the perspective of legislative simplicity, this represents constitutional reality in a Federation. Constitutional considerations also dictate the requirement for separate provisions for financial services (due to a referral of state powers) which can be practically overcome through a policy commitment to maintain the consistency, to the extent appropriate, of unfair contract terms laws across each piece of legislation. This approach is currently adopted with respect to the consumer protection provisions of the *Competition and Consumer Act 2010* (CCA) and the investor protection provisions of the ASIC Act.

6.12 The main advantage of this approach, as opposed to **Option C**, is that:

- the ICA would continue to be the primary source of regulation regarding insurance contracts, and ‘dual pleadings’ in insurance disputes would not be an issue;
- it would enable the provisions to be tailored so that the regime fits in with existing concepts in the IC Act.
  - For example, at least in the context of general insurance, consideration could be given to replacing ‘standard form’ and ‘consumer contract’ under the ACL, with concepts already established under the IC Act, such as ‘eligible contract of insurance’. This would minimise regulatory complexities and anomalies due to marginal gaps/overlaps between the IC Act framework and the UCT regime in the ASIC Act;
- a particular issue that could be addressed is whether some categories of terms in insurance contracts should be subject to unfair terms, but others should be subject only to the other remedies.

6.13 By way of further explanation of the final point, it would be possible to make terms in insurance contracts subject to the unfair contracts terms remedies in respect of the types of terms identified in the ASIC Act and the ACL, for example:

- a term that permits one party (but not the other) to vary the terms of the contract; and

- a term that permits, or has the effect of permitting, one party to unilaterally determine whether the contract has been breached or to interpret its meaning.

6.14 It is not obvious why insurance contracts should be treated differently from other contracts in relation to providing remedies for those types of terms. However, both general and life insurance contracts can be distinguished from many other types of consumer contracts in that the contract for the product and the product are, in effect, one and the same thing. It is arguable that the extent of the cover provided (and not provided) is, in the insurance context, of a similar nature to, if not the same as, the 'main subject matter' of a contract, which is not subject to review under the ACL. It is arguable, on that basis, that the unfair contract terms provisions should be limited in their application to matters that are outside the parameters defining the cover. Issues surrounding the fairness and transparency of exclusions from cover would be dealt with under other IC Act remedies.

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**Table 6.4 Option D impact assessment**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	<p>Access by retail policyholders to additional remedies to prevent reliance on unfair terms in standard contracts</p> <p>Use of 'blanket' banning of unfair terms would serve to prevent future disadvantage to other consumers</p> <p>Access to more appropriate level of cover</p>	<p>Increase in premiums if insurers pass on increased costs</p>
<b>Industry</b>	<p>Enhancement to reputation</p> <p>As compared to <b>Option C</b>, there is no risk of 'dual pleadings' between ASIC Act and IC Act.</p>	<p>Relatively high commercial uncertainty arising from potential 'blanket' banning, leading to higher costs (including reinsurance)</p>
<b>Government</b>	<p>Wider range of remedies for regulator</p>	<p>Legislative amendments will be required. ASIC will administer UCT with its current responsibilities under the IC Act. Need to periodically monitor and potentially update the IC Act to ensure consistency between the IC Act and ASIC Acts.</p>

**Consultation Questions 5**

A. If UCT laws were extended to include insurance, is it preferable for these laws to sit within the IC Act or ASIC Act?

B. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?

C. Would these costs be likely to be higher or lower than **under Option C**

D. What are the potential benefits to consumers (both monetary and non-monetary) - if possible, please state the magnitude (either in dollars or qualitatively) of the benefits?

E. If this option is adopted will insurers:

- (i) be likely to increase insurance premiums?
- (ii) revisit some of their contract offerings?

G. If this option is adopted, are there any:

- (i) additional costs or benefits?
- (ii) factors that impact on the options feasibility?
- (iii) practical limitations on insurers that would impede their ability to comply with the changes?

**Option E – Encourage industry self-regulation to prevent use of unfair terms by insurers**

6.1 Rather than impose government regulation, another option may be to encourage the insurance industry to adopt a self-regulatory stance on inclusion in insurance contracts of terms that are ‘unfair’, in the ordinary sense of the word.

6.2 A possible model is that an industry code of practice would include a guiding principle about the fairness of terms. Consumers that considered an insurer was in breach could complain to a compliance/enforcement body established under the Code, and there would be processes for the body to require the insurer to rectify any

breach of the code that the body identifies. It would also be possible for the body to monitor contracts.

6.3 The March 2010 Options Paper raised self-regulation as a possible means to address alleged unfair contract terms in. Although there was some support from industry groups, the option was opposed by consumer representatives. For example, the Consumer Law Action Centre commented in its submission that:

We strongly believe that Option D would not be effective. It requires the industry to adopt rules on including unfair terms in their insurance contracts, however, the Options Paper highlights that industry representatives do not yet even accept that there is a problem with unfair terms in insurance contracts. They question and attempt to dismiss individual examples on a case by case basis rather than considering the systemic issues raised, and attempt to argue that there is a distinction between terms that are inherently unfair and terms that are fair but are capable of being applied unfairly. Further, the industry has made no attempt to address the issue to this point, for example using existing self-regulatory instruments. The ALRC in 1982 summarised some of the problems with attempting to rely on industry self-regulation to address unfair insurance policy terms, including that not all insurers would sign up to self-regulatory instruments and that the practices of the industry in relation to previous self-regulation initiatives gave no cause for confidence. There remain no indications that the industry is capable of addressing the problem of unfair insurance contract terms via self-regulation.

6.4 Other factors that could weigh against this option would be that, although the General Insurance Code of Practice might be used as a platform to build standards on unfair terms, there is no equivalent code in life insurance, and there would be costs to industry in establishing an assessment, monitoring and enforcement framework. A further consideration is the possibility that approaches to issues under the self-regulatory regime could diverge from the approach taken under the UCT laws that apply to other parts of the financial services sector.

6.5 On the other hand, a self-regulatory solution may offer some advantages from a consumer perspective due to the additional flexibility it could offer, in comparison to a technical legal test.

6.6 However, no self-regulatory model could be successful unless both insurers and consumers had confidence in the body making the assessments, and respected its decisions and recommendations. The persons who made up the membership of such a body would therefore be of key importance.

6.7 Any self-regulatory approaches that led to coordination between insurers over the coverage or price of insurance products may create competition concerns under Part IV of the CCA. The Australian Competition and Consumer Commission is however able to authorise conduct that would otherwise create competition concerns, where there would be a net public benefit. The ACCC would need to consider applications for authorisation under Part VII of the CCA on a case by case basis.

**Table 6.5 Option E impact assessment**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	<p>Possible benefits from changes in insurer's conduct in drafting and administering contract terms</p> <p>Access to potentially more appropriate level of cover</p>	<p>May not provide equivalent level of protection than current UCT regime as applied to other financial products and services under the ASIC Act.</p> <p>Increase in premiums if insurers pass on increased costs</p>
<b>Industry</b>	<p>Enhancement to reputation</p> <p>Likely lower compliance costs compared to <b>Options C and D</b></p>	<p>Costs associated with developing the guidance and ongoing monitoring costs, particularly in the life insurance industry</p>
<b>Government</b>	<p>Would not need to legislate or review / update legislation.</p>	

**Consultation Question 6**

A. What would be the costs and benefits to consumers (both monetary and non-monetary) - if possible, please state the magnitude (either in dollars or qualitatively) of the benefits?

B. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?

C. How do these compliance costs compare to **options C and D**?

D. If this option is adopted will insurers:

(i) be likely to increase insurance premiums?

(ii) revisit some of their contract offerings?

E. If this option is adopted, are there any:

(i) additional costs or benefits?

(ii) factors that impact on the options feasibility?

(iii) practical limitations on insurers that would impede their ability to comply with the changes?

## **PART 2 - OPTIONS WHEN UNFAIR CONTRACT TERMS PROVISIONS APPLY TO INSURANCE CONTRACTS (OPTIONS C AND D)**

6.8 If UCT provisions are to apply to insurance contracts through either applying provisions of the ASIC Act to insurance contracts (Option C) or amending the IC Act (Option D) consideration needs to be given to defining the main subject matter of the contract. This is because the UCT laws exclude the main subject matter of a contract from the scope of review on the basis of unfairness. The broader the main subject matter the more will be excluded from UCT laws. The section below outlines two options – broad and narrow options - for defining the main subject matter.

6.9 If the main subject matter is defined narrowly, consideration could be given to only permitting the regulator (ASIC) to have standing to challenge the terms in the contract. This would reduce potential

uncertainty for insurers by limiting the scope for policyholders to challenge terms on the grounds of unfairness. This option is discussed below in more detail.

## The 'main subject matter' exclusion

6.10 The UCT laws (as applied to financial services in the ASIC Act) provide that a term in a standard form consumer contract (other than an insurance contract, by virtue of section 15 of the IC Act) is unfair if –

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- 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.

6.11 In determining whether a term of a consumer contract is unfair, a court must take into account the extent to which the term is transparent (that is, expressed in reasonably plain language, legible, presented clearly and readily available to all parties), and the contract as a whole.

6.12 The UCT laws exclude the main subject matter of a contract from the scope of review on the basis of unfairness. The relevant section (section 12BI of the ASIC Act) states that section 12BF (which is the provision that voids unfair terms) does not apply to a term to the extent (but only to the extent) that it defines the main subject matter of a contract.

6.13 The Explanatory Memorandum to the relevant Bill includes this passage regarding the main subject matter exclusion:

Where a party has decided to purchase the goods, services, land, financial services or financial product that is the subject of the contract, that party cannot then challenge the fairness of a term relating to the main subject matter of the contract at a later stage, given that the party had a choice of whether or not to make the purchase on the basis of what was offered.

6.14 In the Victorian case of *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd & Matrix Pilates and Yoga Pty Ltd* (Civil Claims), Harbison J. stated:

[T]erms of a consumer contract which have been the subject of genuine negotiation should not be lightly declared unfair. This legislation is designed to protect consumers from unfair contracts, not to allow a party to a contract who has genuinely reflected on its terms and negotiated them, to be released from a contract term from which he or she later wishes to resile.

6.15 The UCT law applies only to standard form contracts. While the ASIC Act does not define a standard form contract, contracts are presumed to be of a standard form unless a party (usually the business) proves otherwise. Certain characteristics of a transaction are always likely to be negotiated, since ultimately a consumer has a choice whether to enter into a contract for the contracted good or service. Guidance issued by ASIC (jointly with the ACCC and State and Territory fair trading agencies) indicated that terms defining the main subject matter of a consumer contract will invariably be the subject of genuine negotiation<sup>27</sup>.

### **‘Main subject matter’ in the context of insurance**

6.16 In the context of an insurance policy, the basis on which a policy is sold may be relevant to considering whether an exclusion from cover can be considered to be part of the main subject matter.

6.17 Nevertheless, the extent to which a contractual term is not clearly defined and / or not generally known to consumers in advance of making the contract affects the question of whether a term can be said to define the main subject matter, is not clear at this stage. This is particularly relevant in considering the extent to which an exclusion from an insurance policy could be considered to have been negotiated or even envisaged by a consumer when purchasing an insurance policy.

6.18 The operation of the main subject matter exemption could be clarified by supplementing the generic UCT laws with additional laws or regulations. This would expressly clarify that specific parts of an insurance policy, such as exclusions, are able to be challenged on grounds of unfairness, notwithstanding they may be categorised as defining the main subject matter. A similar suggestion was included in the submission by National Legal Aid on the 2010 Options Paper, which stated (at page 20) that:

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<sup>27</sup> A term may be ‘genuinely negotiated’ if it relates to a part of the contract that a consumer could have altered (whether or not this would affect the price of the product).

the [unfair contract terms laws] ought to be amended to specifically acknowledge that, in respect of insurance contracts, a term which seeks to limit or exclude liability is not caught by the main subject matter exemption (and as such is caught by the unfair terms provisions).

6.19 To make such a rule in connection with insurance would address the concerns of consumer representatives about the limitation on the effectiveness of UCT laws in the context of insurance due to the main subject matter exemption.

6.20 However, the insurance industry has raised concerns with this proposal, highlighting the risks and costs associated with extending UCT provisions. These concerns arise because insurers rely on contract terms and exclusions when pricing, reserving and purchasing reinsurance cover for a risk. An increase in uncertainty around the contract terms has the potential to lead to higher pricing. It will also influence reserving practices and may increase both the level and uncertainty of claims provisions. In addition, the inclusion of a risk for an insurer (which would have otherwise been excluded were the 'unfair' term lawful) will influence the availability and cost of reinsurance coverage to the insurer.

6.21 All these factors will influence the capital levels and requirements for insurers more generally. The extent of the impact depends on the changes made and the degree of uncertainty that this creates, as well as the individual insurer's circumstances.

6.22 However, it follows that UCT laws that expressly make limitations on cover and exclusions subject to review for unfair contract terms could result in greater risks and costs overall than UCT laws that did not do so or expressly provided that exclusions and limitations on cover are not subject to review.

6.23 For the purposes of the impact assessment, this option has been broken down into three scenarios:

- Option 1 – main subject matter is broadly defined to include limitations or exclusions that impact on the scope of the insurance cover; and
- Option 2 (a) – main subject matter is narrowly defined to exclude limitations or exclusions that impact on the scope of the insurance cover.
- Option 2 (b) – main subject matter is narrowly defined to exclude limitations or exclusions that impact on the scope of

the insurance cover, with remedies in relation to UCT's restricted to the regulator.

### **Option 1 – Should the ‘main subject matter’ of an insurance contract be defined broadly?**

6.24 Under this Option, any terms that sought to limit liability in an insurance contract would be considered to be within the ‘main subject matter’ of an insurance contract. Under existing UCT laws, this would mean that policy exclusions would not be subject to judicial review in terms of ‘fairness’.

6.25 As outlined both above and in **Option C**, insurers use exclusions as a legitimate tool to define risk, and policies are priced on the basis that exclusions will operate (factoring in the cost of the relevant reinsurance treaties).

6.26 This Option recognises the importance of exclusions in the context of an insurance contract, and thus treats terms that seek to limit liability as within the main subject matter of an insurance policy.

6.27 The counter argument to this Option is that as exclusions are essentially quarantined within the main subject matter of an insurance contract, consumers would not be able to utilise UCT provisions in as wide a range of disputes as currently applies to other financial products and services under the ASIC Act. This may lead to fewer instances in which UCT laws would apply in the context of insurance, and may thus reduce the overall effectiveness of introducing a UCT regime for insurance.

**Table 6.6 Option 1 impact assessment (as compared to Option 2)**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	Potentially lower costs for premiums than Option 2	UCT laws would not apply as widely as for Option 2.
<b>Industry</b>	Greater commercial certainty relative to Option 2  Likely lower cost of compliance than Option 2	
<b>Government</b>	Wide range of remedies for regulator	Legislative amendments will be required.

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**Consultation Questions 7**

- A. Do you agree that main subject matter should be clarified in the context of insurance policy exclusions?
- B. Do you consider terms that sought to limit liability genuinely constitute main subject matter of an insurance contract?
- C. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?
- D. What benefits are there for consumers (both monetary and non-monetary) - if possible, please state the magnitude (either in dollars or qualitatively) of these benefits?
- E. If this option is adopted will insurers:
- (i) be likely to increase insurance premiums?
  - (ii) revisit some of their contract offerings?
- F. If this option is adopted, are there any
- (i) additional costs or benefits?
  - (ii) factors that impact on the options feasibility?
  - (iii) practical limitations on insurers that would impede their ability to comply with the changes?

**Option 2(a) – Should the ‘main subject matter’ of an insurance contract be defined narrowly?**

6.28 Under this Option, terms that sought to limit liability in an insurance contract would not generally be considered to be within the ‘main subject matter’ of an insurance contract. This means that under existing UCT laws, most policy exclusions would not be safeguarded from judicial review in terms of ‘fairness’.

6.29 As outlined in Chapter 2, under current UCT laws in the ASIC Act a court could find a term in a consumer contract ‘unfair’ if:

- (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term<sup>28</sup>; and
- (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

6.30 In determining whether a term is unfair, a court must take into account the extent to which the term is transparent (i.e., is expressed in reasonably plain language; legible; presented clearly; and readily available to any party affected by the term), and the contract as a whole.

6.31 Compared to **Option 1**, this Option would possibly cover a broader range of circumstances as consumers would be able to review exclusions on the grounds of unfairness.

6.32 However, this Option would arguably produce less certainty for insurers, as it would largely be up to the interpretation of the court (noting the above parameters of transparency and the contract as a whole) as to whether an exclusion may be considered unfair.

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<sup>28</sup> Under s12BG(4), a term of a consumer contract is presumed not to be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise.

**Table 6.7 Option 2 impact assessment (as compared to Option 1)**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	<p>Wider coverage / protections from unfair terms than Option 1</p> <p>Use of 'blanket' banning of unfair terms would serve to prevent future disadvantage to other consumers</p>	<p>Possible higher cost of premiums than Option 1 if insurers pass on increased costs</p>
<b>Industry</b>		<p>Relatively high commercial uncertainty arising from potential 'blanket' banning, leading to higher costs (including reinsurance)</p> <p>Potentially higher compliance costs than Option 1.</p>
<b>Government</b>	<p>Wider range of remedies for regulator</p>	<p>Legislative amendments will be required</p>

**Consultation Questions 8**

A. Are there any major obstacles (either legal or practical) preventing a narrow definition for main subject matter?

B. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?

C. What benefits are there for consumers (both monetary and non-monetary) - if possible, please state the magnitude (either in dollars or qualitatively) of the benefits?

D. If main subject matter was to be defined narrowly, what types of policy exclusions/ limitations should be excluded?

E. If this option is adopted will insurers:

(i) be likely to increase insurance premiums?

(ii) revisit some of their contract offerings?

E. Will premium increases (if they occur) be higher if the subject matter is narrow rather than broad?

F. Are there any (if this option was adopted):

(i) additional costs or benefits not referred to above?

(ii) factors that impact on the feasibility of this option?

(iii) practical limitations on insurers that would impede their ability to comply with the changes?

**Option 2(b) –Should unfair contract terms provisions be modified so that the remedies are restricted to exercise by a regulatory authority**

6.33 As referred to above, the most significant risk in applying the UCT laws to insurance contracts is the additional uncertainty created due to the risk of challenges to clauses that limit or exclude liability. Insurers argue that, regardless of whether the challenges are ultimately successful, even the prospect of legal challenges would increase risk to the point that

it could impact on the cost and availability of reinsurance, and impact on premiums.

6.34 One option to reduce potential uncertainty for insurers would be to limit the scope for individual policyholders to challenge terms on the grounds of unfairness, but rather permit only the regulator (ASIC) to have standing to challenge the terms.

6.35 Under such an option, ASIC could monitor complaints about allegedly unfair terms made to dispute resolution bodies, and accept complaints directly from the public. If ASIC assessed that a term was likely to be unfair, in the first instance it could approach the insurer(s) involved and seek to have the insurers cooperate to modify the term voluntarily.

6.36 In the event that the insurers involved did not cooperate, under the UCT laws, ASIC could apply to the court to seek orders declaring that a term was unfair, and orders for the benefit of affected consumers. The orders that the court could make to redress the loss or damage suffered by non-party consumers include:

- an order declaring all or part of the contract to be void (either before or after the date that the order is made);
- an order varying a contract or arrangement as the court sees fit (either before or after the date that the order is made); or
- an order refusing to enforce all or any of the terms of a contract or arrangement.

6.1 If a court makes a declaration that a term is unfair and a party subsequently seeks to apply or rely upon the unfair term, it would be a breach of the UCT laws and the court could grant remedies of injunction, an order to provide redress to non-party consumers, or any other orders the court thinks fit.

6.2 Under this option, parties other than ASIC (such as consumers) would not have the power to commence private actions to enforce their rights or to recover loss or damage incurred for specific breaches. Consumers would therefore be reliant on ASIC to take action against insurers on grounds of unfairness.

6.3 The proposed limitation on remedies for persons other than the regulator under this option might however be justified on the basis that:

- In practice, court actions by individual consumers under existing UCT laws are rare. Much more common are

approaches by regulatory authorities to businesses seeking voluntary cooperation in amending terms.

- The restriction on remedies to ASIC would largely address the concerns on the part of insurers about uncertainty and the associated costs that would result. ASIC, as the responsible regulator, would be very unlikely to launch legal actions seeking that terms are declared unfair without providing the insurers with a reasonable opportunity to address the issue, and any actions that were ultimately brought are unlikely to be without merit.

6.4 By limiting a consumer's right to directly pursue remedies against an insurer on grounds of unfairness, this option differs from how the UCT laws are currently applied under the ACL.

6.5 There may be a risk that ASIC would only seek to take action in cases where the potential outcomes were wide-reaching or systemic, and where the cost of taking action could be justified. If enforced in this way, consumers would be at a distinct disadvantage when seeking remedies for unfair contract terms in insurance, relative to other sectors covered by the ACL.

**Table 6.8 Option 1(a) or 2(a) impact assessment (as compared to remedies not restricted to exercise by ASIC only)**

	<b>Benefits</b>	<b>Costs</b>
<b>Consumers</b>	Access to additional remedies, including those resulting from insurers cooperating voluntarily following representations from ASIC, to prevent reliance on unfair terms in standard contracts	Possible reduced cost in premiums compared to unrestricted exercise if insurers pass on increased costs than  Reliance on ASIC to take action on behalf of the consumer
<b>Industry</b>	Reduced commercial uncertainty compared to unrestricted exercise (as ASIC would be unlikely to launch any court action that was without merit)	
<b>Government</b>		Increased costs and onus of responsibility on ASIC as the regulator

**Consultation Questions 9**

*A. Do you consider it necessary (or desirable) to restrict remedies to be exercised solely by the regulator if UCT laws were extended to include insurance?*

*B. Will individual consumers have the same level of protection (as provided in the ACL and the ASIC Act) if the regulator is the only party that can seek remedies in relation to UCT?*

*C. From an industry perspective, what would be the potential compliance costs (both monetary and non-monetary) associated with this option - if possible please provide the magnitude of the costs and a breakdown of categories?*

*D. If this option is adopted will insurers:*

- (i) be likely to increase insurance premiums?*
- (ii) revisit some of their contract offerings?*

*E. Are there any (if this option was adopted):*

- (i) additional costs or benefits not referred to above?*
- (ii) factors that impact on the feasibility of this option?*
- (iii) practical limitations on insurers that would impede their ability to comply with the changes?*

*F. If the subject matter is kept relatively narrow, will insurers face lower levels of uncertainty regarding the potential voiding of terms, if remedies in relation to UCT's are restricted to the regulator?*

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## Chapter 7 Consultation

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7.1 Extensive consultation has been undertaken on the application of UCT laws to insurance contracts.

### 2004 – Review of Insurance Contract Act 1984

7.2 The issue of unfair terms in insurance contracts and, in particular, whether section 15 of the IC Act needed to be retained, was considered as part of the second stage of the review of the *Insurance Contracts Act 1984* in 2004. Submissions to that review were ‘*starkly divided on the ongoing need for section 15 with strongly held views being expressed both in favour and against its retention*’.

7.3 The Review Panel concluded that the consequences of repealing section 15 were too uncertain to warrant taking that step. However, the arguments were finely balanced, and if a nationally consistent model for review of consumer unfair contracts were developed, the balance of consideration may shift and the issue should be revisited.

### 2009 – Inquiry by Senate Economics and Legislation Committee

7.4 The consideration of the same issue in 2009 in the context of the inquiry by the Senate Economics and Legislation Committee into the *Trade Practices Amendment (Australian Consumer Law) Bill*, including the Committee’s conclusion, is described in Chapter 1 of this assessment.

### 2010 – Options Paper

7.5 In March 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, introduced the *Insurance Contracts Amendment Bill 2010 (ICA Bill)* into the Parliament. While the Bill did not deal with unfair contract terms, the Minister released a paper to coincide with Bill, which sought comments on options to address unfair terms included in insurance contracts. The paper described five possible options to deal with the potential for unfair terms in insurance contracts:

- status quo;
- permit the UCT provisions of the ASIC Act to apply to insurance contracts;
- extend IC Act remedies to include tailored UCT provisions;

- enhance existing IC Act remedies; and
- encourage industry self-regulation to better prevent use of unfair terms by insurers.

7.6 A number of comprehensive submissions were received from stakeholder groups in response to the paper. The options most favoured were the status quo (supported by the insurance industry) and permitting the UCT provisions of the ASIC Act to apply (supported by consumer representatives). The other options were generally not supported, although some stakeholders considered one or more of those could be 'second best' solutions if their preferred option were not adopted. Copies of the submissions on the March 2010 options paper are available at [http://www.icareview.treasury.gov.au/content/insurance\\_options\\_submissions.asp?NavID=23](http://www.icareview.treasury.gov.au/content/insurance_options_submissions.asp?NavID=23).

### **2011 – Roundtable discussion of key stakeholders**

7.7 Having regard to significant differences in views among stakeholders expressed in response to the 2010 Options Paper and at other meetings, in March 2011 the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP, convened a roundtable of key stakeholders for the purpose of exchanging views on:

- arguments regarding the extension of UCT laws to insurance;
- how the 'main subject matter' exemption in UCT laws would operate in an insurance context; and
- other options with broadly comparable policy objectives, which could be considered independently of extending UCT laws, in particular:
  - strengthen pre-contractual disclosure requirements – to reduce the risk insureds are surprised by unexpected policy terms;
  - clarify the statutory formulation of the duty of utmost good faith to expressly recognise fairness as an element;
  - industry self-regulation of unfair contract terms – to provide a mechanism for terms causing concern to be addressed by insurers voluntarily; and
  - community education directed at insurance-related issues.

7.8 Although no consensus was reached between insurer and consumer representatives in relation to many of the questions raised, a further option emerged that the parties considered might produce a solution that satisfactorily addressed the key concerns of both sides. The idea was that the UCT laws could be applied to insurance contracts, however only the regulator would have standing to bring actions, rather than individual consumers.

7.9 The option that emerged from the roundtable discussion has since been developed into Option C, as set out previously.

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## ***Chapter 8 Conclusion and recommended option***

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8.1 The assessment of options outlined in Chapter 5 have been developed giving consideration to the divergence of views on the scope of the problem and the likely results of the various options in the insurance context.

8.2 Given this is a consultation RIS, we do not have a recommended option at this stage.

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## ***Chapter 9 Implementation and review***

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### **Implementation**

#### **Changes to the Insurance Contracts Act 1984, ASIC Act or industry code of practice**

9.1 Should consultations justify the need for introducing provisions regarding unfair contract terms in insurance, legislation could be introduced as early as 2012-13. Depending on final measures agreed to, this may involve amendments to either the IC Act; ASIC Act; and / or industry code of practice.

9.2 If reforms were to be introduced, it is currently envisaged that a two year transition period would apply from the date any legislation comes into effect. This would provide sufficient time for insurers to calculate the impact the proposed changes will have on their businesses; make the necessary amendments; and notify policy holders if necessary.

**Consultation Questions 15**

*If UCT provisions were applied to insurance, would a 2 year transition period be adequate for industry and consumers?*

**Consultation on legislation**

9.3 If reforms were to be introduced, there would be public consultation on any draft legislation to allow consumer groups and industry representatives to provide comment on the proposed content of the legislation.

**Review**

9.4 The effectiveness of the proposed measure and legislative amendments would be monitored by ASIC. It is expected that the effectiveness and impact of the introduction of these measures would be reviewed after a sufficient period of time had elapsed.

9.5 In this regard, the time between the commencement of relevant legislation and any review of the operation of the legislation must allow for industry and consumer groups, as well as the Commonwealth, to have gathered sufficient data so as to contribute to a meaningful assessment of the success of the measure.

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## ***Attachment A - Arguments for Status Quo vs. extending unfair contract terms provisions to insurance contracts***

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9.6 The table below summarises the main arguments raised in submissions put forward by various stakeholders (in no particular order) in relation to the status quo and extending UCTs to insurance.

**Table 9.1 Arguments for Status Quo (Option A) vs. Extending UCT provision to insurance contracts**

<b>Arguments</b>	<b>Counter-arguments</b>
The vast majority of insurance claims are processed by insurers without dispute, and most are paid in full. Consumers have access to low-cost dispute resolution mechanisms if issues arise. There is no evidence of systemic reliance on unfair terms to deny claims.	<p>There are numerous examples of unfair terms in insurance contracts, which have been documented in various reports. Overall statistics about claims and dispute rates are misleading, as many disaffected consumers do not have the resources to challenge an insurers' decision.</p> <p>Access to dispute resolution is not limited to insurance – other financial services have access to that and they are still subject to UCT provisions.</p>
Many examples of alleged unfair terms that have been cited relate to complaints about how a term has been applied/interpreted, rather than 'innate' unfairness of the term.	The alleged distinction between an unfair term and unfair application is illusory. If a policy term is unclear/ambiguous and allows 'room to move' by an insurer, the term itself is unfair.
The IC Act, particularly the doctrine of utmost good faith, already provides adequate remedies for this type of complaint against insurers.	In theory this may be true but the duty of utmost good faith has proven, in practice, to be of very little assistance to insureds. Most utmost good faith court cases are allegations by insurers of breaches by insureds. Duty of good faith also only operates on a case by case basis.

<p>Section 35 (standard cover) requires potential insureds of domestic/household policies to be 'clearly informed in writing' about key policy terms and this provides insureds with protection against being surprised by a lack of cover.</p>	<p>The way that 'clearly informed in writing' has been interpreted (i.e. provision of the policy wording is generally sufficient) has not been effective to ensure that insureds properly understand the extent of cover and exclusions. In practice, the standard cover regime does not protect insureds from unfair policy terms.</p>
<p>The IC Act should continue to be the primary source of regulation of insurance contracts. Another layer of regulation will add to complexity and increase disputation.</p>	<p>The IC Act is not a complete code on insurance. It is already supplemented by a range of other legal requirements covering similar ground, such as the disclosure requirements in the <i>Corporations Act 2001</i> (Corporations Act) and consumer protection provisions (other than those excluded by section 15) in the ASIC Act. This is equally the case for other sectors and does not appear to pose unreasonable problems for participants in those sectors. The exclusion for insurance is anomalous and itself creates complexity from an economy-wide consumer protection perspective.</p>
<p>The status quo avoids introducing a difficult distinction between the regulation of consumer and non-consumer insurance contracts.</p>	<p>There are already distinctions drawn between categories of insurance contracts in various regulatory schemes applicable to insurance. For example, within IC Act the prescribed contracts to which standard cover applies, the retail/wholesale distinction for product disclosure rules in the Corporations Act, and parts of consumer protection laws that are not excluded by section 15 (eg. those that allow for remedies in the nature of compensatory damages). This is also the case for other sectors of the Australian economy now subject to UCT provisions.</p>
<p>The broad remedies offered under UCT (such as declaring an offending term to be void) go well beyond the parties to the dispute. What is unfairness in an insurance context depends on particular circumstances and the global</p>	<p>A similar argument could be made in respect of non-insurance contracts.</p>

<p>remedy may not assist all affected consumers.</p>	
<p>Any legal uncertainty that would result from exposure of insurance contracts to unfair contract terms remedies will be a source of additional risk for insurers that will need to be priced in to premiums and allowed for in reserves. There would also be ramifications for reinsurance coverage. This may ultimately impact on pricing and availability of insurance.</p>	<p>The United Kingdom has had UCT laws applying to insurance since 1995. They do not appear to have resulted in any significant negative impacts on the matters mentioned.</p>
<p>There will be significant costs for the insurance industry associated with comprehensive ‘vetting’ of all contracts for unfair terms, regardless of whether there are any that warrant re-drafting.</p>	<p>This argument could also be made for non-insurance contracts.</p> <p>Costs could be alleviated through periodic review of existing contracts.</p>
<p>There are likely to be large numbers of actions by consumers based on UCT provisions that are without merit, unnecessarily creating costs of defending them.</p>	<p>This argument could also be made for non-insurance contracts. Frivolous actions have not proved to be a significant issue for existing UCT regimes.</p>
<p>The ‘main subject matter’ exclusion to UCT laws is uncertain in scope but would be likely to effectively rule out of review for UCTs many key clauses, thereby suggesting the benefits to consumers are limited.</p>	<p>The ‘main subject matter’ exemption (together with a legitimate interest test for unfairness) potentially restrict avenues for review, which should decrease uncertainty level for insurers.</p> <p>The ‘main subject matter’ exclusion could be clarified by additional regulations that define what ‘main subject matter’ is in an insurance context.</p>
<p>Prior inquiries into this issue recommending a generic law (e.g. by the Productivity Commission) did not focus on the special characteristics of the insurance industry.</p>	<p>The prior recommendations clearly favoured an economy-wide approach. The recent consideration by the Senate Economics and Legislation Committee did specifically canvass the position of the insurance industry.</p>