



**ASIC**  
Australian Securities &  
Investments Commission

# **Extending unfair contract terms protections to insurance contracts**

## **Submission by the Australian Securities and Investments Commission**

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## Executive summary

- 1 The Australian Securities and Investments Commission (ASIC) is Australia's national corporate, markets, financial services and consumer credit regulator, with oversight of conduct and disclosure regulation in the general and life insurance sector.
- 2 ASIC welcomes the opportunity to comment on Treasury's proposal paper *Extending unfair contract terms protections to insurance contracts*. We note that some questions in the paper are directed to industry participants. Our submission responds only to questions relevant to ASIC's regulatory functions.
- 3 Since July 2010, ASIC has administered the unfair contract terms (UCT) provisions in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) relating to standard form consumer contracts for financial products and services. Since 12 November 2016, these provisions have also applied to standard form small business contracts.
- 4 In administering these provisions, ASIC has provided regulatory guidance, conducted compliance reviews and issued reports to promote good industry practices and to highlight potentially harmful practices. We have taken steps to address unfair contracts terms in individual circumstances and achieved systemic outcomes benefiting consumers and small businesses more broadly. Examples of our work are summarised in the appendix to this submission.

## Benefits of extending UCT protections

- 5 ASIC supports extending UCT protections to insurance contracts. Life and general insurance products are important risk management tools for consumers and small businesses to protect their living standards and assets.
- 6 Consumers and small businesses should have confidence that the standard form insurance contracts they are offered are fair because such contracts are usually offered on a 'take it or leave it' basis. There is generally no ability for consumers or small business to negotiate the terms of insurance contracts.
- 7 We consider that extending UCT protections to these contracts:
  - (a) would give life and general insurance policyholders the same protections that are currently available for other financial products and services and other standard form contracts throughout the economy;
  - (b) will require insurers to review their standard form contracts and proactively address any terms that could be unfair;
  - (c) can play an important role in promoting trust and integrity in the insurance sector; and

- (d) when appropriately tailored to the specific features of insurance contracts, can help protect consumers and small businesses while still accommodating the legitimate interests of insurers.

8 We consider that some tailoring to suit the specific features of insurance contracts is necessary to extend UCT protections to these contracts to give full effect to these protections. Examples include the following:

- (a) What the 'main subject matter' exemption means in the context of insurance contracts would need to be defined in the legislation. We consider that this should be narrowly defined.
- (b) Consideration should be given to including the quantum of any excess payments within the definition of 'upfront price' of an insurance contract (therefore exempting this quantum from the UCT regime), but not other contractual terms relating to excess payments.
- (c) We support a tailored unfairness test for insurance contractual terms when defining an 'insurer's legitimate interests'.
- (d) The scope of 'standard form contract' should include contracts that consumers and small businesses have chosen from various policy options.
- (e) Consideration should be given to the range of remedies available in relation to unfair contract terms, as seeking to void an unfair term may not always be the most suitable remedy.

## ASIC's key positions

9 The key positions in our submission are as follows:

- (a) We support extending UCT protections to insurance contracts by applying the UCT provisions in the ASIC Act to these contracts (see Section A of this submission).
- (b) While we generally support consistent application of the UCT regime to all products and services (including insurance), some tailoring of the regime for insurance contracts is necessary and appropriate (see paragraph 8 and Section B of this submission).

## A Extending UCT protections to insurance contracts

### Key points

This section looks at two options for extending UCT protections to insurance contracts:

- applying the existing UCT provisions in the ASIC Act to insurance contracts; or
- including UCT protections in the *Insurance Contracts Act 1984* (Insurance Contracts Act).

ASIC supports the first option as it would allow us to address unfair contract terms on a systemic basis, which is an effective approach to dealing with consumer harms.

### Option 1: Applying the UCT provisions in the ASIC Act to insurance contracts (ASIC supports this option)

- 10 ASIC supports applying the existing UCT provisions in the ASIC Act to standard form contracts for general and life insurance. The Australian Consumer Law is the principal consumer protection law in Australia, and is reflected in the ASIC Act, as it applies to financial products and services.
- 11 The ASIC Act therefore includes the core consumer protection provisions that should apply to all for financial products and services, whether or not those products are more specifically regulated under other legislation. The UCT regime is part of these core consumer protection provisions, and should therefore be applied through the ASIC Act.
- 12 UCT protections for insurance contracts should be equivalent to, and harmonised with, those of other standard form contracts for financial products and services and the broader Australian Consumer Law. This objective is best achieved by bringing insurance contracts into the existing UCT regime under the ASIC Act.
- 13 Applying the UCT provisions in the ASIC Act to insurance contracts would allow ASIC to enforce the regime for these contracts consistently with the existing regime for other types of contracts for financial services and products and the broader financial services consumer protection regime.
- 14 ASIC could address unfair contract terms on a systemic basis, which is an effective approach to dealing with consumer harms. A consistent body of law relating to UCT protections would develop over time, preventing a divergence in the application of the substantive law, ASIC's enforcement and regulatory practices and remedies available for consumers.

- 15 We believe that applying the UCT provisions in the ASIC Act to insurance contracts would not create an unacceptable risk of legislative or regulatory uncertainty about legal concepts in this Act and the Insurance Contracts Act, leading to an adverse intermingling of consumer protection provisions.
- 16 Rather, we think that the UCT provisions in the ASIC Act would operate separately from, but complementary to, the duty of utmost good faith in the Insurance Contracts Act.

## **Option 2: Including UCT protections in the Insurance Contracts Act (ASIC does not support this option)**

- 17 ASIC does not support the option of extending UCT protections to insurance contracts by including these protections in the Insurance Contracts Act.
- 18 If UCT protections were included in the Insurance Contracts Act, there would be two separate legislative UCT regimes in the financial services and products sector.
- 19 Such separation presents a risk of divergence in regulatory approaches and case law outcomes over time, which could result in inconsistent consumer outcomes and increase regulatory costs and complexity for both ASIC and industry.
- 20 Including UCT protections in the Insurance Contracts Act would also reduce ASIC's ability to deal with issues on a systemic basis. This is because our regulatory powers (including surveillance or investigation and enforcement) are narrower under the Insurance Contracts Act than under the ASIC Act.
- 21 The general consumer protection provisions in Pt 2, Div 2 of the ASIC Act apply to a broad range of contracts for financial services and products, including insurance, except for the UCT provisions. If the Insurance Contracts Act was used as a mechanism for applying UCT protections to insurance contracts, rather than the ASIC Act, the consumer protection regime under the ASIC Act would apply differently to insurance contracts in some areas compared to contracts for other financial products and services.
- 22 For example, there could be inconsistent protections for consumers and small businesses depending on the type of insurance contract they enter into. The Insurance Contracts Act currently only applies to general insurance contracts that are 'eligible contracts of insurance'. Using this model to extend UCT protections means that some insurance-like products (e.g. funeral insurance) may be excluded from these protections.
- Note: 'Eligible contracts of insurance' are defined as motor vehicle insurance, home building insurance, home contents insurance, sickness and accident insurance, consumer credit insurance and travel insurance: see reg 6 of the Insurance Contracts Regulations 2017.
- 23 Consumers can be disadvantaged by an unfair contract term regardless of the type of insurance contract. We consider that all standard form insurance contracts offered to consumers and small businesses (as covered by the ASIC Act) should be consistently covered by a single UCT regime.

## B Tailoring UCT protections for insurance contracts

### Key points

This section covers ASIC's response to specific proposals for tailoring UCT protections for insurance contracts.

### Exemption for 'main subject matter'

#### The exemption should be defined narrowly

- 24 The 'main subject matter' exemption is part of the existing UCT regime that applies to other financial products and services. For UCT protections to apply effectively to insurance contracts, the main subject matter exemption will need to be adapted.
- 25 ASIC recognises the importance of having an appropriate exemption in the UCT regime for insurance for the 'main subject matter' of the contract. However, an appropriate exemption should balance the legitimate business interests of insurers while addressing the power imbalance consumers face with standard form contracts. The scope of an exemption will ultimately affect the scope of UCT protections for these contracts.
- 26 We support the use of a legislative definition for 'main subject matter' for insurance contracts as a way to provide clarity to insurers about the scope of the exemption and to help ASIC in administering the regime.
- 27 The objectives behind the introduction in 2010 of a national approach to UCT regulation (including the desire to avoid diverging regulatory regimes and jurisdictional inconsistency) would best be reflected, in the case of insurance contracts, by a narrow legislative definition of 'main subject matter' so that only those terms that describe what is being insured (e.g. a house, a motor vehicle or an individual) are exempted.
- 28 This will ensure that insurance contracts will be subject to the same regulatory regime as other standard form contracts to the greatest extent possible and commercially practicable. A broad legislative definition of 'main subject matter' would exclude from UCT protections contract terms that govern insurance cover (including terms on conditions, exclusions and benefits), where these protections are likely to be most relevant.
- 29 We also support this narrow approach because the question of whether a particular term is unfair is most appropriately examined under the test of unfairness, rather than as a question of whether the term falls within the scope of the 'main subject matter' exemption. A narrow definition of 'main subject

matter’ could give insurers an incentive to proactively address and prevent contractual unfairness and potential consumer harm and promote increased trust and confidence in the insurance sector.

### Limitations of disclosure to protect consumers from unfair contract terms relating to insurance cover

- 30 For disclosure to be effective, it must be delivered at the appropriate time, *then* consumers must engage with and understand it. *Finally* it must enhance consumers’ actions or decisions.
- 31 Relevant ASIC research has identified low levels of awareness by consumers about what they are covered for under the insurance products they have bought, or that they have even bought the insurance at all. More generally, the existing disclosure regime has repeatedly and consistently been identified as failing to meet its objective to protect consumers from being sold products that do not meet their needs.
- Note See ASIC’s [Report 256](#) *Consumer credit insurance: A review of the sales practices by authorised deposit-taking institutions* (REP 256) and [Report 470](#) *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470). See also Financial System Inquiry, [Interim report](#) (2014) at paragraphs 3.54–3.58; Insurance Council of Australia [Too long: didn’t read—Enhancing general insurance disclosure](#), Report of the Effective Disclosure Taskforce to Insurance Council Board (2015).
- 32 Table 1 sets out some behavioural insights about the factors that limit the effectiveness of disclosure in all forms (e.g. good/bad, short/long, Product Disclosure Statement/warning statement) from encouraging informed consumer decision making about the cover of insurance products.

**Table 1: Factors that affect consumer decision making**

Factor	How it affects consumer decision making
Supply-side behaviour	<p>Where the incentives of issuers and distributors of insurance are misaligned with their customers, they can work around or undermine traditional interventions such as disclosure.</p> <p>Relevant ASIC findings include different ways consumers are nudged to buy particular insurance products:</p> <ul style="list-style-type: none"> <li>• <i>Add-on insurance in car yards</i>—Decision making was affected by the structure of the process itself (the sale of the insurance at the end of a long day and after the purchase of a product they were emotionally and financially invested in) and by persuasive and pressure sales techniques; and by price framing. Most consumers did not read the disclosure documents even when they were provided.</li> <li>• <i>Funeral insurance</i>—Decision making was affected by exposure to multiple daytime advertisements, creating a growing motivation (and new norm) that consumers should avoid being ‘a burden’. Consumers’ product selection and purchase depended on preference, affordability and who the consumers spoke to.</li> </ul> <p>Note: See ASIC’s REP 470 and <a href="#">Report 292</a> <i>Paying for funerals: How consumers decide to meet the costs</i> (REP 292).</p>

Factor	How it affects consumer decision making
Timing	<p>Insurance products are long-term products, in which decisions to claim are often made long after purchase. Where disclosure is not provided at all, or is provided but at the wrong time, it will not be accessed, assessed, or acted on by consumers.</p> <p>Relevant ASIC findings include that:</p> <ul style="list-style-type: none"> <li>• disclosure is sometimes provided too late, if at all; and</li> <li>• consumers only access and/or assess information about what they are covered for when they actually seek to make a claim.</li> </ul> <p>Note: See ASIC's REP 470 and REP 256.</p>
Complexity	<p>Insurance products involve multiple complex factors—including the scope of cover—that consumers must take into account when making decisions. Recent research has found that consumers' ability to identify good and bad deals became strikingly inaccurate if people had to consider more than two or three different factors.</p> <p>Relevant ASIC findings on home insurance include that, when search processes get too hard, people can make decisions in a way that places least load on their cognition and time resources. For example, some consumers deliberately set out to avoid comparison work, and others used price (only) as a cognitive frame (with less focus on product features and coverage).</p> <p>Note See ASIC's <a href="#">Report 416</a> <i>Insuring your home: Consumers' experiences buying home insurance</i> (REP 416).</p>
Risk	<p>Although the purpose of insurance products is to manage risk, behavioural research consistently shows that most people perceive risk intuitively and inaccurately. We have difficulty understanding probabilistic processes and either overestimate or underestimate risks. ASIC research on home and add-on insurance is consistent with the finding that people have trouble processing risk.</p> <p>Relevant findings include that people can:</p> <ul style="list-style-type: none"> <li>• base their selection of products on those risks that are more tangible, memorable and personally imaginable; and</li> <li>• focus on the probability of events occurring rather than the magnitude.</li> </ul> <p>Note: See ASIC's REP 416 and REP 470; see also Slovic, P, 'Perceptions of risk', <i>Science</i>, Issue 236 (17 April 1987) at pp. 280–285.</p>

## Upfront price

- 33 Contractual terms which set the 'upfront price' payable under a contract are not subject to the existing UCT provisions in the ASIC Act. The upfront price means the amount disclosed to the consumer at or before the time the contract is entered into.
- 34 In applying UCT protections to insurance contracts, ASIC supports the proposal to include an insurance contract's premium and the quantum of any excess payments as part of the contract's 'upfront price'. This is consistent with the common practice of linking the relative size of insurance excesses and premiums (e.g. consumers who elect to have a higher excess pay a lower premium).

- 35 We note that terms relating to contingency costs can be an area of potential contractual disadvantage for consumers and small businesses: see, for example, [Media release \(10-234MR\)](#) *ASIC sets out expectations of lender practices on mortgage early termination fees* (10 November 2010).
- 36 While it may be appropriate to exclude from review the quantum of excess payments, ASIC considers that other contractual terms relating to excess payments should be open to review (e.g. the timing of the payment and the situations in which such payments are required).

## Standard form contracts

- 37 ASIC supports the proposal that insurance contracts that consumers and small businesses have chosen from various ‘take it or leave it’ policy options should be covered by UCT protections.
- 38 This approach reflects that such options, while subject to some level of consumer choice, are not the subject of genuine negotiation. It also reduces the risk of uncertainty about the scope of the UCT regime.

## Meaning of ‘unfair’

- 39 ASIC supports including a tailored unfairness test in UCT protections for insurance contracts. This would provide greater clarity for insurers, small businesses and consumers and would help us in administering the regime.
- 40 We support the presence of *both* of the following two elements for the definition of the ‘insurer’s legitimate interests’:
- (a) the term reasonably reflects the underwriting risk accepted by the insurer in relation to the contract; *and*
  - (b) it does not disproportionately or unreasonably disadvantage the insured or third party beneficiary.
- 41 Without the second element, we think there is a risk that potentially minor issues for an insurer’s underwriting risk could significantly limit the effect of UCT protections for insurance contracts. It seems appropriate for a court to be able to consider (among other things) proportionality and reasonableness in determining whether a term is unfair and necessary to protect the insurer’s legitimate interest.
- 42 This approach may also enhance trust and integrity in the UCT regime by reducing the incentive for an insurer to seek to avoid their obligations by drafting contractual terms that are connected to underwriting risk, even if only in a peripheral way.

## Remedies for unfair terms

- 43 For the reasons outlined in Treasury’s proposals paper (namely, that there may be circumstances where voiding a term may not be the preferred outcome for a policyholder), ASIC supports the proposal that a court be able to make orders other than voiding a term if the court considers it would be a just outcome for the consumer or small business.
- 44 This approach would promote the fairness objective of the UCT regime by providing flexibility and ensuring that consumers and small businesses have access to remedies that are tailored to the specific circumstances of their case.
- 45 This ability for the court to select alternative remedies may also have the broader benefit of demonstrating to industry how the unfairness of particular terms should be redressed. Insurers using the same, or similar, terms in their standard form contracts could then review the term in light of the court’s orders to ensure their term complies with the fairness test.
- 46 While relevant to UCT protections generally (i.e. not just to insurance contracts), it seems appropriate for consideration to be given to the introduction of a prohibition and civil penalty regime for unfair contract terms, as exists for other consumer protection provisions in the ASIC Act.
- 47 Having penalties attached to a prohibition would have a strong deterrent effect against the use of unfair contract terms and would give the relevant regulators appropriate powers to address these terms. We welcome further discussion with Treasury on this point.

## Third party beneficiaries

- 48 ASIC supports the proposal to extend UCT protections to third party beneficiaries (either consumers or small businesses). Third party beneficiaries are persons or businesses who may receive a benefit under an insurance policy if a claim is made, even if they are not a party to the insurance contract, and are specifically provided for and defined in the Insurance Contracts Act.
- 49 Examples might include where an insurance product is entered into by a superannuation fund trustee on behalf of the fund’s members or where a third party whose property is damaged by a policyholder’s insured motor vehicle benefits from cover under the policy.
- 50 In this context, we also consider it appropriate for the proposed legislative changes to apply to life insurance policies where the arrangement otherwise meets the criteria for UCT protections (e.g. a standard form contract where life insurance is entered into by a trustee for the benefit of the members of a self-managed superannuation fund). This is because the insurer will generally have all or most of the bargaining power, and the insurance cover may be offered to the trustee on a ‘take it or leave it’ basis.

## Transitional arrangements

- 51 ASIC supports the timely introduction of UCT protections for standard form contracts for general and life insurance, and considers that no longer than the proposed 12-month transition period is appropriate.
- 52 A 12-month period is consistent with the transitional timeframes that applied during the introduction of the UCT regime in 2010 and its extension to small businesses in 2016.
- 53 We expect insurers will use the transition period to proactively review their standard form insurance contracts and address any potentially unfair contract terms before the regime commences.

## Appendix: ASIC's work on unfair contract terms

Table 2: ASIC actions and regulatory outcomes

Type of contract	ASIC's concern	Regulatory outcome
Small business loan contracts	ASIC and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) conducted a review of small business loan contracts offered by the 'big four' banks. ASIC and the ASBFEO were concerned that the banks had not done enough to ensure their small business loan contracts complied with the UCT provisions.	Our review has led to the banks making changes to their small business loan contracts, and brought about wider change across the industry.  Note: See <a href="#">Report 565 Unfair contract terms and small business loans</a> (March 2018).
Travel cards	ASIC conducted an industry-wide review of travel cards which allow consumers to transfer funds into one or more currencies for use overseas. Previously, unused funds were forfeited upon the card's expiry.	Our review led to: <ul style="list-style-type: none"> <li>• four travel card issuers changing their terms and conditions so that customers do not forfeit their funds when the cards expire; and</li> <li>• \$5.7 million being released to consumers that otherwise would have been forfeited.</li> </ul> Note: See <a href="#">Media Release (14-262MR)</a> ASIC concerns see CBA release \$2.2 million for 45,000 travel card customers (8 October 2014) and <a href="#">Media Release (15-229MR)</a> Consumers can reclaim funds on expired travel money cards following ASIC action (25 August 2015).
Rental agreements	ASIC investigated four businesses involved in the hire and sale of water coolers and first aid kits using 'rent to own' agreements. We were concerned the agreement contained unfair terms which provided an automatic rollover of the rental term unless the consumer took steps to cancel the contract.	We accepted a court enforceable undertaking, resulting in the businesses agreeing to not enforce their rights under the agreements.  Note: See <a href="#">Media Release (14-021MR)</a> Unlicensed rental companies enter into enforceable undertaking with ASIC (4 February 2014).
Household goods rental agreement	We investigated the standard form rental agreement used by Mr Rental Australia Pty Ltd due to concerns that an early termination fee was an unfair term.	We accepted a court enforceable undertaking, resulting in \$300,000 in refunds to approximately 1,560 consumers and a removal of the fee.  Note: See <a href="#">Media Release (13-022MR)</a> ASIC accepts enforceable undertaking from Mr Rental (12 February 2013).
Debt management contract	MyBudget Pty Ltd provided budgeting and debt management services to people experiencing financial difficulty. ASIC raised concerns about a number of potentially unfair terms in its terms of service agreement.	MyBudget agreed to amendment or remove the terms of concern.  Note: See <a href="#">Media Release (11-12AD)</a> ASIC obtains changes to contract terms under new consumer law (20 January 2011).

Type of contract	ASIC's concern	Regulatory outcome
Home loans early termination fees	We were concerned that early termination fees in some home loan contracts were potentially unfair.	<p>After a public consultation process we issued <a href="#">Regulatory Guide 220</a> <i>Early termination fees for residential loans: Unconscionable fees and unfair contract terms</i>, setting out when we would consider that such a fee may be unconscionable or unfair.</p> <p>The Government prohibited these fees from 1 July 2011.</p> <p>Note: See <a href="#">Media release (10-234MR)</a> <i>ASIC sets out expectations of lender practices on mortgage early termination fees</i> (10 November 2010).</p>

## Key terms

Term	Meaning in this document
add-on insurance	General insurance policies that are 'added on' to the sale of a primary product, most commonly with the purchase of a motor vehicle
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
ICA	Insurance Council of Australia
Insurance Act	<i>Insurance Act 1973</i>
Insurance Contracts Act	<i>Insurance Contracts Act 1984</i>
insurer	An insurance company authorised to conduct new or renewal insurance business in Australia by the Australian Prudential Regulation Authority
policy	The insurance contract
Product Disclosure Statement	A document that must be given to a retail client for the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act  Note: See s761A of the Corporations Act for the exact definition.
REP 470 (for example)	An ASIC report (in this example numbered 470)
s6 (for example)	A section of the Insurance Contract Regulations 2017 (in this example numbered 6), unless otherwise specified
UCT	Unfair contract terms
UCT provisions	The UCT provisions in the ASIC Act relating to standard form consumer contracts for financial products and services, which have also applied to standard form small business contracts since 12 November 2016  Note: See Div 2 of Pt 2, Subdiv BA of the ASIC Act