The Secretary,
Unfair terms in insurance contracts: Options Paper
Corporations and Financial Services Division
The Treasury
Parkes ACT 2600

ICAReview@Treasury.gov.au

Dear Sir,

The National Insurance Brokers Association Submission on Unfair terms in insurance contracts Options paper

The National Insurance Brokers Association (**NIBA**) is pleased to be able to respond to the "Unfair terms in insurance contracts" Options paper.

In NIBA's view, all aspects of insurance are comprehensively regulated in Australia today. In fact Australia's insurance regulation is well regarded worldwide and is often used as an example to be followed by other countries.

The insurance regulation in Australia incorporates prudential supervision, strong licensing requirements for those dealing or advising on insurance products, appropriate disclosure obligations in relation to products and advice, industry codes of practice, free independent external dispute review schemes for consumers and specific legislation, such as the Insurance Contracts Act.

The Insurance Contracts Act, was developed with the specific intention of ensuring that insurance contracts and the practices of insurers in relation to such contracts operate fairly and has recently been the subject of a comprehensive review that found it was essentially working well. The currently proposed changes to the Act will further strengthen the position of consumers.

Because of the existence of such comprehensive insurance based regulation in Australia, the arrangements have traditionally excluded any generic consumer based requirements and specific insurance solutions have been adopted to ensure that consumers are adequately protected.

Section 15 of the Insurance Contracts Act excludes insurance contracts from the operations of a Commonwealth, State or Territory Act that provides relief in the form of judicial review for harsh, oppressive, unconscionable, unjust unfair and inequitable contracts or the making of a misrepresentation.

NIBA notes that the issue focussed on in the Options Paper is the actual or potential disadvantage or loss suffered by consumers as a result of insurance contracts containing contract terms that are harsh and/or unfair.

NIBA considers that reasonable provision already exists under the insurance regulatory regime (particularly once amendments to the Insurance Contracts Act before the Parliament come into

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operation) for dealing with harsh and/or unfair terms in insurance contracts and that there is no obvious need to apply general unfair terms in standard contracts to contracts of insurance.

The licensing and disclosure obligations under the Corporations Act, independent external dispute resolution arrangements and General Insurance Code of Practice also provide protection to consumers that is not available to most industries subject to unfair terms in standard contracts legislation.

While generic unfair terms in standard contracts legislation may, in a few cases, give additional consumer protection to that offered under the Insurance Contracts Act, in NIBA's view, these relatively small benefits are far outweighed by the likely disadvantages that would arise in terms of compliance cost and potential confusion that could arise were there two regimes.

If evidence to the contrary is provided by others, NIBA is happy to consider the impact further, but even if this is the case, any adjustments deemed necessary should be made in the Insurance Contracts Act so that a single set of requirements continue to apply to insurance contracts.

Having two different requirements attempting to do similar things, whether in the same or different pieces of legislation, is fraught with danger. Duplication would mean contradictory requirements, confusion and additional legal and administrative costs which will be borne by consumers by way of increased insurance premiums. While NIBA has not attempted to quantify these additional costs they are nevertheless real and cannot be ignored.

There is also some doubt as to whether insurance contracts would in fact be caught under existing generic unfair terms in standard contracts legislation if section 15 of the Insurance Contracts Act no longer applied. The Options Paper notes that insurance contracts can be distinguished from many other types of consumer contracts in that the contract for an insurance product and the product are, in effect, one and the same thing and that the 'main subject matter' of a contract, in this case insurance, is not subject to review under the generic legislation.

Traditionally, insurance brokers represent the interests of the purchasers of insurance, the policyholders, and in making this submission NIBA is concerned with the interests of policyholders rather than insurance companies.

Insurance operates most effectively for consumers when there are clear contractual obligations and responsibilities that are well understood by both parties to the contract and this would not be likely to be the situation if separate unfair terms in standard contracts were to apply to insurance contracts.

The evidence available to NIBA indicates that the insurance regulatory regime is working well with minimal consumer complaint and that issues arising in relation to the fairness of provisions in contracts are adequately dealt with by the existing legislation and the operation of the internal dispute resolutions schemes and the Financial Ombudsman Service.

The consumer examples referred to in the Options paper were in many cases not relevant to the issue and even where they potentially were, it was not clear whether the point was valid given the lack of information on the precise circumstances involved.

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NIBA’s answers to the specific questions asked in the Options Paper follow.

> ***Consultation question 1***
>
> *Please provide any data/information, not referred to above, that would assist in determining the extent to which unfair contract terms in insurance contracts are causing consumers actual or potential loss or damage.*

Despite what some consumer group argue, Australia does have very effective consumer regulation for insurance products. 98% of all insurance claims are paid by insurance companies. While this is a high rate, it does not mean that there is not room for insurance companies to improve claims handling and there is no reason why recently improved standards should not further enhanced.

While generally supporting measures directed at reducing the current extent of claims disputes between insurers and their policyholders, NIBA questions whether applying generic unfair contract terms to insurance would, in fact, materially assist in reducing claim disputes and ensure policyholders are treated fairly.

It is NIBA’s view that few, if any, of the problems identified in the examples of unfair terms in insurance contracts provided to the Senate Economic and Legislation Committee would be solved simply by the removal of section 15 of the Insurance Contracts Act. In many of the examples the problem was not so much a contractual one but an administrative one and/or a problem that might be rectified under current arrangements as modified by the Bill in the House of Representatives to amend the Insurance Contracts Act.

In other cases they were not disputes about the unfairness of the clause but whether the clause could be applied in the circumstances. By way of example, the travel insurance luggage example involved a dispute as to how a clause regarding supervision of luggage should be interpreted in the circumstances of the case, not whether the term itself was unfair. A difference in view as to the application of circumstances to the clause does not make the clause itself unfair.

Those that argue for change must not only provide examples of problems but they must clearly indicate exactly how the existing arrangements have failed and how their proposed solution would rectify the problem. They must also indicate that the benefits of the change outweigh the costs. To-date this does not appear to have happened. An industry solution to perceived problem is likely to yield a better result than a legislative one in this case.

> ***Consultation question 2***
>
> *Please provide details of any existing regulation, not referred to above, that affects unfair terms in insurance contracts.*

The analysis provided in the options paper is a very comprehensive one.

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How the provisions work

The effect of the provision relating to generic unfair contract terms in the ASIC Act is that the business party to the contract will not be able to rely on a term in a contract if the term is unfair. ASIC has the right to bring an action to scrap the unfair term from every relevant contract of the business and therefore the business will not be able to rely on that unfair term in any of its contracts of that nature.

The effect of the relevant provisions in the Insurance Contracts Act is that an insurer will not be able to rely on a term in an insurance contract if reliance on that term can be seen to be in breach of its duty to act with the utmost good faith.

Conduct by the insurer that amounts to unfair dealing will be seen as being in breach of the insurer's duty to act with the utmost good faith.

ASIC can similarly, under s55A of the Insurance Contracts Act, bring an action if it is satisfied that insureds have suffered damage, or are likely to suffer damage, because of the terms of the contracts or the conduct of the insurer breaches the provisions of the Insurance Contracts Act.

This power will be extended to s13 breaches under the proposed changes to the Insurance Contracts Act. ASIC will also be able to bring an action under the Corporations Act in relation to such a breach pursuant to an insurers Australian Financial Services Licence conditions , including in relation to claims handling and settlement.

NIBA is of the view that the relevant provisions in the Insurance Contracts Act provide similar but not identical protection to consumers against terms which might be unfair in insurance contracts.

Onus of Proof

In order to establish that a term is unfair, and therefore void, it needs to be proven that the term:

- would cause a significant imbalance in the parties' rights and obligations under the standard form contract; and
- is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term.

The onus of proof will lie on the claimant (usually the consumer or ASIC) to establish that the term in a standard form contract has caused a significant imbalance in the parties' rights and obligations under the standard form contract. This needs to be proved on the balance of probabilities. S3(4) provides that unless the defendant (usually the business) can prove otherwise, there is a presumption that the term is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term.

There is also a rebuttable presumption that the contract is a standard form contract and the onus is on the business to prove otherwise. If a party wishes to argue that the contract has been negotiated and is not in a standard form, then the party is required to present the contract to show that the contract is not a standard form contract.

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Under the Insurance Contracts Act the onus of proof is also on the claimant to establish that the other party did not act with the utmost good faith when relying on a term in the insurance contract.

Accordingly, under the both systems the onus of proof will remain on the claimant to establish that the term has caused a significant imbalance in the parties' rights and obligations.

The main difference is that under the generic provision the business party will bear the onus to rebut the presumptions that the contract is a standard form contract which is simply a trigger for the legislation's applicability. There is no such restriction in the Insurance Contracts Act and such a restriction would appear difficult to incorporate sensibly in the context of the Act's other provisions.

More effective solutions under the Insurance Contracts Act

There are a number of other provisions in the Insurance Contracts Act that ensure insurance companies cannot take advantage of uniformed consumers.

These provisions provide specific remedies for the insured that are appropriate for insurance transactions and do not simply void the provisions as would occur under the generic provision in the ASIC Act.

Relevant provisions in the Insurance Contracts Act include;

- Avoiding a contract for fraud (s31).
- Minimum claim amounts in relation to certain types of insurance (s35 see table above).
- Requirement that pre-contractual written notice be provided of unusual terms (s37 see table above).
- Rendering void provisions in interim contracts of insurance that make the application to, or the acceptance of replacement cover by the insurer a condition precedent to the interim cover (s38).
- Excluding or limiting liability due to another insurance contract (s45).
- Relying on exclusions regarding pre-existing defects, imperfections and pre-existing sickness or disability (ss 46 and 47).
- Termination of some renewable insurance contracts (section 58).

Specific insurance industry solutions offer insurance consumers a far higher level of protection than do the generic provision under the ASIC Act.

Remedies

Because the duty of utmost good faith is an implied term in every contract of insurance, the insured will be able to claim any contractual remedies. This will include seeking remedies under the Insurance Contracts Act.

Under both the ASIC Act and the Insurance Contracts Act, ASIC has the right to bring actions on behalf of consumers (insureds in the case of the Insurance Contracts Act), when ASIC is

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satisfied that the consumer has suffered damage, or is likely to suffer damages as a result of a term in a contract to which the consumer is a party.

The ASIC Act also provides the consumer with the right to obtain an injunction against the business party to the standard form contract.

Under the current arrangements ASIC has a similar right to obtain an injunction against insurers for a breach by the insurer of the provisions of s12 of the ASIC Act.

Part IA of the Insurance Contracts Act gives ASIC responsibility for the general administration of the Insurance Contracts Act and vests in ASIC a number of specific powers to support this role, such as the power to obtain documents.

A new section 11F is to be inserted into the Insurance Contracts Act that gives ASIC powers to intervene in matters arising under the Act. The provision is similar in form to the existing power that ASIC has to intervene in proceedings begun by other persons about matters arising under the *Corporations Act 2001* (section 1330). It allows ASIC to be represented in the proceedings by a staff member, a delegate, a solicitor or counsel.

An insured who is a party to an insurance contract has the additional remedy of lodging a dispute with the Financial Ombudsman Service. The Financial Ombudsman Service may make the following orders:

- it may decide that the insurer "undertake a course of action to resolve the dispute" including specified matters such as the payment of a sum of money, the forgiveness or variation of a debt or the meeting of a claim under an insurance contract by, for example, repairing, reinstating or replacing items of property;

- it may decide that the insurer compensate the applicant for direct financial loss or damage; and

- it may award compensation to an applicant for consequential financial loss or damage or non-financial loss (subject to certain qualifications) up to $3,000 per claim made in the dispute. No such award can be made for a dispute arising as a result of a claim on a General Insurance Policy that expressly excludes such liability.

The new version of the General Insurance Code of Practice which will come into effect on 1 May 2010 will also highlight the duty of utmost good faith (see clauses 1.19 and 1.20) and provides additional protection to members of the Code. NIBA notes that the Financial Ombudsman Service will also consider the Code in its decisions.

Remedies are also available to insurance policyholders under the Corporations Act.

S912A(1) - sets out the general obligations on a financial services licensee (including general insurers), these include the obligations to:

- do all things necessary to ensure that the financial services covered by the licence are provided efficiently and fairly; and

- comply with the financial services laws.

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ASIC may, if the general insurer does not comply with its obligations under s912A of the Corporations Act make the following orders:

- banning orders (s920A);
- subject to s915I, suspension or cancellation of the insurer's license (s915C(1); or
- the imposition of conditions on the license.

A consumer who is a retail client has the right to claim compensation from a licensee for loss or damage suffered because of breaches of certain Products Disclosure Statement obligations under the Corporations Act.

S1012B places an obligation on a financial services licensee to give a retail client a product disclosure statement if the licensee makes an offer to issue a financial product, or when the licensee issues a financial product.

S1013D sets out the main content requirements for a Product disclosure statement and this includes:

- information about any significant benefits to which a holder of the product will or may become entitled, the circumstances in which and times at which those benefits will or may be provided and the way in which those benefits will or may be provided;
- information about any significant risks associated with holding the product;
- information about the cost of the product;
- information about any other significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product;
- information about the dispute resolution system that covers complaints by holders of the product and about how that system may be accessed; and
- information about any cooling-off regime that applies in respect of acquisitions of the product (whether the regime is provided for by a law or otherwise);
- any other statements or information required by the regulations.

S1021B(1) of the Corporations Act provides that a product disclosure statement will be defective if there is a misleading or deceptive statement in the disclosure document or statement.

General insurance policy wordings form part of the PDS and significant penalties apply for breaches of the above obligations.

Rights will also apply in relation to s13 breaches under the proposed changes to the Insurance Contracts Act, including in relation to claims handling and settlement.

Over and above such rights, a consumer who is an insured under a contract of general insurance has the right, under s1019B(1) to return the insurance product (during the cooling-off period) if the consumer is unhappy with the product.

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Consultation question 4	
A.	*Please provide details of any additional costs and benefits, not referred to above, of the status quo.*
B	*If possible, please state the magnitude (either in dollar terms or qualitatively) of the costs and benefits referred to above and any additional costs and benefits.*

NIBA supports the status quo options as it provides a reasonable level of consumer protection (see comments above) and will not involve any additional cost either in terms of insurance company administration and it avoids confusion by policyholders as to the impact of changes on them.

NIBA believes that the status quo is the best option for consumers and for insurance companies. NIBA is however open to considering changes to the Insurance Contracts Act per Option B if it can be established that there is a significant gap and the costs of making the change to consumers, insurers and insurance brokers do not outweigh the benefits. At present this does not appear to be the case.

Consultation question 5	
A	*Please provide details of any additional costs and benefits, not referred to above, of Option A.*
B	*If possible, please state the magnitude (either in dollar terms or qualitatively relative to the status quo) of the costs and benefits referred to above and any additional costs and benefits.*
C	*Are there any other factors that impact on the feasibility of this option?*

NIBA considers that Option A is the worst option as it will involve:

- insurance companies and insurance brokers incurring additional costs that will be passed on to consumers,
- significant confusion and uncertainty and could mean a reduction in consumer benefits and the application of different regimes to different types of policyholders i.e. consumers vs business.

NIBA also questions the statement that 'blanket' banning of unfair terms would serve to prevent future disadvantage to other consumers is a benefit under Option B.

NIBA suggests that an insurance company that continued to use a term or provision in an insurance contract that was found to be unjust or unfair may in fact be in breach of its duty under the Insurance Contracts Act to act with utmost good faith and its obligations under the Corporations Act to ensure that its insurance services were provided in an efficient, honest and fair manner.

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There may also be complexities specific to insurance given insurance contracts are backed by reinsurance arrangements and the direct insurers are in many cases restricted to terms imposed on them by reinsurers. The impact of the voiding provisions would have a significant impact on the insurers and their ability to recover under the relevant reinsurance agreement. NIBA expects APRA would have some concern with this result.

NIBA also notes that other regimes, in particular the UK are moving towards a uniform regime of consumer protection for insurance consumers akin to the Australian model. See the Law Commission and Scottish Law Commission, Consumer Insurance Law: Pre Contract Disclosure and Misrepresentation. Option A would be taking Australia in a contrary direction.

NIBA believes that any benefit that might arise under this option are far outweighed by the costs.

Consultation question 6	
A	*Please provide details of any additional costs and benefits, not referred to above, of Option B.*
B	*Where possible, please state the magnitude (either in dollar terms or qualitatively, relative to the status quo) of the costs and benefits referred to above and any additional costs and benefits.*
C	*Are there any other factors that impact on the feasibility of this option?*

NIBA does see some advantage of this Option over Option A, namely that all consumer protection provisions relating to insurance would be under the one piece of legislation, the Insurance Contracts Act.

NIBA is only open to considering changes to the Insurance Contracts Act per Option B if it can be established that there is a significant gap and the costs of making the change to consumers, insurers and insurance brokers do not outweigh the benefits. At present this does not appear to be the case.

Consultation question 7	
A	*Please provide details of any additional costs and benefits, not referred to above, of Option C.*
B	*If possible, please state the magnitude (either in dollar terms or qualitatively, relative to the status quo) of the costs and benefits referred to above and any additional costs and benefits.*
C	*Are there any other factors that impact on the feasibility of this option?*

NIBA agrees that if change is necessary to overcome a perceived detriment due to terms in an insurance contract that are unfair or harsh it is best that the change is made in the Insurance Contracts Act. NIBA, however, remains to be convinced that any benefit in taking up Option C would exceed the cost.

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Consultation question 8	
A	*Please provide details of any additional costs and benefits, not referred to above, of Option D.*
B	*Where possible, please state the magnitude (either in dollar terms or qualitatively, relative to the status quo) of the costs and benefits referred to above and any additional costs and benefits.*
C	*Are there any other factors that impact on the feasibility of this option?*

NIBA supports industry self regulation. It may assist industry develop ways of overcoming perceived consumer disadvantage without involving additional administrative costs that would be passed onto consumers through increased premiums. Self regulation could also lead to better claims handling by insurers and an enhanced industry image.

Conclusion

It is NIBA's firm view that it is not appropriate to apply consumer protection provisions by means other than amendment of the Insurance Contracts Act. The Insurance Contracts Act provides specific and focussed solutions to issues and should be the vehicle for any necessary consumer protection provision.

In terms of the options considered in the Options Paper, based on the information available, NIBA supports the status quo in terms of legislative change with any necessary improvements being carried out by way of Industry Code of Practice.

NIBA would only be open to considering changes to the Insurance Contracts Act per Options B or C if it can be established that there is a significant gap and the costs of making the change to consumers, insurers and insurance brokers do not outweigh the benefits. At present this does not appear to be the case.

NIBA supports industry initiatives directed at improving claims handling procedures and practices.

Yours sincerely

Noel Pettersen
Chief Executive officer

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