

28 August 2019

Manager
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The Treasury
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Dear Sir/Madam

EXTENDING UNFAIR CONTRACT TERMS TO INSURANCE CONTRACTS

The National Insurance Brokers Association of Australia (**NIBA**) appreciates the opportunity to make this submission in response to the *Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019 (the Bill)*.

NIBA is the industry association for insurance brokers across Australia. The association has around 350 member firms, employing over 4,000 insurance brokers in all States and Territories, in the cities, towns and regions of Australia.

ABOUT INSURANCE BROKERS

Insurance brokers work with their clients to assist them to:

- understand and manage their risks, including the risk of loss or damage to property as a result of adverse weather or other climate -related events;
- obtain appropriate insurance cover for their risks and their property; and
- pursue claims under their policies when an insured event occurs, in which case the insurance broker becomes the advocate for the client during the assessment and resolution of the claim.

Insurance brokers act primarily for and on behalf of their client, and they owe legal duties as a professional to their clients for the nature and quality of the work they perform on their behalf. When acting for and on behalf of the client, insurance brokers do not SELL insurance policies – they PURCHASE insurance policies on behalf of their clients from the markets available to them.

In some cases, insurance brokers may provide services for insurers under agency arrangements.

GENERAL CONCERNS ABOUT THE BILL AND REGULATORY IMPACT STATEMENT

NIBA is normally supportive of fair and reasonable improvements in consumer protection and regulatory powers, implemented in accordance with sound regulatory practice. However, if legislative changes have the potential to disrupt the insurance markets, particularly the nature, supply and cost of insurance, policyholders and consumers are unlikely to be better off, and could well be substantially worse off as a result of the so-called “reforms”.

Any reforms that have a significant adverse effect on insurers can adversely affect consumers and hinder the ability of insurance brokers to advise, assist and support those consumers. As you will see from this submission, NIBA is concerned that the proposed legislation could well have a serious adverse impact on insurers, and we strongly urge the Government to give very careful consideration to these concerns before any further action is taken in relation to the proposed legislation.

NIBA understands that the decision has been made to proceed with the reforms, despite there being valid concerns about the evidence used to justify the reforms.

NIBA will not repeat prior submissions in this regard but notes that it remains of the view that reasonable provision already exists under the insurance regulatory regime (particularly the Insurance Contracts Act and the External Dispute Resolution Scheme of which all insurers must be members of that must consider “fairness”) for dealing with harsh and/or unfair terms in insurance contracts.

In NIBA’s view, no evidence of any substantial merit has been provided in support of the view that the existing regime does not *or cannot (if used properly by those seeking to rely on it)* address any consumer concerns in this regard.

Further, to the extent any gap may be shown to exist, it is unlikely, based on the proposals, that a proper cost benefit analysis would justify the current proposed changes.

NIBA notes that in the Regulatory Impact Statement (**RIS**), Treasury estimates that the initial administrative cost of making these changes will be the incurring by insurers of *one-off cost of approximately \$3.5 million*, predominantly the legal costs of reviewing standard form contracts and updating them.

Based on current proposals and lack of clarity and limited transition period, NIBA believes that costs would be significant and would include:

- Review and amendment of every policy wording which is sold to consumers or small businesses caught by the UCT. This will include a significant range of policies not considered to be retail client insurance under the Corporations Act or standard/prescribed contracts under section 35 of the Insurance Contracts Act. This will occur on an ongoing basis.
- Review and amendment of all associated documentation including scripting, application forms, schedules and other customer communications involving confirmation of cover, variations, cancellations and refunds.
- Review and amendment of all claims handling practices and procedures to reflect the above changes.
- Review and amendment of all training of staff and representatives to take into account the above changes.
- Review and amendment of all agency and outsourcing arrangements to take the above into account.
- Review and amendment of all reinsurance arrangements to reflect changes to risk and increased uncertainty.

The RIS states that insurers have also raised concerns that in addition to the administrative costs of the amendment, the changes will result in higher prices for consumers. This is because insurers will not be able to rely on contractual terms that define the risk held by the

insured. Insurers may respond to this uncertainty by either increased premiums or reducing cover for standard form contracts. Treasury acknowledges that it is *unclear how material any price impact will be*, which is concerning to NIBA.

The RIS notes that costs imposed on insurers may also be offset, albeit by an *unquantifiable amount*, from increased consumer and small business confidence in the insurance industry leading to higher rates of insurance uptake. The costs may also be reduced by the 18 month transition period that allows insurers to incorporate this process into their periodic update and review of their standard form contracts and documents.

NIBA notes that added to the above costs will be the costs associated with litigation and disputes, especially where consumers can access both the unfair contracts legislation as well as the Insurance Contract Act.

NIBA believes that the proposals are likely to result in:

- insurance pricing uncertainty, with flow on effects to the reinsurance market;
- a reduction in available coverage for consumers, passing the end risk to the community;
- additional insurance cost being imposed on consumers for little if any real added benefit; and
- significant compliance and systems change costs being imposed on insurance brokers, many of whom are small businesses as well as insurers and their agents which would greatly outweigh any benefits of the change.

NIBA asks whether Treasury has sought a report from APRA, as the insurer's prudential regulator, on its view regarding the likely impact.

Finally, NIBA submits that if the Government remains committed to implement "reform" in this area, it should proceed in a manner consistent with overseas reforms, and not on the basis of the draft legislation circulated as part of the current round of consultation.

THE MAIN SUBJECT MATTER CHANGE IN THE BILL CREATES A DIFFERENT UCT REGIME FOR INSURANCE WHEN COMPARED TO OTHER INDUSTRIES

This difference arises in the proposal to limit the **main subject matter carve out**.

The ASIC Act presently excludes terms that define the main subject matter of a contract from the UCT regime. The Bill will amend the ASIC Act to provide that the main subject matter of an insurance contract is limited to the description of what is being insured.

The Explanatory Memorandum provides:

"In line with FSRC recommendation 4.7, for insurance contracts the main subject matter will be limited to the extent that the term describes what is being insured. For example, the house, car, or person that is insured. [Schedule 1, item 4, subsection 12BI(4) of the ASIC Act]."

Where a term describes what is being insured and is the basis for the existence of the contract, that term is the main subject matter of the contract and is not subject to the unfair contract regime. For example:

Example 1.3

Isla purchases home insurance for a house at 17 Drayton Street. The policy describes the house as a four bedroom, brick veneer freestanding house. This description (a four bedroom, brick veneer freestanding house at 17 Drayton Street) is the main subject matter of the contract and is not subject to the unfair contract regime.

Example 1.4

Jess purchases car insurance. The policy describes the car as a 2018 Kia Carnival S 2.2-litre four-cylinder turbo-diesel with a modification to take wheelchairs. This description (a 2018 Kia Carnival S 2.2-litre four-cylinder turbo-diesel with a modification to take wheelchairs) is the main subject matter of the contract and is not subject to the unfair contract regime.”

From a practical perspective, the concept of “describes what is being insured” and the examples provided appear to refer to the attributes of the dwelling ie “the type”.

It does not appear to be intended to extend to the “usage” of the dwelling or insured item e.g domestic or business usage and so on. Insurers underwrite and price home and contents insurance based on the location, structure and usage of the building, not merely the nature of the structure of the building. UCT legislation must allow for this to continue.

In terms of persons insured under an indemnity policy, it appears to catch the person but not any other limiting factors such as the person’s role or activities that the cover relates to (e.g as a director or either role regarding a type of business). The Explanatory Memorandum’s examples above relate to a car or house which are relatively straight forward as each involves property insurance. However, many policies provide liability insurance where it is more difficult to describe what is being insured.

Property cover is usually reasonably definite; liability insurance depends more upon legal principles. Take, for example, motor vehicle third party property damage policy. In the case of that policy, the subject matter is the liability of the owner or driver of the motor vehicle to others, especially other road users. The motor vehicle to which the policy attaches is not the subject matter of the policy, because the policy does not insure damage to the insured’s vehicle.

ASIC should have the power to make regulations to clarify the main subject matter/what is being insured, as it does in relation to insurance concepts under chapter 7 of the Corporation Act 2001.

In addition, exclusions define main subject matter/what is being insured.

Similarly to deductibles and excesses, exclusions set out the basis for the existence of the contract. If they are transparent to the consumer, they should be outside the UCT regime. For example, motor insurance policies typically exclude coverage where the driver of the vehicle is guilty of driving under the influence of alcohol or drugs. Will these provisions be included in the main subject matter of the policy, or will they be subject to UCT challenge?

As endorsements involve additional premium for more cover ie part of the price payable, they should be outside the UCT regime.

The limitation creates a regime that is harsher on insurers than other industries. It creates an unfair playing field. Policy limitations, conditions precedent to cover and exclusions that affect the scope of cover would not be considered part of the 'main subject matter' and would be open to review. If this concern occurs after the legislation is in operation, it will become extremely difficult for insurers to underwrite and price the risks they insure. Consumers will consequently have much greater difficulty obtaining reasonable cover at affordable prices. This cannot be allowed to occur.

The current UCT regime leaves the courts to fairly decide what the main subject matter of a contract is and when the legitimate interests test is met. Courts generally limit main subject matter to those matters central to the consideration that passed between the parties when the contract was formed.

For a mobile phone contract, the terms relating to the make, model and extras of the phone being sold would not be reviewable for unfairness. For insurers, it would be more restrictive.

In an insurance context, the main subject matter central to the provision of the insurance is not just the item or person insured but the scope of cover provided in relation to that item or person.

NIBA also notes that non-Insurance Contracts Act insurance such as marine insurance (e.g. pleasure craft) is subject to the standard UCT regime, creating another inconsistency.

The net effect of the Bill is that insurers may not be able to rely on contractual terms that legitimately define the scope of the risk agreed to be shared between the insurer and insured.

The proposed narrow limitation:

- exposes terms which clearly define the insured risk and the insurer's liability to challenge under the UCT regime;
- is contrary to the position taken for other industries, with no justification provided for doing so;
- is inconsistent with the UK and EU and New Zealand where the terms which clearly define or circumscribe the insured risk and the insurer's liability are not caught; and
- makes it virtually impossible for an insurer to safely price its insurance and for reinsurers to do the same. This will increase costs to insureds and affect the type of insurance that can be offered safely.

The definition should either be:

- left undefined, leaving the courts to fairly decide on what the main subject matter is, as is the case for other industries; or
- qualified in an appropriate, clear and fair manner to take into account the unique nature of insurance and its operation.

If insurers cannot rely on the terms forming the basis of their insurance contracts, they are forced to price the risks accordingly. There will be flow on effects to reinsurance arrangements and costs and the capital insurers will be required to hold. All of this may restrict policy cover and increase the end cost to consumers.

No evidence has been provided in support of such a significant change.

As noted above, the proposals are also inconsistent with *all* other equivalent regimes such as the UK, EU and New Zealand. NIBA is not aware of any significant consumer concerns being identified regarding these regimes.

The question arises, why should Australia be different to the international position and the current Australian UCT position?

NIBA asks whether Treasury has sought a report from APRA, as the insurer's prudential regulator, on its view regarding the likely impact.

We understand that Treasury has not conducted an analysis of how the UCT proposals would work in the context of the Insurance Contracts Act. NIBA's view is that it can make many of the Insurance Contracts Act provisions practically worthless. There is no consideration of this issue we have identified.

Sound regulatory practice would dictate that this is a minimum requirement.

CARVE OUT FOR TRANSPARENT EXCESS TERMS

Terms that set an amount of excess or deductible under the contract and which are transparent at the time of purchasing the contract are exempt from the UCT regime. This is because such excesses or deductibles which the insured chooses to either increase or decrease would form the basis for the existence of the contract. NIBA supports this change.

The Explanatory Memorandum notes:

Example 1.5 James renews his car insurance for a 2014 IS300 Lexus, paying a \$500 premium. A 'basic' excess of \$1000, payable when any claim is made, was clearly presented in the quote and also on the renewal notice. The quantum of the excess (\$1000) is not subject to challenge under the UCT regime.

NIBA note the reference to "quantum" not being subject to challenge. Does this indicate that a term regarding an excess, to the extent it may set conditions for trigger of payment of the excess, are still open to challenge?

TYPES OF CONTRACTS CAUGHT

The definition of consumer contract and small business contract are broader than the Insurance Contracts Acts Standard covers, Corporations Act retail client covers and General Insurance Code of Practice retail insurance definition.

Consideration should be given to limiting the scope of insurance contracts caught by the UCT protections in a manner that is consistent with the approach taken by the above existing insurance specific consumer protections.

The definitions of a "consumer contract" and "small business contract" can catch contracts well beyond those that are appropriate for UCT type protection and are also triggered if one insured is a small business under the policy when all others are not.

Here is an example of where a problem can arise - a corporate group could purchase a professional indemnity policy covering all members, only one of which is a small business. The same Corporate group may purchase an ISR policy which also covers an individual director for a personal item of property. If the term is unfair only in the context of the individual

small business or individual and is void this can have a significant impact on other participants.

Consideration should be given as to whether certain types of policy should be excluded consistent with the approach taken by existing insurance specific consumer protection.

Another issue unique to insurance is that the same type of policy may or may not be caught as a standard form contract depending on the circumstances.

The example is provides that an insurance contract will still be a standard form contract even if a consumer can choose between several options such as levels of premium, excess or sum insured, as long as the consumer does not have the ability to negotiate the *underlying terms and conditions governing the contract*.

The Explanatory Memorandum provides the following examples:

Matthew is a consumer wishing to purchase home and contents insurance. He requests a broker to recommend the best insurance policy. The broker, acting for Matthew, seeks contracts from several insurers. The contracts are prepared by the insurer, do not take into account Matthew's specific characteristics and the broker does not negotiate on Matthew's behalf. As such, the contracts would be considered standard contracts and Matthew, as the party to the contract, can bring action under the UCT regime.

BBB Limited is a small business seeking professional indemnity insurance. BBB Limited requests a broker to recommend the best insurance policy. The broker, acting for BBB Limited, seeks quotes from several insurers. In preparing the contracts, the broker negotiates specific clauses due to the nature of BBB Limited's business. As such, the contract is not considered a standard form contract and BBB Limited, as the party to the contract, cannot take action under the UCT regime.

One issue will be whether negotiation of *one term* is enough to knock it out or not, and if so, what type of term?

IMPACT OF A BREACH

We believe, as with New Zealand, only ASIC should only have the power to declare void a term for breach of the UCT regime. If not, given the lack of clarity of the current proposals, it is likely that the number of disputes relating to insurance will exponentially increase, along with the flow on cost impact to insurers and ultimately consumers.

TRANSITION PERIOD

The timeframe of 18 months appears to be inadequate. Assuming the above issues are properly addressed, product design and underwriting of the majority of products will need to be significantly reviewed, reinsurance arrangements renegotiated and systems changes made which will take significant time and cost to implement, as will training.

In New Zealand, the UCT provisions did not apply to variations of the terms of pre-existing insurance contracts or to new insurance contracts that effectively renew pre-existing contracts and this should be considered.

CARVE OUT WHERE THE TERM IS ONE REQUIRED, OR EXPRESSLY PERMITTED, BY A LAW OF THE COMMONWEALTH OR A STATE OR TERRITORY?

No change is proposed to this carve out. The law expressly permits something if it expressly allows it to happen.

Section 35 of the Insurance Contracts Act removes a restriction on an insurer's use of non-standard cover provisions where the insurer proves that, before the contract was entered into, the relevant exceptions apply.

Where an insurer does provide the minimum cover, in some respect it can be argued that because an insurer is required to provide the minimum prescribed cover for prescribed events in the regulations (taking into account the exclusions that are permitted to be applied re the prescribed events as described), section 35 has the "express effect" of permitting the provision of such minimum cover for the minimum amounts. i.e. the minimum cover for minimum amount provision is safe. It is not clear if this is Treasury's intent and clarification is needed.

THIRD-PARTY BENEFICIARIES

Third party beneficiaries are allowed to bring actions against insurers under the UCT regime where the contract with the insured otherwise falls within the relevant criteria as explained below.

Under the existing UCT regime, a court can only declare that a term is unfair on application by a party to the contract or ASIC.

The amendments provide that third party beneficiaries of insurance contracts (which are not parties to the insurance contract and get their rights under section 48 of the Insurance Contracts Act) have the ability to bring actions against insurers under the UCT regime, as there are circumstances where they will be required to take action in place of the contracting party.

The Explanatory Memorandum states as an example that death benefit nominees under a life insurance policy or individuals covered under certain group insurance policies (e.g. a policy purchased by small sporting associations on behalf of club members to cover personal injury incidents) are likely to be able to bring actions under the UCT regime in relation to contracts covered by the regime.

Third party beneficiaries are defined in the Insurance Contracts Act as a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends.

The definitions of consumer and small business and definition of standard form contracts (section 12BK of the ASIC Act) continue to relate to the parties to the insurance contract, not third party beneficiaries. This means that while third party beneficiaries can bring actions, the actions will only be successful if the tests of unfairness and standard form contracts are met with reference to the parties that negotiated the contracts, not the third party beneficiaries.

The Explanatory Memorandum provides the following example:

A contract for insurance purchased on a group basis by a large superannuation trustee would likely not be covered by the regime. A superannuation trustee would be unlikely to meet the definition of a small business or consumer and is likely to have significant bargaining power in negotiating such contracts so the contract would not meet the definition of a standard form contract.

As NIBA reads this, very few group policies will meet the consumer or small business definitions or standard form contract criteria.

RELIEF MAKING POWER FOR ASIC

There should be an express power for ASIC to provide relief in acceptable circumstances where there is an unintended impact. Waiting for legislative change would create unnecessary delay.

INTERACTION WITH INSURANCE CONTRACTS ACT

No analysis in this regard is documented.

It is crucial that the UCT legislation and Insurance Contracts Act regime operate effectively.

The aim of the Insurance Contracts Act is to ensure that:

“... a fair balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and the practices of insurers in relation to such contracts, operate fairly, and for related purposes”

If a term is open to challenge under UCT, the net effect is that many provisions of the Insurance Contracts Act (IC Act) will be rendered ineffective, be of little use or result in unnecessary duplication or costly challenge.

The following are some good examples.

It should be made clear that any provision in a policy that reflects an insurer's rights under section 28 of the IC Act arising from compliance with the duty of disclosure or misrepresentation provisions are unaffected.

This will avoid any confusion, duplication, inconsistency or unnecessary challenges.

The IC Act imposes certain minimum cover rules in section 34-35 which apply automatic minimum cover unless the insurer notifies the insured they won't be providing the minimum cover. The Bill should be amended should make it clear that where:

- the minimum cover is provided as described; or
- more than minimum cover provided and this additional cover includes the minimum cover permitted exclusions,

the minimum cover or minimum cover exclusions should not be subject to unfairness testing.

An insurer is exempt from mid-term variation provisions to the prejudice of the insured in the IC Act for certain specifically excluded types of policies i.e. section 53 won't apply in such cases. The UCT would create a result inconsistent with this.

Under section 54, an insurer may not refuse to pay claims in certain circumstances.

Where the effect of a contract of insurance would, but for section 54, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.

Sub-section (2) provides that subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay *the claim*.

The courts have found that section 54 will not apply in relation to “a restriction or limitation which must necessarily be acknowledged in the making of a claim, having regard to the type of insurance contract under which that claim is made.”

The Bill as drafted means that this approach will be open to challenge.

In cases where an insurer could rely on section 54(2) to refuse to pay a claim for a provision of the type specified, is it the intent that such a provision can still be found invalid under UCT laws? If so, section 54 becomes useless until the UCT issue is first tested. The same result would apply to the duty of utmost good faith provisions under sections 13 and 14.

A proper analysis is required and clear carve outs provided to avoid any confusion. In short, anything insurers are permitted to do under the IC Act should be clearly identified as terms that are “required or expressly permitted by law.”

CONCLUSION

These changes would recognise the unique characteristics of insurance contracts per clause 1.29 of the draft explanatory memorandum.

These changes would also increase certainty so that consumers, small business and insurers would know what and what is not covered. The aim of insurance should be to pay valid claims quickly. The proposal should not result in greater debate as to coverage.

NIBA would be pleased to have the opportunity to discuss these matters in further detail, and to explain our concerns regarding the increasing complexity of legislative and regulatory intervention in relation to life and general insurance.

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