NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA (NIBA)

SUBMISSION ON INSURANCE CONTRACTS AMENDMENT (UNFAIR TERMS) BILL 2013 (UCT Bill)

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 400 member firms and over 3000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia.

Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling an estimated $16 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 400 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on Risk Insurance products.

NIBA appreciates the opportunity to be able to provide feedback on the UCT Bill.

ABOUT INSURANCE BROKERS

The role of insurance brokers

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent. Insurance brokers offer many benefits to customers and consumers:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages

- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;
- assistance in interpreting, arranging and completing insurance documentation;
- experience in predicting, managing and reducing risks; and
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).

In limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

EXECUTIVE SUMMARY

NIBA supports any change that appropriately addresses any 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.

NIBA strongly agrees with the Productivity Commission commentary that "Regulation provides key foundations for a well-functioning economy. But regulation generally comes with costs as well as benefits for society."[1]

Given the nature of insurance contracts and the fact that specific legislation was enacted to deal with the unique issues associated with them it is crucial that before any reform is implemented proper consideration be given to whether the principles of good regulation have been met.

Based on the information provided in the RIS relevant to the introduction of the UCT Bill, NIBA is still concerned that it has not been made clear that the changes proposed:

- are justified on any sound legal and empirical basis;
- will produce benefits that justify costs, considering the distribution of effects across society

and taking economic, environmental and social effects into account;

- will minimise costs and market distortions; and
- will promote innovation through market incentives and goal-based approaches.

[1] Productivity Commission 2011, page 9

That said, NIBA has considered the UCT Bill and sets out below some of the significant concerns it has about the practical application of the UCT Bill as currently drafted. NIBA believes that further detailed consultation is required between key stakeholders to achieve a more workable result.

SUBMISSION ON ISSUES

Proposed timing

The amendments will commence 12 months after the Act receives Royal Assent.

The amendments will apply to:

- standard form consumer contracts of general insurance which are entered into, or renewed on, or after, commencement; and
- a term in a standard form consumer contract of general insurance that is varied on or after commencement.

As noted in prior submissions in relation to the Insurance Contracts Amendment Bill 2013 for the duty of disclosure changes, such a time frame may not give insurers a sufficient transition period. A similar transition period to the duty of disclosure changes would appear reasonable in the circumstances.

Who can access rights under the UCT Bill?

NIBA is concerned that the position of third party beneficiaries (i.e. those persons who are not contracting parties to the policy but are entitled to cover pursuant to section 48 of the IC Act (**TPB**) is not clearly dealt with.

The UCT Bill refers to the concept of a "party" but it is not clear whether the intent is to limit it to the contracting insured(s) under the standard form contract or also TPBs (see for example s15B(1)(a),(b),(c), (3), (4) and 15C which use the term party. The intent should be made clear to avoid dispute.

What contracts are caught?

The new regime applies to a "standard form consumer contract of general insurance".

A "consumer contract" is a contract to which at least one of the parties is an individual, and whose acquisition of what is supplied under the contract is wholly or predominately an acquisition for personal, domestic or household use or consumption.

NIBA has no issue with the breadth of contracts covered by this definition although people now have to grapple with the following consumer based concepts in relevant legislation affecting most insurance:

- Insurance Contracts Act (**IC Act**) standard form contract definitions and special terms that apply to them;
- Corporations Act retail client types of insurance (broader than IC Act prescribed classes); and
- new UCT Bill class of contracts.

The UCT provisions of the IC Act do not apply to contracts of life insurance or other contracts excluded by the IC Act. NIBA has no concerns with this at present.

In determining whether a contract is a standard form contract, a court may take into account such matters as it thinks relevant, but must take into account the following:

- whether one of the parties has all or most of the bargaining power in the transaction;
- whether the contract was prepared by one party before any discussion by the parties about the transaction;
- whether one party was required to accept or reject the terms of the contract;
- whether another party was given an effective opportunity to negotiate terms of the contract (other than those not affected (see below));
- whether the terms of the contract (other than those not affected (see below) take into account the specific characteristics of another party or the transaction;
- any other matter prescribed in regulations.

The above tests could allow subjective aspects of the consumer and the transaction to be taken into account. Is this the intent as it may be open to some argument?

NIBA therefore respectfully submits that further consideration should be given to the nature of the contracts to which the UCT Bill will apply. NIBA believes it is highly desirable to utilise an existing definition of consumer contracts, rather than establish a new, third, concept of what might be regarded as a consumer contract of insurance.

Certain terms are not affected

Certain terms are unaffected by the changes, but only to the extent that the term:

- defines the main subject-matter of the contract.

  The draft explanatory memorandum does not seek to explain what is intended to be covered by the term “main subject-matter of the contract”. This is the area likely to give rise to most dispute as a narrow definition will favour consumer and a wide definition will favour insurers. NIBA notes that the term “subject matter” is already used in I C Act in ss 16-18, 42, 49, 50, 54 etc which could support limited meaning. NIBA questions whether this is the actual intent of the term in the proposed legislation? To avoid unnecessary and costly litigation (which will result if the issue is left unresolved) better guidance as to intent should be provided with at least some examples.

- sets the upfront price payable under the contract. The upfront price payable under a standard form consumer contract of general insurance is consideration that is:

    - provided, or is to be provided, for the supply under the contract; and
    - disclosed at or before the time the contract is entered into.

  It does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event; or

  There is likely to be some debate as to how an "excess" which helps set the upfront price under a contract will be treated and whether it is included. Some guidance in the draft Explanatory Memorandum to this effect could save argument.

- is a term which Commonwealth, State or Territory law expressly permits or requires.

  There is no guidance or example in the draft Explanatory Memorandum on what terms this is intended to cover. The term "permits" seems to be very broad in scope and could give rise to some argument.

When is a term unfair?

A term is unfair if it:

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

  NIBA has no major concerns with this concept.

- is not reasonably necessary to protect the legitimate interests of the party advantaged by the term.

  It will be presumed that a term is not "reasonably necessary in order to protect the legitimate interests" of the insurer advantaged by the term, unless the insurer proves otherwise. An insurer will be taken to have proved that a term is reasonably necessary to protect their legitimate interests if they prove that the term *reflects the underwriting risk accepted by the insurer*.

  NIBA notes that it is not entirely clear what is intended by the term "reflects the underwriting risk accepted by the insurer". Exclusions from cover seem likely to be safe in most cases where there is a valid underwriting reason for their inclusion (and proof can be shown to this effect), with the greatest risk for insurers likely to arise in relation to conditions of cover which may not have such a justification for inclusion. The legitimate interests test would in any case seem to be sufficient by itself; and

- would cause detriment to a party if it were to be applied or relied on.

  NIBA has no major concerns with this concept.

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" and the contract as a whole.

For these purposes, the definition of "transparent" is a term that is:

- expressed in reasonably plain language;
- legible;
- presented clearly; and
- readily available to any party affected by the term.

NIBA notes that this adds yet another concept to "clearly inform" in s35 and 37 of the IC Act and "clear, concise and effective" in the Corporations Act. The result of the changes it to further add to the complexity of any dispute that may arise where all such concepts may come into play.

A non-exhaustive, indicative list of examples of the types of terms that may be considered unfair is included in the Amendment Bill as follows [*We note our comments in italics next to each*]:

a) a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract; *[a number of provisions in the IC cover such terms e.g s54]*

b) a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract; *[certain policies may restrict an insured's termination rights so this will be relevant]*

c) a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract; *[e.g premium refund clause]*

d) a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract; *[section 53 of the IC Act deals with such situations as well but subject to certain carve outs in the regulations]*

e) a term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract; *[such clauses would be rare in insurance in most cases]*

f) a term that permits, or has the effect of permitting, one party to vary the upfront price payable under the contract without the right of another party to terminate the contract; *[such clauses would be rare in insurance in most cases]*

g) a term that permits, or has the effect of permitting, one party unilaterally to vary financial services to be supplied under the contract; *[such clauses would be rare in insurance in most cases]*

h) a term that permits, or has the effect of permitting, one party unilaterally to determine whether the contract has been breached or to interpret its meaning; *[such clauses would be rare in insurance in most cases]*

i) a term that limits, or has the effect of limiting, one party's vicarious liability for its agents; *[such clauses would be rare in insurance in most cases]*

j) a term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent; *[such clauses would be rare in insurance in most cases]*

k) a term that limits, or has the effect of limiting, one party's right to sue another party; *[such clauses would be rare in insurance in most cases]*

l) a term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract; *[such clauses would be rare in insurance in most cases]*

m) a term that imposes, or has the effect of imposing, the evidential burden on one party in proceedings relating to the contract; *[such clauses would be rare in insurance in most cases]*

n) a term of a kind, or a term that has an effect of a kind, prescribed by the regulations.

The list does not prohibit the use of those terms, nor do they create a presumption that those terms are unfair. There may be circumstances in which the use of such a term is reasonably necessary to protect an insurer's legitimate interest.

NIBA has no major concerns with the above.

What happens if a term is found to be unfair?

ASIC or a consumer can seek a declaration from the court that a term is unfair.

NIBA notes that in most cases a consumer would approach FOS in relation to such an issue. NIBA is concerned as to whether FOS would have jurisdiction to address such an issue in accordance with the principles in the UCT Bill where a Declaration has not been obtained. If not, the practical effect and use of the UCT Bill to consumers would be very limited. NIBA recommends that the opinion of FOS be sought on this matter.

A new section 15A provides that under a standard form consumer contract of general insurance, an insurer will "fail to comply with the duty of the utmost good faith" [but does not specifically state that it is the duty under section 13] if either:

- a term of the contract is declared to be an unfair term under section 12GND of the applied enforcement provisions of the ASIC Act (see below); or

- the insurer relies on, or purports to rely on such a term.

The Notes to section 15A refers to sections 13 and 14 but not in any clear way. The second part of the test is an "or". Should this be an "and" as the second test is dependant on the first by reference to "such a term".

The effect of the above seems to be to deem there to be a breach of section 13 in relation to a particular contract after a declaration or reliance on such a declared term by the insurer, and as

result, a breach of section 14 which prevents reliance on a term if to do so were to fail to act with the utmost good faith (which is deemed by s15A to be the case).

The draft Explanatory Memorandum notes that the remedy differs to those in the UCT provisions of the ASIC Act which provides that if a term in a standard form contract for a financial product or service is unfair, the term is void (subsection 12BF(1) of the ASIC Act). The draft Explanatory Memorandum states that:

- the remedy of 'voidance' would affect all the standard form contracts which use the same term, whereas 'non-reliance' would only affect the *particular contract* which is the subject of the declaration.

- it is anticipated that an insurer that has a term in a general insurance contract that is declared to be unfair would make arrangements to amend that term in standard form consumer contracts of general insurance that are entered into subsequently.

NIBA does not believe that the wording in s15A clearly achieves the above result and may give rise to argument.

A breach of the duty of utmost good faith gives rise to orders by the court for damages or an injunction. In considering whether to exercise a power for an affected contract the court must consider:

- the contract as a whole; and
- the extent to which the insurer has complied with the requirements of the IC Act (other than proposed section 15A) in relation to the contract (s15H).

NIBA does not believe that the operation of s15H is clear enough and is likely to give rise to argument as to what should and should not be taken into account. If a term of the IC Act provides a lesser remedy than under s15A can a court choose to go with the lesser remedy?

ASIC can bring an action against the insurer for breach of its licensing conditions under Chapter 7 of the Corporations Act.

NIBA has no issue with this.

If the contract can operate without the unfair term being relied on, the contract will continue to bind the parties.

This is a fair result.

ASIC's powers

Provided that the ASIC powers are practically the same as under the ASIC Act and can be effectively used to bring an appropriate action NIBA has no major concerns.

If you have any queries or require further information do not hesitate to call.

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National Insurance Brokers' Association of Australia

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