

**Proposal to Extend Unfair
Contract Terms to Insurance
Contracts**

Legal Aid NSW submission to The
Treasury

August 2018

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Legal Aid 
NEW SOUTH WALES

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About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 24 offices and 221 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with LawAccess NSW, community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal

services. Our community partnerships include 29 Women's Domestic Violence Court Advocacy Services.

Legal Aid NSW's Civil Law Division provides assistance to some of the most disadvantaged and vulnerable members of our society and has significant experience in assisting people with insurance problems.

Legal Aid NSW welcomes the opportunity to make a submission to the Treasury regarding the proposal to extend unfair contract term laws (**UCT laws**) to insurance contracts. Should you require any further information, please contact

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Introduction

Legal Aid NSW has long advocated for UCT laws to form part of Australian insurance law and welcomes this consultation process.¹ Legal Aid NSW broadly supports the proposal to amend section 15 of the *Insurance Contracts Act 1984* (Cth) (**IC Act**) to allow UCT laws to apply to insurance contracts. We believe that adoption of this approach will benefit consumers, industry and the market. It will promote consistency across the industry and help to increase consumer awareness of the law. Consumers will be able to apply the same test of unfairness against a range of financial products, whether it be a financial product or service, a general insurance contract, a funeral insurance contract or a life insurance contract.

However, we have concerns about some elements of the proposed model, in particular the proposal to introduce a tailored definition for unfairness that would only apply to insurance contracts. Our detailed responses to the questions in the Proposals Paper follow.

Introduce the UCT laws to IC contracts - Questions 1 to 4

As indicated above, we support the primary proposal to extend UCT laws in the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**) to insurance contracts. We do not anticipate that this proposal will result in any major disadvantage for the market or consumers.

We believe that extending UCT laws to insurance contracts will bring about the following benefits:

- improvements in fairness in insurance contracts
- providing the regulator with a mandate to address unfair contract terms in insurance contracts.
- improvements in consumer understanding of insurance products
- greater clarity in insurance contracts and
- improvements in underwriting guidelines, particularly for travel insurance and credit card insurance.

The proposal would also complement existing protections contained in the IC Act for insurance policy holders.²

¹ See response from National Legal Aid in 2010 to Treasury Consultation Paper on Unfair Terms in Insurance Contracts.

² Sections 14, 35, 37 and 54 of the *Insurance Contracts Act 1984* (Cth).

Whilst we are unable to comment on specific costs to be borne by insurers in complying with the proposed model, we consider that if standard form insurance contracts are vetted before entering the market to ensure compliance, any cost to insurers will be minimal.

Legal Aid NSW does not support either of the alternative options set out in the Proposals Paper for extending UCT laws, namely:

- enhancing the current IC Act remedies or
- introducing unfair contract term laws into the IC Act.

These options would lead to a lack of consistency across the industry and would make it more difficult for consumers, particularly vulnerable consumers, to navigate the insurance market. In addition, we consider that if either of these proposals were adopted it is likely to be more expensive for insurers to comply with these provisions.

Main subject matter exclusion – Questions 7 to 9

Legal Aid NSW considers that a tailored ‘main subject matter’ exclusion for insurance contracts is necessary. We agree with the proposal to narrowly define ‘main subject matter’ as terms that describe what is being insured. We do not support the inclusion of any further contract exclusions in the main subject matter.

Upfront Price – Questions 11 to 12

Legal Aid NSW does not support the proposal that the quantum of the excess payable under an insurance contract should be always considered part of the upfront price, and therefore excluded from review under UCT laws.

We suggest that upfront price should be related to both the dollar value of the policy and the risk to the insurer.

For example, in an insurance policy for a motor vehicle, we understand that younger drivers will be charged more and have a higher excess than older, more experienced drivers because the risk to insurers is greater in insuring younger drivers. The higher upfront price and excess is a reflection of this in the policy and we would not consider this to be unfair.

In contrast, any provisions in relation to the payment of an excess, including payment of a high excess or attempts to compel consumers to pay an excess upfront should be subject to the UCT laws.³

³ See *Calliden Insurance Limited v Chrisholm* [2009] NSWCA which confirmed that a failure to pay the excess upfront should not be a bar to claiming under an insurance policy

Standard form contracts – Questions 13 to 14

Legal Aid NSW supports the proposal that insurance contracts that allow consumers or small businesses to choose between different policy options and level of cover should still be considered as standard form contracts for the purpose of UCT laws. We agree this would be analogous to the provisions applying in the European Union. We consider this is important as it takes into consideration the power imbalance between insurers and consumers, as evidenced by a consumer's inability to negotiate the terms of standard contracts at the time of entering into the contract.

Meaning of unfair – Questions 15 to 17

Legal Aid NSW does not consider that it is necessary to tailor the definition of unfairness for insurance contracts and treat insurance contracts differently to any other consumer contracts.

We do not consider that there should be any further specific tailoring for general insurance contracts or life insurance contracts, even considering the longevity of life insurance contracts.

Legal Aid NSW does not support the proposal to define an insurer's legitimate business interests as being:

“when the term reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and it does not disproportionately or unreasonably disadvantage the insured.”

We believe that the current unfair contract term test in section 12BG(1) of the ASIC Act is sufficient. A tailored extension which only applies to insurance contracts is not necessary for the following reasons:

- The current test in the ASIC Act of “legitimate business interests” would encompass underwriting decisions without the need for a specific reference to underwriting in the legislation. There is already counterbalance in the ASIC Act at s12BG (1) (a) and (c) which refer to “imbalance” and “detriment”.
- “Underwriting” is an example of a legitimate business interest, it is not the only legitimate business interest. “Underwriting” does not need to be specifically referred to, in order to be a relevant consideration. There are sections in the IC Act, for example section 28 and section 29 which rely on underwriting, though this is not stated as such and these sections have been operational since the Act's inception in 1984.
- The Financial Ombudsman Service (FOS) has clearly defined procedures for the provision of underwriting, as they relate to sections 28 and s 29 of the IC Act. We

expect that FOS (the Australian Financial Complaints Authority from November 2018) would follow a similar process on unfair terms and provision of underwriting.⁴

- If necessary, the Explanatory Memorandum for the amendments to the IC Act, could show Parliament's intent regarding how underwriting could be used as evidence to substantiate legitimate business interest. Again, the FOS Circular referred to above is instructive here; as FOS has made it clear as to how the evidence of underwriting will need to be presented for an assertion on underwriting to be established.
- The current ASIC test for unfairness in s12BG (1) already incorporates the concepts of proportionality, objective reasonableness and prejudice to the insured, as well as the need to balance rights and obligations. This test has its origins in the common law restraint of trade clauses.
- The concept of 'disproportionate and unreasonable disadvantage to the insured' is a high additional threshold that is subjective in nature and has no basis in common law doctrine as we know it. This creates an additional hurdle for a consumer to establish unfairness and is likely to lead to uncertainty in the market because of the application of an additional test for insurance.
- The proposed tailored extension of unfair contract term laws represents a shift from an objective test of reasonableness, as per the current ASIC Act test, to a subjective test whereby the consumer needs to establish they have suffered disadvantage.
- The proposed tailored extension may be seen to create the need for additional proof, beyond what is required under the existing test, of consumer detriment in order to establish an unfair term.
- A subjective test element would fundamentally change the nature of 'unfairness' as a test for consumer protection for insurance contracts. It does not meet a key legislative intent, namely the proper and objective assessment, on a reasonable basis, of the impact of particular terms included in standard form contracts at the time of drafting.
- The development of a 'special' test for insurance would represent a significant departure from the Productivity Commission's *Report on Consumer Protection Framework* (2008) on the importance of consistency in consumer protection laws across markets.

⁴ See FOS Circular edition 3 2010 at <https://www.fos.org.au/circular3/Nondisclosure.html>

Terms that may be considered unfair – Questions 18 to 20

Legal Aid NSW supports the proposal to include examples that are specific to insurance contracts in UCT laws provided that the list remains non-exhaustive.

We support the three terms referred to in the proposals paper. In addition, we suggest the following terms be considered for inclusion as examples of unfair terms.⁵

Terms that:

- Charge the consumer a large sum of money or an amount that goes beyond what would be considered a reasonable pre-estimate of loss incurred by the firm, if a consumer does not fulfil their obligations under the contract or cancels the contract.
- Require a consumer to fulfil all their contractual obligations, while letting the firm avoid its own.
- Automatically renew a fixed length contract on the date of expiry, where the deadline for the customer opting not to extend is unreasonably short.
- Allow a firm to change the price payable under the contract after a consumer has agreed to the conditions in the contract.
- Bind consumers to hidden terms.
- Limit a firm's obligation to honour its agents' commitments to the consumer.
- Allow the firm to transfer its rights and obligations under the contract, where this may reduce guarantees for the consumer, without the consumer's agreement.
- Mislead the consumer about the contract or their legal rights.
- Exclude or limit the consumer's legal rights or remedies when the firm has failed to meet its obligations under the contract.

Remedies for unfair terms – Questions 21 to 23

We agree with the position in the proposal paper that if a term is deemed to be unfair, it is void. This is consistent with the effect of UCT laws in other contexts and provides consistency.

Legal Aid NSW notes the concern that, in some instances, if a term is void it may remove the basis for the claim entirely. Therefore, we support the proposal that other orders can be made that will provide an appropriate and just outcome in all the circumstances.

⁵ Financial Conduct Authority (UK), Examples of Unfair terms, first published on 6 August 2015, accessed at: <https://www.fca.org.uk/firms/unfair-contract-terms/examples-unfair-terms>

Third party beneficiaries – Questions 24 to 26

Legal Aid NSW supports the proposal that third-party beneficiaries are able to seek declarations that terms in a contract are unfair. Legal Aid NSW has assisted a number of vulnerable consumers who fall within this category, especially in group life insurance policies and credit card travel insurance policies.

These policies are specifically designed to benefit the third party and there is no reason why they should not enjoy the same protection. Legal Aid NSW appreciates that superannuation fund trustees owe obligations to act in the best interests of fund members. However, for the purpose of consistency across the financial services industry as a whole, we consider that UCT laws should also apply to these products, in particular, to group life insurance products.

Legal Aid NSW notes that currently the IC Act provides remedies under sections 28 and 29 for avoiding contracts in general and life insurance matters as a result of misrepresentation.

Tailoring for specific insurance contracts – Questions 27 and 28

Legal Aid NSW does not consider that there should be any other specific tailoring of UCT laws to specific features of general and life insurance contracts, for reasons that we have already explained above.

Legal Aid NSW supports the proposal that unilateral premium adjustments by life insurers should not be considered unfair in circumstances where the premium increase is related to the management of an insurer's risk. However, we do not agree entirely with the proposal in Question 28, namely that a term will not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy. This is because there may be terms in the policy about premium increases that could still be deemed unfair under the proposed changes.

Transitional Arrangements – Questions 29 to 32

Legal Aid NSW agrees with the proposal of a 12 month transition period for the provisions to take effect and the timeframe set out in the proposal relating to new, renewed and varied contracts. We consider the transitional period should apply to all forms of insurance contracts, including life insurance products.