

Update

Unfair Terms in Insurance Contracts – Proposed enhanced Consumer Protection in Australia

Background – the Australian Position

Like its UK counterpart, the Australian Federal Government has also recently been considering perceived deficiencies in consumer protection law as it applies to insurance contracts. In particular, the Australian government, in conjunction with industry and consumer lobby representatives, has been considering ways to address the imbalance between the protection currently offered to insurance consumers in the *Insurance Contracts Act 1984* and that available to consumers of other non-insurance financial products and services under the *Australian Securities and Investments Act 2001*.

In 2009, the Australian Senate Economic-Legislation Committee recommended that amendments be introduced to the *Insurance Contracts Act 1984* to provide insurance consumers with a similar level of protection to that available to non-insurance consumers.

In 2010, the Australian Federal Government released an options paper inviting submissions in relation to the actual or potential consumer disadvantage arising from unfair insurance contract terms, the adequacy of the existing insurance regulation, and the options available for dealing with unfair terms in insurance

contracts. On 17 March 2010, the *Insurance Contracts Amendment Bill 2010* was introduced to the Australian Parliament but did not proceed.

On 20 December 2012, the Australian Federal Government announced that it will legislate to protect consumers from unfair contract terms in insurance contracts. Draft legislation will be released for consultation in 2013.

Insurance law and unfair contract terms law in the UK

The Law Commission and the Scottish Law Commission commenced a joint review of insurance contract law and consumer insurance in relation to disclosure and representations in January 2006. As a result of the review, the *Consumer Insurance (Disclosure and Representations) Act 2012* received Royal Assent on 8 March 2012 and is expected to come into force in 2013¹. There are some important differences between the UK law and the Australian law. However, the new consumer insurance law in the UK has been brought more closely into line with the law in Australia, because the review involved an analysis of the Australian position, for example, the practical effect of the law of misrepresentation.

¹The Law Commission and the Scottish Law Commission, *Insurance Contract Law* <<http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm>>.

Currently, the *Unfair Contract Terms Act 1977 (the Act)* and the *Unfair Consumer Contracts Regulations 1999 (the Regulations)* deal with unfair contract terms in the UK. However, the Act and the Regulations contain inconsistent and overlapping provisions, using different language and concepts to produce similar but not identical effects². The Act excludes insurance contracts from the unfair contract terms regime but the Regulations do apply to insurance contracts. The effect of this is that although the Act does not provide any protections for consumers of insurance, the Regulations may be enforced in relation to insurance contracts by public bodies as well as individual consumers³, and it permits the Office of Fair Trading and 11 other 'qualifying bodies' to go to court to prevent unfair terms from being used⁴. In light of the numerous inconsistencies between the Act and the Regulations, it was recommended by the Law Commission and the Scottish Law Commission that the Act and Regulations be brought together under a single regime⁵, and where the two regimes differed, a provision in favour of consumers should be adopted⁶. The final recommendations of the Commissioners were accepted in principle by Government. Therefore, it is possible that insurance contracts will no longer be excluded from the Act and as a result, the UK's unfair contract terms law may come into line with Australia's proposals to extend the unfair contract terms regime to insurance contracts.

In light of the parallels between Australia and England regarding the direction and focus of regulatory change to insurance contracts, we provide further information about the Australian proposals below.

Current Australian Law

Subdivision BA of the *Australian Securities and Investments Act 2001 (ASIC Act)* governs unfair contract terms in standard form consumer contracts, which applies to most financial products and services⁷. The effect of the unfair contract terms regime in the ASIC Act is that if a court decides that a term in a consumer contract is unfair, the term is void. However, section 15 of the *Insurance Contracts Act 1984 (the ICA)* expressly excludes insurance contracts from the operation of any other Act (Commonwealth, State or Territory) that provides relief in the form of judicial review of harsh, oppressive, unconscionable, unjust, unfair or inequitable contracts. The ICA applies to most consumer and commercial contracts of insurance, although not to compulsory motor and workers compensation insurance, marine insurance and reinsurance contracts. This means

relevantly that the ASIC Act do not apply to most types of insurance contracts to which the ICA applies, and as a result there is no unfair contract terms law that currently applies to such contracts.

Insurance industry representatives have argued that there is no justification for having an unfair contract terms regime apply to insurance contracts⁸, and "to the extent there are unfair contract terms in insurance, they could be addressed by the existing laws"⁹. Contrastingly, consumer advocates support the introduction of an unfair contract terms regime in the ICA, arguing that "the existing protections in the ICA are insufficient"¹⁰. The existing protections provided under the ICA offer significant protection to insureds. For example:

1. There are pre-contractual rules that are directed at an insurer informing an insured about the terms of a policy before it is entered into, for example, under section 37 of the ICA, insurers need to 'clearly inform' insureds in writing, before a contract is entered into, of the effect of any terms 'of a kind that are not usually included in insurance contracts that provide similar insurance cover'¹¹.
2. There is a reciprocal duty of utmost good faith imposed on the insured and insurer under section 13 of the ICA, which requires both parties to act with fairness, propriety and honesty¹². The effect of this is that a party is prevented from relying on a term of the insurance contract if to do so would be to fail to act with the utmost good faith (section 14 of the ICA).
3. Section 53 of the ICA has the effect of rendering void an insurance contract term that allows the insurer to vary an insurance contract to the prejudice of a person other than the insurer. However, the *Insurance Contracts Regulations 1985* declare certain classes of contract as exempt from the application of section 53, for example life insurance, superannuation contracts and certain types of commercial insurance contracts.
4. Section 54 of the ICA provides relief to insureds whose acts or omissions, that occurred after the contract was entered into, would otherwise entitle an insurer to deny a claim. For example, an insurer may refuse to pay a claim only if an act of the insured can be reasonably regarded as capable of causing or contributing to the loss claimed (section 54(2) of the ICA), or an act was necessary to protect the safety of a person or to preserve property (section 54(5)(a) of the ICA).

²The Law Commission and the Scottish Law Commission, *Unfair terms in Consumer Contracts: a new approach? Summary of the Issues Paper* (July 2012), p 3.

³The Law Commission and the Scottish Law Commission, *Unfair terms in Consumer Contracts: a new approach? Issues paper* (25 July 2012), p10.

⁴Ibid.

⁵Ibid, p 16.

⁶Ibid.

⁷Treasury, *Unfair terms in insurance contracts* (undated) <<http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2011/Unfair-Terms-in-Insurance-Contracts>>.

⁸Ibid, p 4.

⁹Ibid, p 16.

¹⁰Ibid.

¹¹Australian Treasury, *Unfair Terms in Insurance Contracts, Draft Regulation Impact Statement for Consultation* (12 December 2011)

<<http://archive.treasury.gov.au/contentitem.asp?ContentID=2256>> p12.

¹²Vermeulen v SIMU Mutual Insurance Association (1987) 4 ANZ Ins Cas 60-812.

Proposed Reform of the Insurance Contracts Act 1984

It is proposed the unfair contract terms regime will be based on the unfair contract terms regime that applies under the ASIC Act. The proposed definition of an unfair term specifically in relation to contracts of insurance is that the term:

- Would cause a significant imbalance in the parties rights and obligations under the contract
- Would cause detriment to a party if relied on
- Is not reasonably necessary to protect the legitimate interests of the party advantaged by the term. For the purposes of determining whether a term in an insurance contract is reasonably necessary to protect a legitimate interest, a term will be reasonably necessary if it reflects the underwriting risk accepted by the insurer

The unfair contract terms regime will apply to consumer contracts that are 'standard form' insurance contracts, excluding life insurance contracts. In particular:

- It will be included as part of the duty of utmost good faith. The effect of this is that if a term is found to be unfair, the insurer will be in breach of the duty of utmost good faith and will not be able to rely on the term
- In addition, the court will be empowered to exercise a discretion and award a more appropriate remedy
- ASIC and consumers will each have the right to take action under the proposed unfair contract terms regime in the ICA
- Insurers will have the onus of proof that a term is reasonably necessary to protect their legitimate interests;
- ASIC will have a new range of enforcement powers in the ICA, that are currently available to it to administer the unfair contract terms in the ASIC Act. This is to be achieved by replicating in the ICA the enforcement powers granted to ASIC in the ASIC Act

The unfair contract terms regime will not apply to a term in an insurance contract:

- That defines the main subject matter of the contract, for example, a term under a contract for financial services or products that refers to the goods or services that a consumer is acquiring¹³. In this regard, consumer advocates took the view that the unfair contract terms

provisions should apply to all insurance contract terms except those that define the core elements of the insurance contract, in particular, the class of insurance cover and premium. Contrastingly, the insurance industry took the view that the subject matter exemption should apply to terms that circumscribe the risk that the insurer accepts under the contract

- Sets the upfront price payable under the contract, for example, the amount borrowed under a consumer credit agreement, which may include the interest payable and any fees disclosed¹⁴
- Is a term required, or expressly permitted by a law of the Commonwealth, or a State, or Territory

Comments

The proposed amendments will undoubtedly be advantageous for consumers, and in light of the profound changes and uncertainty which will arise, will have significant implications for insurers, insurance brokers, the industry's advisers, regulators and also dispute resolution bodies such as the Insurance Ombudsman. It will be necessary in particular to:

- Understand the new regime and its impact on policy terms, conditions and pricing
- Analyse and understand the application of the definition of unfair term
- Consider what contracts will be deemed to be a 'standard form' insurance contract
- Identify what terms of the 'standard form' insurance contract will be considered to be 'defining the main subject matter', and 'setting the upfront price payable'

The significant uncertainty which could arise may have the unintended effect of resulting in reduced cover and increased premium costs as the industry grapples to assess increased exposures. It is therefore critical for both consumers and the insurance industry, that the unfair contract terms regime to be included in the ICA, is clear, easy to apply and fairly balanced as between the insurer and consumer interests.

What happens next in Australia?

The Australian Department of Treasury has indicated the draft legislation will be released for consultation in 2013. We will keep you updated with any developments.

¹³ Ibid, p9.

¹⁴Australian Competition and Consumer Commission, the Australian Securities and Investments Commission et al, *A guide to unfair contract terms* (undated), <<http://www.accc.gov.au/content/index.phtml/itemId/937060>>, p10.

Further information

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