

# The Unfair Contract Terms draft bill - What will it mean for insurers?

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## Overview

The Unfair Contract Terms (UCT) regime, which has historically excluded from its operation insurance contracts regulated by the *Insurance Contracts Act 1984* (the ICA),<sup>1</sup> is now by virtue of the fallout of the Financial Services Royal Commission set to operate to regulate standard form insurance contracts as defined under the UCT regime.<sup>2</sup>

On 31 July 2019, the Department of Treasury circulated its exposure draft of the *Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019* (the Bill), and is now seeking consultation from the wider insurance industry. The proposed changes are proposed to work in conjunction with, and not in place of, the existing ICA consumer protections and allow a court to make a declaration not only that specific terms in a particular policy wording constitute unfair terms, but that all contracts with similar wording are unfair.

## Reasons for Change

The UCT regime, which appears in Subdivision BA of Part 2 Division 2 of the *Australian Securities and Investment Commission Act 2001*, was introduced in 2010 to protect consumers from unfair terms in standard form contracts.

Traditionally, it was considered that sufficient consumer protections were in place for consumers of insurance contracts under the ICA by virtue of the following:

- Pre-contractual disclosure to policy holders concerning the terms of the policy before it is entered into.
- The duty of utmost good faith preventing parties from relying on terms if to do so would be inconsistent with the duty.

- Rules governing reliance on specific policy terms as defined in the ICA.

However, following the Royal Commission and discussions, it is now considered that those protections are insufficient. Issues identified included a general power imbalance between an insurer and an insured around negotiating policy terms and the ease with which insurers satisfy the disclosure requirements for unusual and potentially unfair terms.

It is considered that by allowing the UCT regime to apply to standard form insurance contracts, ASIC or the courts will be able to address any imbalance, perceived or otherwise, that may arise.

## What is an unfair term?

Pursuant to the UCT regime<sup>3</sup>, an unfair term is one that:

- (a) causes a significant imbalance in the parties' rights and obligations arising under the contract; and
- (b) is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- (c) would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

The draft Explanatory Memorandum to the Bill provides the following examples of unfair terms in relation to an insurance contract:

- a term that allows the insurer to, instead of making a repair, elect to settle the claim with a cash payment calculated according to the cost of repair to the insurer, rather than how much it would cost the insured to make the repair;

- a term in a contract that is linked to another contract (for example a credit contract) which limits the insured's ability to obtain a premium rebate on cancellation of the linked contract;
- a term that would allow the insurer to require the insured to pay an excess, before the insurer pays the claim.

### What will it apply to?

The substance of the Bill, which is proposed to come into effect 18 months after the Bill receives royal assent, purports to include in the UCT regime insurance contracts offered to consumers or small businesses, and those that fall within the definition of a 'standard form contract'.<sup>4</sup>

Put simply, a 'standard form contract' is one which contains standardised, non-negotiable provisions that are normally offered on a 'take it or leave it' basis.

A consumer's ability to select between options when taking out a policy (such as levels of premium, excess or sum insured) does not mean that the contract is not of a standard form. The true test as to whether a contract is of a standard form is whether the insured has the ability to negotiate the underlying terms and conditions governing the contract.<sup>5</sup>

The same approach will apply to cases where a broker acts as an intermediary. The draft Explanatory Memorandum to the Bill provides examples as follows:

*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.*

The Bill also outlines the ways in which insurance contracts will be dealt with under the UCT regime, which are as follows:

#### 1. Main subject matter

The ASIC Act presently excludes from the UCT regime terms of a policy that define the 'main subject matter' of a contract (those that describe what is being insured). Policy exclusions and conditions are not within the category of 'main subject matter' (arguably unless they relate to restricting the subject matter to be insured) and will therefore likely fall under the UCT regime. The draft Explanatory Memorandum provides examples including:

*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.*

#### 2. Quantum and excess terms

While the Bill incorporates a narrow definition of 'main subject matter', it amends the ASIC Act to exclude from the UCT regime terms that set the quantum (including policy limits) or existence of the excess or deductible in an insurance contract - so long as they are presented transparently.

#### 3. Third party beneficiaries

Third party beneficiaries of insurance contracts will be permitted to bring an action under the UCT regime against insurers, where previously this would have been limited to the party to the unfair contract. The assessment of unfairness will be determined in relation to the party to the contract, and not the third party beneficiary.

A party to a contract and ASIC, as well as a third party beneficiary in the case of an insurance contract can make an application to a court that a particular term is unfair and the term will be void if it is 'unfair'. A court can also make a declaration that the term would be unfair across all similar standard form contracts.

## Implications for General Insurers

The Bill, if passed in its present form, has the potential to affect a large range of general insurance contracts, given the narrow description of 'main subject matter'.

While the draft bill is proposed to work in conjunction with the ICA protections that already exist for consumers, the potentially competing operation and practical application of the two separate pieces of consumer protection legislation will not be known until the final legislation commences once passed.

Ultimately, the UCT regime will come into effect in some form as regards insurance policies and it is likely to be close to the form contained in the draft bill. Insurers will need to revisit not only their present policy wordings, but also consider the appropriateness of current premiums and underwriting criteria given certain exclusions or terms might be exposed under the UCT regime. This will particularly be the case for insurers who operate within niche markets to which the UCT regime may apply.

Insurers will need to review and consider the broad spectrum of their currently offered products with a view to determining whether any provisions might be open to challenge under the legislation if it passes. Should a policy term be challenged and ruled to be unfair and therefore void, a court may also make a declaration that would impact an entire product line employing the term. The direct and broader implications of such a finding would be significant not just for the affected insurer but also other insurers offering similar products.

The Department of Treasury is seeking responses from the wider industry up until 28 August 2019.

TurksLegal will provide you with further updates as the bill progresses and evolves. Please contact Richard Wang or Paul Angus if you require any specific advice regarding the proposed UCT legislation or draft bill.

Below is a link to the explanatory memorandum, exposure draft and regulation impact statement:

<https://treasury.gov.au/consultation/c2019-t372650>

<sup>1</sup> By virtue of section 15 of the Insurance Contracts Act

<sup>2</sup> Recommendation 4.7 of Final Report of Final Services Royal Commission dated 4 February 2019

<sup>3</sup> Section 12BG of the ASIC Act

<sup>4</sup> section 12BK of the ASIC Act

<sup>5</sup> Draft Explanatory Memorandum to the Bill, at paragraph 1.19

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