

# ALLIANZ AUSTRALIA INSURANCE LIMITED SUBMISSION

Extending Unfair Contract Terms  
Protections to Insurance Contracts

*24 August 2018*

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Manager  
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Dear Sir/Madam

## **EXTENDING UNFAIR CONTRACT TERMS (UCT) PROTECTIONS TO GENERAL INSURANCE CONTRACTS**

### **1. ABOUT ALLIANZ AUSTRALIA INSURANCE LIMITED**

Allianz Australia Insurance Limited is one of the nation's largest insurers, with more than 4,300 employees, a combined premium income of more than \$4.5b and assets of approximately \$7.5b. The company provides insurance to more than 3.5m customers and workers compensation insurance to approximately 25% of Australia's workforce.

### **2. INTRODUCTION AND EXECUTIVE SUMMARY**

Thank you for the opportunity to provide comment on Treasury's proposals paper Extending Unfair Contract Terms Protections to Insurance Contracts (**the proposals paper**).

#### **Justification for the proposals**

Allianz notes that the decision has been made to progress with the UCT reforms so will not repeat past comments on the significant protections that already exist for consumers regarding the fairness of their contracts with insurers, in particular, the Insurance Contracts Act 1984 (Cth) (**IC Act**) and Corporations Act 2001 (Cth).

Allianz's principal concern is that a fair and workable model be implemented to avoid a regime that:

- does not achieve its stated objectives and specified benefits – We do not believe the proposals will do this – See **Attachment A** for details;
- is inconsistent with the UCT regime that applies to other industries – As proposed, it will be clearly inconsistent with existing UCT rules in significant respects, which would unfairly disadvantage insurance compared to other industries;
- creates such uncertainty that insurers may not be able to reasonably price or offer insurance or obtain reinsurance protection, at all or at a reasonable cost – the proposals create significant uncertainty as explained below. Of most concern

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;

- causes conflict and confusion with other insurance legislation such as the IC Act – We understand from recent consultation that Treasury has not conducted an analysis of whether such conflict will arise and its impact; and
- unnecessarily increases costs for insurers and consumers for little or no real value. The proposals impose what are unfair and unclear rules on insurers that are different to the existing UCT regime. There is no clear analysis of the impact of the proposals on industry and associated legislation. A proper cost benefit analysis is crucial before proceeding with any proposal.

Given the significant issues raised, it is crucial that APRA, as regulator of insurer solvency, should be consulted and their views considered.

### **Key issues summarised**

- **Stated objectives and benefits of the proposals**

The proposals do not in our view meet the stated objectives or benefits in many important respects which we explain in **Attachment A**.

A key stated objective is to “ensure that consumers and small businesses who purchase insurance **have the same access to protection from unfair terms in insurance contracts as they do for other contracts for financial products and services**” [our bold]. This is not the result of the proposals for the reasons outlined below.

- **Main subject matter limitation – insurers are being treated unfairly**

Anything within the main subject matter of the contract is not subject to the UCT rules. The current UCT regime does not define the main subject matter. Courts generally limit main subject matter to those matters central to the consideration that passed between the parties when the contract was formed.

The proposal is to expressly limit the main subject matter in an insurance contract to terms that describe what is being insured.

This limitation is unclear and creates a regime that is harsher on insurers than other industries.

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

The proposed narrow limitation:

- exposes terms which clearly define the insured risk and the insurer’s liability to challenge under the UCT regime. Voiding such a term exposes the insurer to a risk it has not priced into the premium and also one for which it has not obtained reinsurance protection;

- is contrary to the position taken for other industries, with no justification provided for doing so;
- is inconsistent with the UK, EU and New Zealand where the terms that clearly define or circumscribe the insured risk and the insurer's liability are not caught. No consumer issues of concern have been identified in these regimes that we are aware of; and
- makes it very difficult 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 safely offered. We expect APRA would also have prudential concerns.

See **Attachment A** for details.

The definition should either:

- be qualified in an appropriate, clear and fair manner to take into account the unique nature of insurance and its operation so that an insurer can rely on contractual terms that legitimately define the scope of the risk agreed to be shared between the insurer and insured (our preference); or
- be left undefined, leaving the courts to fairly decide what the main subject matter is, as is the case for other industries.

- **Legitimate interest test - insurers are being treated unfairly**

The proposal is that a term will be deemed to be reasonably necessary to protect the insurer's legitimate interests (and thus safe) when the term:

- reasonably reflects the underwriting risk accepted by the insurer in relation to the contract; and
- does not disproportionately or unreasonably disadvantage the insured.

The above does not apply to other industries subject to the UCT regime. The tests are unclear in many ways and create a regime that is harsher on insurers. The above makes it very difficult for an insurer to safely price its insurance and for reinsurers to do the same.

See **Attachment A** for details.

The legitimate interest test should either be:

- qualified in an appropriate, clear and fair manner to take into account the unique nature of insurance so that an insurer can rely on contractual terms that legitimately define the scope of the risk agreed to be shared between the insurer and insured (our preference); or

- left undefined, leaving the courts to fairly decide on what legitimate interest is, as is the case for other industries.

- **Types of contracts caught**

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 existing insurance-specific consumer protection. The definitions of a “consumer contract” and “small business contract” can catch contracts well beyond those that are appropriate for UCT-type protection (eg professional indemnity insurance) and are also triggered if one insured is a small business under the policy when all others are not. For example, where a Liability policy covers both a large entity and its small business subsidiary as contracting insureds. The cover provided to the large entity could be then subject to review under the UCT provisions.

Another issue unique to insurance is that some policy types purchased through brokers and which can be negotiated eg professional indemnity, should not be caught by the UCT provisions even though they could be issued as standard form in other circumstances.

See **Attachment A** for details.

- **Impact of a breach**

Given the lack of clarity of the specialised insurance proposals the avoidance remedy is not in our view appropriate. It should be left to the court to decide the appropriate remedy in the circumstances.

If despite our submissions, the regime as proposed is implemented, we request that, like in New Zealand, only the regulator ASIC, and not consumers, be permitted to apply for a declaration that a term is unfair.

- **Where any UCT changes should be located**

It makes most sense to build a UCT regime for insurance into the IC Act. The main issue is that any changes and their impact on other provisions of the IC Act need to be considered carefully. We explain why in **Attachment A**.

- **Transition period**

The proposed transition period is not adequate. Assuming the above issues are properly addressed, product design and underwriting of the majority of Allianz’s 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. A minimum of 2 years transition would be required.

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.

**Attachment A** sets out our comments on whether the stated objectives and benefits of the proposed regime are likely to be met, as well as our response to each of the Proposals Paper questions.

## ATTACHMENT A

### OBJECTIVES IN CONSULTATION PAPER

We comment below on each of the identified objectives of the proposed model:

- **ensure that consumers and small businesses who purchase insurance have the same access to protection from unfair terms in insurance contracts as they do for other contracts for financial products and services**

It will not be the same. Under the proposal, all the terms in an insurance contract (save the very narrow main subject matter limitation) could be subject to the UTC regime. This would represent a broader and more onerous application of UTC than would be the case for other contracts for financial products and services.

- **increase incentives for insurers to improve the clarity and transparency of contract terms, and remove potentially unfair terms from their contracts**

The changes as proposed create significant uncertainty and are likely to significantly increase pricing of risk. The proposals do not refer to standard terms proposals that Government has proposed.

- **provide appropriate remedies for consumers and enforcement powers for the Australian Securities and Investments Commission (ASIC).**

In many cases, given the breadth and lack of clarity of the proposals the remedies will not be appropriate.

- **Extending the UCT laws to insurance contracts will also bring Australia into line with comparable jurisdictions, including the United Kingdom, the European Union and New Zealand, where insurance contracts are not excluded from those jurisdictions' UCT laws**

This statement is not accurate. The proposed regime is inconsistent with the other regimes in a significant manner as those regimes all *at least* operate to exclude terms that:

- identify the uncertain event or that otherwise specify the subject matter insured or the risk insured against (EU and UK); or
- exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances (NZ).

### STATED BENEFITS OF THE PROPOSED MODEL

With respect to the stated benefits of the proposed model:

- **it will ensure that insureds are provided with protection under the same UCT laws which are already available to consumers in relation to other financial**

**products and services. This will enable the courts, consumers, external dispute resolution schemes, and the regulator to take a consistent approach**

- **it is consistent with the objective of the Australian Consumer Law that the UCT protections should be applied economy wide**

It creates a different regime and set of rules likely to create inconsistency and an uneven playing field.

- **it will not negatively affect or create uncertainty regarding the judicial interpretation of the IC Act and its existing legal principles and consumer protections**

At no point is there any discussion of how the IC Act and other legislation will operate in conjunction with this law to the extent there may be an inconsistency. See Interaction with Insurance Contracts Act Section below for our commentary.

## **PROPOSAL PAPER QUESTIONS**

### **1 Do you support the proposal to amend section 15 of the IC Act to allow the current UCT laws in the ASIC Act to apply to insurance contracts regulated by the IC Act?**

No, for the reasons set out in this submission and by the Insurance Council of Australia. Consultation with consumer and other stakeholders indicates that the concerns principally arise from the view that the duty of utmost good faith remedy in the IC Act is not working. In our view, there is no evidence of this and to the extent any evidence has been put forward, it has not been convincing.

For example, a reference was made by consumer representatives to low FOS disputes regarding the duty of utmost good faith and the number of FOS decisions made against insureds in such disputes.

Low FOS disputes can be evidence of fairness issues having been addressed by insurers in internal dispute resolution or otherwise. FOS decisions against insureds, where FOS as an independent organisation approved by ASIC is obliged to consider issues of “fairness” in addition to the law, does not support the argument that the duty is not effective.

ASIC statements made about the lack of clarity in case law regarding the operation of the duty of utmost good faith have not in our view been properly tested and are unjustified.

### **2 What are the advantages and disadvantages of this proposal?**

These are explained in our responses to the proposals below.

Allianz’s principal concern is that a fair and workable model be implemented to avoid a regime that:

- is inconsistent with the UCT rules that apply to other industries – this is currently the proposal;
- creates such uncertainty that insurers cannot reasonably price or offer insurance or obtain reinsurance protection for it or at a reasonable cost – the current proposal does this in a number of ways explained below;



- causes conflict and confusion with other insurance specific legislation such as the IC Act – We understand from recent consultation that Treasury has not conducted an analysis of whether such conflict will arise and its impact; and
- unnecessarily increases costs for industry and ultimately consumers for little or no real value. With a new model that imposes greater obligations than under the existing UCT model proposed and a lack of analysis of the impact of the proposals on industry and associated legislation, a proper cost benefit analysis is crucial.

The proposals give rise to a significant risk of the above occurring and APRA should be closely consulted on the potential impact on insurers.

**3 What costs will be incurred by insurers to comply with the proposed model? To the extent possible, identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs in reviewing contracts).**

Based on current proposals and lack of clarity and the limited transition period, the 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.

Consideration should be given to limiting the operation to policies that are wholly prescribed/standard form contracts under the Insurance Contracts Act. The definition could be amended to include any forms of insurance deemed necessary eg insurance of personal or domestic property as included in the Corporations Act.

- 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 reinsurance arrangements to reflect changes to risk and increased uncertainty.

**4 Do you support either of the other options for extending UCT protections to insurance contracts?**

The simplest option would be to build the changes into the existing IC Act, *but* qualifying the impact of the provisions in the context of existing provisions as needed. We have sought to identify issues in the Interaction with Insurance Contracts Act section below.

Incorporating UCT into the IC Act would avoid any confusion as to the applicable legislation and would be likely to simplify training and compliance procedures and reduce compliance costs.

## **5 What are the advantages and disadvantages of these options?**

As above.

## **6 What costs would be incurred by insurers to comply with these options? To the extent possible please identify the magnitude of costs and a breakdown of categories (for example, substantive and/or administrative compliance costs).**

As above.

## **7 Do you consider that a tailored 'main subject matter' exclusion is necessary?**

The existing UCT legislation does not define the main subject matter. The proposal is to limit the main subject matter to terms that “describe what is being insured, for example, a house, a person or a motor vehicle”. 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. This creates a regime for insurance contrary to other industries subject to UCT rules and contrary to the intent of the main subject matter provision.

### **Current UCT approach in Australia**

The *Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) (EM)* relevantly stated:

#### *Main subject matter of the contract*

*5.59 The exclusion of terms that define the main subject matter of a consumer contract ensures that a party cannot challenge a term concerning the basis for the existence of the contract. [Schedule 1, item 1: Chapter 2, Part 2-3, paragraph 26(1)(a)]*

*5.60 Where a party has decided to purchase the goods, services, land, financial services or financial products that are the subject of the contract, that party cannot then challenge the fairness of a term relating to the main subject matter of the contract at a later stage, given that the party had a choice of whether or not to make the purchase on the basis of what was offered.*

*5.61 The main subject matter of the contract may include the decision to purchase a particular type of good, service, financial service or financial product, or a particular piece of land. It may also encompass a term that is necessary to give effect to the supply or grant, or without which, the supply or grant could not occur.*

The proposed limitation is not consistent with this approach and has significant consequences in an insurance context.

The following case law in a non-insurance context shows the significance of the proposed change:

- in Australian Competition and Consumer Commission v Servcorp Limited [2018] FCA 1044, the main subject matter of the service contract was the length of the contract term, the location of the office space and the upfront price payable.

In the above contract, which is significantly simpler than an insurance contract, the court considered more factors than the insurance limitation ie merely the item being insured being the house or car.

- in Abraham v Gogetta Equipment Funding Pty Ltd Medium Neutral Citation: [2017] NSWCATCD 22, the main subject matter of a rental contract was found to be those **matters central to the consideration that passed between the parties** when the contract was formed (our emphasis). This included the total agreed price, the term of the contract, and the monthly payments. The court found that a clause providing that “the Hirer’s obligations including the obligation to pay rent continues notwithstanding any defect ... of the Equipment” was an ancillary or subsidiary term. It has no effect unless there was a “defect, breakdown, accident or seizure of the Equipment”. In this sense, it was not a term concerned with the existence of the contract and was not a term necessary to give effect to the supply of the Equipment.

This is an approach that could be applied to insurance contracts and goes further than the proposed restriction.

The proposed restriction creates an unfair playing field with no justification provided for the approach in the proposal paper.

### Other jurisdictions

The proposal is inconsistent with the EU, UK and New Zealand positions. We believe that it is most appropriate to tailor the provisions to insurance contracts in the manner that has been done in other jurisdictions. In the EU, courts have referred to it as covering terms that lay down the essential obligations of the contract and, as such, characterise it, See *v Caja de Ahorros y Monte de Piedad de Madrid*, C 484/08, EU:C:2010:309.

Terms ancillary to those that define the very essence of the contractual relationship cannot fall within the concept of ‘the main subject-matter of the contract’, within the meaning of that provision (judgments in *Kásler et Káslerné Rábai*, C-26/13, EU:C:2014:282, paragraph 50, and *Matei*, C-143/13, EU:C:2015:127, paragraph 54). In an insurance contract this is not just the item or person insured, as proposed by Treasury.

The EU, in order to avoid a lack of clarity in the insurance context, included an insurance specific qualifier in Recital 19 of EC Directive 93/13/EEC on Unfair Terms in Consumer Contracts: [our bold]

*“Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; whereas the main subject matter of the contract and the price/ratio may nevertheless be taken into account in assessing the fairness of terms; **whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer’s liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer.**”* (Our emphasis)

EC Directive 93/13/EEC generally has the result that the terms which clearly define the insured risk and the insurer's liability are not subject to UCT assessment since these restrictions are taken into account in calculating the premium paid by the consumer. There is no evidence we are aware of that the above has caused any issues for consumers.

The UK adopts a similar position to the EU regarding the view on what is excluded as main subject matter. It is generally considered that the main subject matter concept in the UK applies to core provisions, being the insuring clause and exceptions clauses. Ancillary clauses, such as claims provisions have been found to be outside the main subject matter – See *Bankers Insurance Company Ltd v Patrick South, Mark Ian Gardner* [2003] EWHC 380 (QB).

In New Zealand, they do not qualify or define what is carved out as the “main subject matter”. Instead, they apply specific insurance carve outs in the provisions dealing with unfair terms by deeming the following terms to be terms that are reasonably necessary in order to protect the legitimate interests of the insurer (in effect removing them from the regime):

- a term that identifies the uncertain event or that otherwise specifies the subject matter insured or the risk insured against.
- a term that specifies the sum or sums insured or assured.
- a term that excludes or limits the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances.
- a term that describes the basis on which claims may be settled or that specifies any contributory sum due from, or amount to be borne by, an insured in the event of a claim under the contract of insurance.
- a term that provides for the payment of the premium.
- a term relating to the duty of utmost good faith that applies to parties to a contract of insurance.
- a term specifying requirements for disclosure or relating to the effect of non-disclosure or misrepresentation, by the insured.

### **Practical issues with proposed limitation**

In terms of the narrow limitation proposed, the proposals paper notes that the concept will only cover terms that “describe what is being insured, for example, a house, a person or a motor vehicle”. It then gives, as an example, a home and contents policy and notes that terms excluded from review would include “those which detail the insured property, such as the location and type of dwelling”. The concept of “describes what is being insured” and the example which appears to refer to the attribute of the dwelling ie “the type” creates a lack of clarity. For example, what is a “type of dwelling”, is it a house vs apartment etc, does it extend to the materials of the building such as brick or timber, does it also extend to the “usage” of the dwelling eg domestic or business usage and so on?

In terms of a person insured under an indemnity policy, how is the “description” concept to be interpreted? Is it just the named person or also the role they are being covered for eg as a director or officer or for business purposes only? Where the line should be drawn is unclear.

If the issues above were clarified in a way that narrowed the main subject matter even further, any provisions dealing with the “scope of cover” would be subject to challenge as an unfair term. If insurers cannot rely on the terms forming the basis of their insurance contracts, they will be 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. This is likely to result in restrictions to policy coverage and an increase in premiums for consumers.

What is needed is clarity (whether at the point of the main subject matter carve out or unfairness test) and a fair carve out of insurance terms to allow insurers to safely price their products.

One possibility could be to apply the EU carve out but make the reliance on the carve out subject to the relevant term being both prominent and transparent. By way of example, by applying the EU test to a home buildings policy, the following should not be subject to UCT testing:

- a term that identifies the uncertain event (ie accidental damage or defined covered event) or that otherwise specifies the subject matter insured (the home of the specified type at the specified risk address) or the risk insured (liability arising as a home owner) against;
- a term that specifies the sum or sums insured or assured (eg building sum insured, sub-limits for specified items or limit of liability);
- a term that excludes or limits the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances (eg exclusion for flood or where usage of home is for commercial purposes or where activity causing loss arises due to consent of the insured);
- a term that describes the basis on which claims may be settled or that specifies any contributory sum due from, or amount to be borne by, an insured in the event of a claim under the contract of insurance (eg replacement vs repair, choice of repairer by insurer, second hand or non-manufacturer parts vs new/manufacture parts);
- a term that provides for the payment of the premium (eg annually or by instalments).

We are not aware of any significant consumer issues being raised regarding this approach, including in the recent review - European Commission (2017), Results of the Fitness Check of consumer and marketing law and of the evaluation of the Consumer Rights Directive, [http://ec.europa.eu/newsroom/just/item-detail.cfm?item\\_id=59332](http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=59332).

In New Zealand, they have a main subject matter carve out in section 46K without special treatment for insurance. Instead, as noted above, they apply specific insurance carve outs in the provisions dealing with unfair terms by deeming the following terms must be taken to be terms that are reasonably necessary in order to protect the legitimate interests of the insurer (in effect removing them from the regime).

The last two requirements are designed to avoid any inconsistency between this UCT legislation and the rules in other insurance specific legislation:

- a term relating to the duty of utmost good faith that applies to parties to a contract of insurance:
- a term specifying requirements for disclosure or relating to the effect of non-disclosure or misrepresentation, by the insured.

**8 If yes, do you support this proposal or should an alternative definition be considered?**

See above.

**9 Should tailoring specific to either general or life insurance contracts also be considered?**

If determined to be appropriate. See other issues section for specific areas of concern.

**10 Do you support this proposal or should an alternative proposal be considered?**

We support this proposal that terms setting the upfront price and the excess payable are excluded from review. It should be clarified that deductibles are also excluded from review as well as any additional premium payable on variations/endorsements mid-term.

**11 Do you agree that the quantum of the excess payable under an insurance contract should be considered part of the upfront price and, therefore, excluded from review?**

Yes

**12 Should additional tailoring specific to either general or life insurance contracts also be considered?**

Not necessary.

**13 Is it necessary to clarify that insurance contracts that allow a consumer or small business to select from different policy options should still be considered standard form?**

We do not believe this is necessary as the standard form option scenarios giving rise to the concern would fit the criteria specified above.

**14 If yes, do you support this proposal or should an alternative definition be considered?**

See above.

**15 Do you consider that it is necessary to tailor the definition of unfairness in relation to insurance contracts?**

No. This creates an unfair playing field in financial services and creates the issues noted below. For example, discretionary mutual fund providers would not be subject to the same rules.

**16 Do you support the above proposal or should an alternative proposal be considered? For example, should the approach taken in New Zealand’s *Fair Trading Act* be considered?**

The preferred proposal is that a term will be deemed to be reasonably necessary to protect the insurer's legitimate interests (and thus safe) when the term:

- reasonably reflects the underwriting risk accepted by the insurer in relation to the contract; and
- does not disproportionately or unreasonably disadvantage the insured.

This is to allow a court to consider factors beyond whether a term is taken into account in the calculation of the premium. For example, a term may only incidentally relate to the insurer's risk, or may have a relatively minor effect on an insurer's premium rating structure, but have a disproportionate effect on the policyholder.

The Proposal Paper notes that the rationale for this includes:

- it encourages appropriate risk bearing between insurers and consumers by incentivising insurers to ensure their contract terms accurately and transparently reflect their underwriting risk; and
- it is consistent with the objective of the Australian Consumer Law that UCT laws should be given a broad application by reducing the risk for an insurer changing their premium rating structures to exclude terms from reviewability.

We do not support the above proposal. It imposes requirements that are not consistent with current UCT regime applicable to other industries and provides no valid reasons for or evidence in support of making such a change. Our position regarding what insurance terms should and shouldn't be subject to review is set out in the discussion of the main subject matter above. The NZ position has the advantage of clearly carving out types of provisions that will avoid unnecessary dispute, cost and uncertainty. In relation to the proposal as described in the consultation paper, we make the following comments.

**Current position in current UCT regime**

Currently, it is a matter for the court to determine whether a term is reasonably necessary to protect the legitimate interests of the respondent. ACCC Guidance provides some useful background and stating:

*“Not reasonably necessary”*

*A court must find that the term is not reasonably necessary to protect the legitimate interests of the party that would be advantaged by the term. The meaning of legitimate interest is open to interpretation by the court.*

*A term is presumed not to be reasonably necessary to protect the party’s interests unless that party proves otherwise. The party advantaged by the term needs to provide evidence that its legitimate interest is sufficiently compelling to overcome any detriment caused to the consumer, and that therefore the term was ‘reasonably necessary’.*

*Such evidence might include relevant material relating to a business’s costs and structure, the need to mitigate risks, or particular industry practices.”*

There is no evidence that suggests this is not appropriate in an insurance context.

### **New concept of “reasonably reflects the underwriting risk accepted by the insurer”**

It is unclear how an insurer could form a view on what is described in the consultation paper as “reasonably reflects the underwriting risk accepted by the insurer in relation to the contract”? No useful guidance is provided nor any examples. The only explanation regarding this concept is “This approach would provide that terms defining the insured risk and are taken into account in the calculation of the premium should not be considered unfair.” This explanation does not reflect the extremely broad words used to describe the concept “reasonably reflects the underwriting risk accepted by the insurer in relation to the contract”.

Such a concept imposes a reasonableness test on the provision. For example, on a plain reading an insured could argue that even if a term defines the underwriting risk (eg an exclusion for damage caused by tree lopping with the consent of the owner in a home buildings policy) and is taken into account in the calculation of the premium (ie per the Consultation paper explanation), it could still be considered unfair if as a provision or as priced, it doesn’t “reasonably reflect the underwriting risk” actually accepted. The tree lopping qualification based on consent would then be subject to challenge in every case.

If there is no clarity on where the line is to be drawn, regulators and consumers could consistently test the underwriting decisions of insurers and expose the decision-making process to competitors with flow on competition law issues.

Is the test a subjective or objective one in terms of the insurer’s position?

### **New concept of not disproportionately or unreasonably disadvantaging the insured**

The proposed test that the term must also not:

- disproportionately; or
- unreasonably,

disadvantage the insured, is also unclear.

It is not clear if the reference to the insured is the particular insured based on their subjective or objective personal circumstances or all insureds from a general perspective. For example, if cover is provided for an event, in a term that only some insureds benefit from and others do not, those that do not will always be disadvantaged and how do you determine whether the proportionality or unreasonableness tests are met or not? What happens when there is an exclusion applied where the cover provided was optional.

For example, flood cover is offered as optional in a home policy and some insureds accept it, but others do not. The term excluding cover for flood is open to challenge. Is the exclusion for flood open to challenge after analysis of the basis on which the insurer made the decision to make the offer optional? This would be of significant impact on the insurer that priced the policy on the basis of the exclusion. Voiding the term exposes the insurer to a risk it has not priced into the premium and also one for which it has not obtained reinsurance protection. We expect APRA would have significant concerns in this regard as well.

We question:

- what is the relevant proportion of disadvantage that is sufficient to create an issue? – there is no certainty on where the line can be drawn. In many cases, underwriting involves a judgment call. The risk is that underwriters start to develop products that cover more, but which are not affordable for many.



- is the unreasonableness of the disadvantage a subjective or objective test in the context of the insurer's decision making?

The above makes it very difficult for an insurer to safely price its insurance and for reinsurers to do the same. Has APRA, as regulatory of insurer solvency, been consulted on what could be a significant impact on insurers? Given the consequences of a breach, this level of ambiguity and its impact on the certainty of pricing is not acceptable. If despite our submissions, the regime as proposed is implemented, we request that like in New Zealand, only the regulator ASIC, and not consumers, be permitted to apply for a declaration that a term is unfair.

**17 Should tailoring specific to either general or life insurance contracts also be considered?**

We do not support this approach.

**18 Do you consider that it is necessary to add specific examples of potentially unfair terms in insurance contracts?**

It is not necessary in the legislation itself. We have no issues with examples being provided elsewhere, subject to them being accurate and informative. We do not support examples that will promote unnecessary or misconceived challenges.

**19 Do you support the kinds of terms described in the proposal or should other examples be considered?**

No information is provided on why these are considered unfair terms, nor scenarios of when and why this has been found to be the case. In many cases they will not be unfair. For example, there is a scenario where an insurer wishes to repair under the policy and has a right to do so, but the insured does not want this and wants a cash settlement. It would not seem unfair that the insurer rely on a term in such a case that permits it to pay a claim based on the cost of repair or replacement that may be achieved by the insurer where it has priced the policy on this basis.

**20 Should tailoring specific to either general or life insurance contracts also be considered?**

Yes, where appropriate and subject to the comments above.

**21 Do you support the remedy for an unfair term being that the term will be void? Is a different remedy more appropriate (for example, that the term cannot be relied on)?**

Given the lack of clarity of the specialised insurance proposals the voidance remedy is not in our view appropriate. It should be left to the court to decide the appropriate remedy in the circumstances. If despite our submission, the regime as proposed is implemented, we request that like in New Zealand, only the regulator (ie ASIC) and not consumers, be permitted to apply for a declaration that a term is unfair.

**22 Do you consider it is appropriate for a court to be able to make other orders?**

See above.

**23 Should tailoring specific to either general or life insurance contracts also be considered?**

See above.

**24 Do you consider that UCT protections should apply to third-party beneficiaries?**

It is not on the face of it unreasonable to apply appropriate protection to such persons to the extent they are directly affected. It is unclear how the tests referred to above ie “reasonably reflects the underwriting risk and not “disproportionately or unreasonably disadvantage the insured” would be applied in a group context and also in circumstances where the third-party beneficiary pays nothing.

For example, the term as it applies to the third-party beneficiary, may have no impact on the contracting insured as the cover is only provided to the third-party beneficiary. How are the actions of the group purchasing body (the contracting insured) to be taken into account in forming a view on fairness as it applies to the beneficiaries?

Will this legislation potentially expose the contracting insured to liability (eg for not providing the third-party beneficiaries with the cover represented by them) and create a disincentive for such schemes and the benefits they bring?

**25 Do you support the above proposal or should an alternative proposal be considered?**

See above.

**26 Superannuation fund trustees may have substantial negotiating power and owe statutory and common law obligations to act in the best interest of fund members. Do these market and regulatory factors already provide protections comparable to UCT protections such that it would not be necessary to apply the UCT regime to such products?**

An exemption may create a competitive disadvantage for insurers not offering the same insurance through a trustee directly to consumers.

**27 Do you consider that any other tailoring of the UCT laws is necessary to take into account specific features of general and/or life insurance contracts?**

We expect carve outs and clarification will be required if the proposals are progressed in the proposed form due to the current ambiguity.

**28 Do you agree that unilateral premium adjustments by life insurers should not be considered unfair in circumstances in which the premium increase is within the limits and under the circumstances specified in the policy?**

Yes.

**29 Is a 12 month transition period adequate? If not, what transition period would be appropriate?**

It is not adequate. Product design and underwriting 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. A minimum of 2 years transition would be required.

**30 Are the transition arrangements outlined above appropriate or should alternative transition arrangements be considered?**

In New Zealand, the UCT provisions do not apply to variations of the terms of pre-existing insurance contracts or to new insurance contracts that effectively renew pre-existing contracts. See Section 26A(3) Fair Trading Act 1986 NZ. We submit a similar approach should be taken in Australia.

**31 What will insurers need to do during the transition period to be ready to comply with the new UCT laws?**

See above

**32 Should tailoring specific to either general and/or life insurance contracts be considered?**

Yes, as appropriate.

## **OTHER ISSUES**

### **Scope of contracts caught**

Consideration should be given to the scope of insurance contracts caught by the UCT protections. To be a “consumer contract” at least one party must be an individual whose acquisition of the insurance is wholly or predominantly an acquisition for personal, domestic or household use or consumption.

For a contract to be caught as a “Small business contract” at least one party must be a small business where the premium is less than \$300,000. We note that the above definitions catch contracts well beyond those that are considered:

- Standard covers under the IC Act;
- Retail client covers under the Corporations Act; and
- General Insurance Code of Practice Code “Retail insurance” definition.

This will require a case by case analysis for *all* policies, including on variation and renewal. This does not currently occur under the Corporations Act, IC Act or Code as the types of policies caught are clearly identified. In the Corporations Act the definition of a small business relates to the number of employees in the business not the amount of the premium. We recommend that the definition of small business in the Corporations Act be adopted for consistency.

As 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 above.

### **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 the Insurance Contracts Act (IC Act)**

It is crucial that the UCT legislation and IC Act regime operate effectively. The aim of the IC 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 IC Act will be rendered ineffective, be of little use or result in unnecessary duplication or costly challenge. The following are some 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 the insured's non-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 sections 34-35 which apply automatic minimum cover unless the insurer notifies the insured they won't be providing the minimum cover. The proposals should make it clear that where:

- the minimum cover is provided as described (ie the prescribed events as qualified by permitted exclusions); or
- more than minimum cover is provided and this additional cover includes the minimum cover permitted exclusions,

the minimum cover or minimum cover exclusions that are in the policy, 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 ie section 53 won't apply in such cases. The UCT would create an inconsistency 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 UCT 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 become ineffective until the UCT issue is first tested. The same result would apply to the duty of utmost good faith provisions under section 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 Act should be clearly identified as terms that are “required or expressly permitted by law.”

### **Another potential main subject matter test**

If the EU or New Zealand approaches are not options, a possible middle ground may lie in consideration of the approach taken by courts regarding section 54 of the Insurance Contracts Act. In considering this provision, the courts have looked at the concept of a “restriction or limitation that is inherent in a claim”. See High Court Decision in *Maxwell v Highway Hauliers Pty Ltd* [2014] HCA 33.

In summary, section 54 provides that where the “effect” of the policy is to allow an insurer to refuse to pay a claim, either in whole or in part, because the insured or a third party has done some act (an act also includes an omission or failure to act), after the policy was entered into, section 54 applies certain restrictions on the insurer subject to limited carve outs.

The High Court in *Maxwell* explained the objectives of section 54 as follows:

*“The Act is described in its long title as an Act to reform and modernise the law relating to certain contracts of insurance so 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.*

*The more specific objects of s 54 of the Act were explained in the report of the Australian Law Reform Commission which recommended its introduction. Those objects included striking a fair balance between the interests of an insurer and an insured with respect to a contractual term designed to protect the insurer from an increase in risk during the period of insurance cover. That balance was to be struck irrespective of the form of that contractual term. In particular, no difference was to be*

*drawn between a term framed: as an obligation of the insured (eg "the insured is under an obligation to keep the motor vehicle in a roadworthy condition"); as a continuing warranty of the insured (eg "the insured warrants he will keep the motor vehicle in a roadworthy condition"); as a temporal exclusion from cover (eg "this cover will not apply while the motor vehicle is unroadworthy"); or as a limitation on the defined risk (eg "this contract provides cover for the motor vehicle while it is roadworthy")."*

The courts have held 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."

It is possible that a similar approach could be adopted by appropriate drafting to achieve a balance between the EU position and the narrow definition proposal, and it is worthy of further discussion and testing.

**ALLIANZ AUSTRALIA INSURANCE LIMITED**