Unfair Terms in Insurance Contracts – Options Paper

Submission by Financial Ombudsman Service ("FOS")

This is the submission by FOS on the matters raised in the Treasury's *Options Paper: Unfair Terms in Insurance Contracts* released on 17 March 2010 ("Options Paper").

This submission has been prepared by the office of FOS. Views expressed in this submission do not necessarily represent the views of the board of FOS.

Information about FOS

FOS commenced operations on 1 July 2008. It is an independent dispute resolution scheme that was formed through the consolidation of three schemes:
- the Banking and Financial Services Ombudsman ("BFSO");
- the Financial Industry Complaints Service ("FICS"); and
- the Insurance Ombudsman Service ("IOS").

On 1 January 2009, two other schemes joined FOS, namely:
- the Credit Union Dispute Resolution Centre ("CUDRC"); and
- Insurance Brokers Disputes Ltd ("IBD").

Replacing the schemes previously operated by BFSO, FICS, IOS, CUDRC and IBD, FOS provides free, fair and accessible dispute resolution for consumers unable to resolve disputes with financial services providers that are members of FOS.

Members of BFSO, FICS, IOS, CUDRC and IBD are now members of FOS. The members of those schemes included:
- BFSO – Australian banks and their related corporations, Australian subsidiaries of foreign banks, foreign banks with Australian operations and other Australian financial services providers;
- FICS – life insurance companies, fund managers, friendly societies, stockbrokers, financial planners, pooled superannuation trusts, timeshare operators and other Australian financial services providers;
- IOS – general insurance companies, re-insurers, underwriting agents and related entities of member companies;
- CUDRC – credit unions; and
- IBD – insurance brokers, underwriting agents and other insurance intermediaries.

It is estimated that FOS covers up to 80% of banking, insurance and investment disputes in Australia. As well as its functions in relation to dispute resolution, FOS has powers to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice including the General Insurance Code of Practice ("Insurance Code").

FOS is a not-for-profit organisation governed by an independent board whose members include representatives from consumer agencies and the financial services industry.

FOS is an external dispute resolution scheme approved by ASIC. Membership of FOS is open to any financial services provider carrying on business in Australia including providers not required to join a dispute resolution scheme approved by ASIC.

FOS operates under published Terms of Reference ("TOR"). The current TOR came into effect on 1 January 2010. They were developed through a process that involved extensive stakeholder consultation and have been approved by ASIC. The TOR require FOS, when deciding disputes, to do what it considers fair in the circumstances, having regard to:

- legal principles;
- applicable industry codes or guidance as to practice;
- good industry practice; and
- previous decisions of FOS and its predecessors.

Outline of submission

This submission presents information and comments about certain matters raised in the Options Paper, namely:

- the current position (or *status quo)*;
- assessment of options in the Options Paper; and
- industry self regulation.

1. The current position

In examining various options, the Options Paper looks at whether the options offer solutions only for individual cases or wider solutions that may impact on many cases. Some of the action that FOS takes currently may have a wide impact, as explained below.

1.1 Decisions in individual disputes

As indicated above, when deciding disputes, FOS's primary obligation is to do what is fair in the circumstances. It is required to do this having regard to considerations including the applicable law (which may include legislation such as the *Insurance Contracts Act 1984* ("ICA")) and industry codes (which may include the Insurance Code). Where FOS makes a final decision in relation to a dispute, which the consumer accepts, the decision binds the financial services provider. Our decisions may also have a wider impact. For example:

- The decision made in a dispute may cause the financial services provider involved in the dispute to change its practices or terms in its contracts. In a number of instances over recent years, insurers have adapted their approaches to interpretation and application of policy provisions as a consequence of decisions by FOS.

- After learning of a decision against a financial services provider, other financial services providers may change their practices or terms in their contracts. We publish insurance decisions on our website and provide information about decisions through regular publications such as our Circular and Electronic Newsletter. We also conduct training sessions on technical issues that we consider in the course of dispute resolution. For example, we have recently conducted seminars on issues relating to:
    - non-disclosure and the application of sections 21, 21A, 22 and 28 of the ICA;
    - ICA provisions including sections 46 and 54; and
    - the concept of "utmost good faith".

- FOS holds industry liaison meetings with insurers. Through these meetings, insurers receive information on important issues considered in the course of dispute resolution such as the duty of disclosure. The meetings help to ensure that matters are dealt with consistently throughout the insurance industry.

1.2 Systemic issues and serious misconduct

A systemic issue raised by a dispute is an issue that will have an effect on consumers beyond the parties to the dispute. Our TOR require us to identify systemic issues, monitor their resolution and report on them to ASIC. Sections 1.2.1 to 1.2.4 below outline our approach in regard to systemic issues identified through dispute resolution activities.

Serious misconduct is conduct that may be fraudulent, grossly negligent or involve wilful breaches of law or obligations under the TOR. Our TOR require us to report to ASIC on serious misconduct by financial services providers.

1.2.1 How FOS identifies a systemic issue

When we receive a dispute, we consider whether it raises an issue which is possibly systemic. Most possible systemic issues are identified when we receive disputes, but identification can occur at any stage in the dispute resolution process.

Some examples of characteristics that may assist in identifying a possible systemic issue are:

- receipt of a number of new disputes about the same issue;
- where the issue that affected the parties to a dispute could have affected others in a similar way;
- where the person raising a dispute with us claims that the issue affected others in a similar way; or
- where a financial services provider indicates that it has internally identified that an issue affects a group of consumers.

1.2.2 Steps taken after systemic issue identified

If we consider that a dispute raises a possible systemic issue, we send a letter to the financial services provider to:

- provide details of the possible systemic issue;
- seek further information; and
- invite the financial services provider to make submissions in response.

Upon receipt of the financial services provider's response, we decide whether the issue is definitely systemic in nature.

Following identification of a definite systemic issue, our staff identify any other disputes that may be affected by the systemic issue.

1.2.3 Resolution of systemic issue

Where we determine that an issue is definitely systemic in nature, we work with the financial services provider to ensure that:

- all affected consumers are identified and appropriately compensated for financial loss, if any, in a fair manner; and
- a strategy is put in place to prevent the problem from recurring.

1.2.4 Reporting of systemic issues to ASIC

We are obliged, under our TOR, to report systemic issues to ASIC. Our reports do not identify financial services providers but do include statistical information regarding possible and definite systemic issues identified together with details of the nature, progress and resolution of the definite systemic issues.

If a financial services provider does not rectify a definite systemic issue in accordance with our requirements, we take the following action:

- we notify the financial services provider that we believe that a report, identifying the financial services provider, should be made to ASIC;
- we give the financial services provider time to make submissions on whether an identifying report should be made to ASIC;
- if there is no response or the response does not satisfy us that the financial services provider has adequately rectified the definite systemic issue, we make a report to ASIC. The report will identify the financial services provider and provide details of the systemic issue, the action taken by us and the response from the financial services provider, if any.

1.3 Monitoring compliance with the Insurance Code

The Insurance Code confers on FOS responsibility for monitoring participating companies' compliance with the code's service standards. We monitor this compliance by:

- conducting an on-site review of each participating company's compliance annually; and
- investigating possible breaches of the Insurance Code.

FOS may obtain information about possible breaches of the Insurance Code, for example, through on-site reviews, complaints received from consumers or our consideration of disputes. The code also requires participating companies to monitor

their compliance with the code and to identify significant breaches and report these to FOS.

Companies cooperate with our investigations of possible breaches of the Insurance Code and regular compliance reviews. Often, companies amend their processes and procedures to minimise the likelihood of investigations or recurrence of issues examined in reviews.

2. Assessment of options in the Options Paper

2.1 Complexity and amount of change

The ICA provides a specialised legislative framework for insurance contracts. The ICA reflects insurance concepts and principles and uses terms that have particular meanings in relation to insurance. We believe that these factors will need to be taken into account in any reforms implemented. In view of these factors, we would expect Options B and C to involve less complex legislative amendments, and less change, than Option A.

2.2 Extent of amendment required under Option A

The Options Paper indicates that Option A involves amendments to section 15 of the ICA. The Options Paper does not explain whether Option A involves:

- amendments to ICA provisions other than section 15; or
- applying modified versions of unfair contract terms provisions of the *Australian Securities and Investments Commission Act 2001* ("ASIC Act") and, if so, how they would be modified.

As discussed above and acknowledged in the Options Paper, insurance legislation needs to be tailored. To illustrate our point, we refer to the fact that the unfair contract terms provisions in the ASIC Act do not apply to terms that define the main subject matter of a contract. We consider that the main subject matter of an insurance contract is the extent of the cover provided. Terms that define the extent of cover are central provisions of insurance contracts. If there is to be a major exclusion from the unfair contract terms provisions, certain ICA provisions might need to be strengthened. In our view, it is desirable to take this factor into account in any assessment of Option A.

2.3 Standard form insurance contracts

The unfair contract terms provisions in the *Australian Consumer Law* ("ACL") and the ASIC Act apply to consumer contracts in a standard form. We assume that if comparable provisions were to apply to insurance contract terms regulated by the ICA, they would only apply to standard form contracts. The *Insurance Contracts Regulations 1985* set out terms that apply in certain categories of insurance contracts including motor vehicle, home building, home contents and travel insurance contracts ("Prescribed Terms").

The Options Paper does not indicate whether the Prescribed Terms would be subject to unfair contract terms law under any (or all) of the options. We note that

the unfair contract terms provisions in the ACL and the ASIC Act do not apply to terms required or permitted by a law.

There are other issues concerning standard form insurance contracts that may need to be clarified. For example:

- Would any contract that contains the Prescribed Terms be a standard form contract under the unfair contract terms law?
- Would contracts that contain the Prescribed Terms be the only standard form contracts in their categories? Expressed differently, could a contract in a category for which there are Prescribed Terms be a standard form contract if it does not contain the Prescribed Terms?

2.4 Determining whether a term is unfair

Paragraph 11 of the Options Paper refers to industry submissions that, under unfair contract terms law, it would be necessary to analyse all of the facts of a case to determine whether reliance on a particular term was unfair. The Options Paper does not state whether these submissions are correct. It merely indicates, in paragraph 12, that determining whether a term is unfair would involve legal analysis. We think that a statement to clarify whether the industry submissions are correct would help stakeholders to understand and assess the options.

3. Industry self regulation

Information about our role in monitoring compliance with the Insurance Code is provided above. Additional information about the Insurance Code is noted below.

- The Insurance Code applies to participating companies. At present, there are about 140 participating companies. We are aware of only three general insurers that are not covered by the code. They are not major insurers.
- The Insurance Code is a living document that has evolved to respond to changes since it was initially introduced in 1994. The latest round of amendments is due to commence on 1 May 2010.
- Based on our dispute resolution experience, we believe that consumer representatives are conversant with the Insurance Code and the actions that it allows to be taken.