28 April 2010

Unfair Terms in Insurance Contracts: Options Paper
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

ICAReview@treasury.gov.au

UNFAIR TERMS IN INSURANCE CONTRACTS

Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the Unfair Terms in Insurance Contacts – *Options Paper* (March 2010).

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than $7.8 billion of premium per annum. It employs more than 13,500 people of which around 9,300 are in Australia. IAG operates some of Australia's leading insurance brands including NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and The Buzz. IAG also distributes insurance in Victoria through the RACV brand. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

IAG supports the detailed submission to the *Options Paper* made by the Insurance Council of Australia.

IAG is strongly of the view that there is no justification to have the unfair contacts terms provisions of the *Trade Practices Amendment (Australia Consumer Law) Bill* apply to terms in insurance contracts. In this regard IAG makes the following points:

a) Adequacy of the current legislative regime

The current legislative regime (under the *Insurance Contracts Act 1984(Cth)* and the *Corporations Act 2001(Cth)*) that applies to insurance contracts together with the Financial Ombudsman Service dispute resolution scheme and the General Insurance Code of Practice provide more then adequate protection to retail consumers of insurance products.

Insurance Contracts Act 1984 (Cth): There is a raft of consumer protections under the *Insurance Contracts Act 1984*. Some of these protections are referred to in the *Options Paper.* Significant protections include sections 13, 14 and 54 of the *Insurance Contracts Act 1984*. Attachments A and D of the Insurance Council's submission provides evidence that these protections work.

Insurance Australia Group Limited
ABN 60 090 739 923

388 George Street
Sydney NSW 2000
Australia

T +61 (0)2 9292 9222
www.iag.com.au

Amendments to the *Insurance Contracts Act 1984* introduced into Parliament in March 2010 will increase consumer protections under the Act.

It is of particular note the preamble to the *Insurance Contracts Act 1984* outlines its specific purpose:

> "*An Act to reform and modernise the law relating to certain insurance contracts so that a fair balance is struck between the interests of the insurers, insureds and other members of the public and so that the provisions included in such contracts, and practices of insurers in relation to such contracts, operate fairly, and for related purposes*."

The provisions of *Insurance Contract Act 1984* seek to ensure balance and fairness but in a manner that is specific to insurance contracts and in a manner that recognises that terms can be appropriately relied on in some circumstances but inappropriately relied on in other circumstances.

<u>*Corporations Act 2001 (Cth*</u>): Under the *Corporations Act 2001* there is an over arching obligation on insurers as the holder of an Australian Financial Services Licence to do all things necessary to ensure that financial services covered by their licence are provided efficiently, honestly and fairly (section 912A of the *Corporations Act 2001*). This obligation would apply to retail consumer.

There is also the product disclosure regime under the *Corporations Act 2001* and the cooling off provisions of this regime. The cooling off provisions enables an insured to opt out of the insurance contract after purchase if they change their mind. This gives the customer time to look at the product after purchase to consider carefully whether the product is really suitable for them. Further, section 991A of the *Corporations Act 2001* states "*A financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable*." This section provides if a person suffers loss or damage because a financial services licensee contravenes this provision they may recover the amount of the loss or damage against the licensee.

<u>Financial Ombudsman Service dispute resolution regime</u>: The Financial Ombudsman Service (FOS) also provides a strong remedy for retail insurance customers. The FOS is:
a) available to customers at no cost; and
b) its decisions are binding on the insurer but not the customer.

The current FOS *Terms of Reference*, which apply as from 1 January 2010, give the FOS broad decision making powers. Significantly clause 8.2 states:

> *"Subject to paragraph 8.1, when deciding a Dispute and whether a remedy should be provided in accordance with paragraph 9, FOS will do what in its opinion is fair in all the circumstances, having regard to each of the following:*
> *a) legal principles;*
> *b) applicable industry codes or guidance as to practice;*
> *c) good industry practice; and*
> *d) previous relevant decisions of FOS or a Predecessor Scheme (although FOS will not be bound by these)."*

Note the need for the FOS to do what is fair in all the circumstances having regard to a) to d) above.

General Insurance Code of Practice: The General Insurance Code of Practice also provides protection to consumers. Note particularly the amendments which take effect on 1 May 2010 which require the objectives of the Code and its provisions to be applied having regard to the fact that a contract of insurance is a contract involving the utmost good faith.(see Clause 1.19 of the Code and the Insurance Council's submission attachment A)..

b) Lack of evidence supporting unfair terms

Specific claims examples have been provided in submissions to the Senate Economics Committee as evidence that unfair terms are a problem in insurance contracts. However care needs to be exercised when relying on specific examples. This is because each claim turns on its facts. Further, if focusing on a term in a contact, it is important to note the issue may not be the term itself. Rather the issue may be the application of the term to a given factual circumstance. It is this issue that particular provisions of the Insurance Contracts Act, such as section 14, protect against. This is demonstrated in the Insurance Council's submission. One will see section 14 remedies have been invoked where the FOS consider this appropriate- see for example attachment D to the Insurance Council submission.

To determine whether there is any objective evidence that unfair terms are a problem in insurance contracts one really needs to focus on statistical data. IAG is not aware of any statistical study done on unfair terms and insurance contracts. However statistics provided in Financial Ombudsman Service Annual Reports in relation to disputes generally do not support any additional consumer legislative remedies in the retail insurance sector. Financial Ombudsman Service Annual Report 2008, Table 11 Summary of Insurer's Annual Returns, for personal lines products shows there were 3,167,439 claims lodged with insurers. Of these:

a) only 17,973 ended up in a dispute (only about 0.5%), and
b) only 2,046 ended up being dealt with by the FOS (only about .06%).

These are very small numbers. Of the .06% we don't know what percentage, if any, relate to alleged unfair terms. However one can safely assume there would be a myriad of other matters that these disputes could relate to. So is there really an issue in relation to unfair term in insurance contracts?

c) The unfair contracts test is unsuitable for insurance contracts

Unfortunately the unfair terms legislation, because of the nature of the test, would have the potential to declare a term unfair and thus void just based on the facts of a particular case. All that needs to be shown is:

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

As noted above the effect of a term being declared as unfair is that it is void. This means the term can never be relied on in the contract. Any changes in the underlying policy terms may also impact on reinsurance coverage.

Certain remedies under the Insurance Contracts Act, such as those under section 14 and 54, only impact on an insurer's ability to rely on a term in relation to an individual claim. These remedies are more appropriate because they recognise there may be circumstances where a term should be able to be relied on and other circumstances where it would not be appropriate for that same term to be relied on.

d) Unwarranted layering of legislative regimes

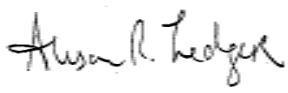
The application of the unfair contracts terms provisions to insurance policies would result in unwarranted layering of regulatory requirements on insureds and insurers. Whilst regulation must effectively address failures in consumer protection (where there is evidence supporting failure) it must also avoid adding unnecessary duplication and complexity.

Conclusion

While IAG has been, and remains, supportive of the Government's objectives in reforming Australia's financial services sector, particularly in relation to the adoption of a uniform licensing regime and an improved disclosure and conduct framework for financial services providers, for the above reasons , IAG recommends that the Government adopt the option of maintaining the status quo.

If you wish to discuss this matter or make further inquiries please contact Andrew Yeend, Senior Corporate Lawyer on 9292 8051 or me on 9292 8026.

Yours sincerely



Alison Ledger
Head of Group Strategy
Insurance Australia Group