



Investment & Financial Services Association Ltd

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Unfair Terms in insurance contracts: Options Paper
Corporations and Financial Services Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: ICAReview@treasury.gov.au

Dear Sir/Madam

Unfair terms in insurance contracts – Options paper

The Investment & Financial Services Association (IFSA) is the peak body representing Australia's life insurance, retail and wholesale funds management and superannuation industries. IFSA has over 135 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians.

IFSA appreciates the opportunity to comment on the *Unfair Terms in Insurance Contracts: Options Paper* (Options Paper). The Options Paper discusses the potential extension of the *Trade Practices Amendment (Australian Consumer Law) Act (ACL)*, or the equivalent provisions in the *Australian Securities and Investments Commission Act 2001 (ASIC Act)*, to insurance contracts.

1. Introduction and recommendation

Treasury states that it is seeking through its Options Paper to clarify 'the nature and scope of the problem'. The problem is defined to be 'the actual or potential disadvantage or loss suffered by consumers as a result of insurance contracts containing contract terms that are harsh and/or unfair'.

The Options Paper, in seeking to explore the nature and scope of the problem, has provided examples sourced from submissions to the Senate Committee from the National Legal Aid and Consumer Action Law Centre, among others¹. It is to be observed that of all of the particular examples in the Options Paper of terms in

¹ See submissions to the Senate Committee from Consumer Action Law Centre, Insurance Law Service (Consumer Credit Legal Centre (NSW) Inc), Legal Aid Queensland, National Legal Aid and Choice

insurance contracts that were said to be harsh and/or unfair, none of the selected examples related to insurance policies that were life risk policies.

That is not to suggest that it is inconceivable that such a term could arise in a life risk policy. What it does suggest, however, is that the consumer experience is that life risk insurance policies are not commonly a source of contract terms that could be said to be harsh and/or unfair to consumers; or alternatively to the extent that such terms arise in life risk policies, the existing law and disputes mechanisms provide adequate protection for consumers against such terms.

IFSA's life insurance members submit that the best option to achieve the objective of preventing consumers from suffering detriment due to terms in insurance contracts that are harsh or unfair with respect to life risk insurance is to maintain the status quo, allowing for the amendments proposed to the *Insurance Contracts Act 1984 (IC Act)* and recent amendments to the Financial Ombudsman Service (FOS), for the reasons that:

- (i) the consumer experience in life risk insurance is overwhelmingly not one of suffering detriment due to harsh and/or unfair terms in standard contracts;
- (ii) the existing law, allowing for IC Act amendments and recent amendments to the FOS Terms of Reference, does provide appropriate protection for consumers against harsh and/or unfair contract terms;
- (iii) industry practice for life insurance contracts dictates that, generally, they are non-cancellable by the insurer (other than for non-payment of premium) and not capable of unilateral amendment by the life insurer, other than in respect of premium variations applied to a group of policyholders as a class;
- (iv) life risk insurance involves a significant degree of intermediation. Intermediaries scrutinise contract terms on behalf of clients, and are often involved in the claims process, providing a further layer of consumer protection based upon commercial and/or fiduciary considerations and obligations;
- (v) as noted elsewhere in this submission, the incidence of unfair terms in life insurance contracts is in fact very low. Nevertheless, the extension of unfair contract terms legislation to life insurers could lead to forum shopping and more litigation if declined claims are met by complaints that one or more terms of the policy were unfair, irrespective of the fact that such complaints may be without merit. The cost of responding to such claims would increase compliance costs for life insurers and be passed on to consumers without, we submit, any significant or material benefit to consumers.

2. Consumer experience in life risk insurance

Of the 4798 complaints to FOS in 2007-2008, and 6406 complaints in 2008-2009, relating to insurance products, only 9% of these complaints related to life insurance².

The published FOS statistics do not separately identify "unfair contract terms and conditions" complaints received. However a review of the first 100 FOS determinations returned by the keyword search "unfair contract terms and conditions"

² Financial Ombudsman Service 2008-2009 Annual Review

reveals 9 of those 100 complaints being related to life risk insurance. FOS found in favour of the life insurer in 7 out of those 9 complaints.³

Further, an IFSA member and major Australian life insurer has provided data that in 2008, only 65 complaints were made concerning denial of claim, against 6256 claims made in that year. In 2009, only 47 complaints were made concerning denial of claim, against 6270 claims made.

This information above is a good indication of the very low levels of consumer complaints made in relation to life risk policies.

3. Existing law and recent/proposed amendments

The Options Paper summarises some of the consumer protection offered by sections 13 and 14 of the IC Act.

These provisions are, in the experience of IFSA members, commonly understood and invoked by consumers and their representatives, including advisers, trustees and lawyers, seeking to challenge the decision of a life insurer in relation to claims and policy matters. FOS and the Superannuation Complaints Tribunal provide consumers with a cost-free avenue to enforce the protection offered by these sections, and increasingly consumers elect to do so⁴. A consumer need not incur legal cost and embark upon the litigation process to obtain the protection of these provisions.

- **Insurance Contracts Act**

Under s13 of the IC Act a term is implied into each contract of insurance that each party (including the life insurer) will act with utmost good faith. This duty which is implied into all contracts of insurance does protect consumers against the inclusion of unfair terms in insurance contracts and is, we submit, a reason why these terms are uncommon in insurance contracts.

Recent proposed changes to the IC Act address the current concern that the existing law did not provide adequate protection for consumers because the “reliance on the consumer to take proactive steps to hold insurers to account was undermining the impact of these provisions [ss13 and 14 IC Act].”⁵

In addition to expressly extending the protection of ss13 and 14 to third party beneficiaries, the proposed changes to the IC Act provide ASIC with the power to intervene in matters where it is alleged there has been a breach of the duty of good faith.

The IC Act also provides consumer protection, as noted in the Options Paper, through ss 35 and 37, 21, 21A, 26 and 28, 44, 46 and 47, 53 and 54.

³ Keyword search (simple) “unfair contract terms and conditions” at

http://www.fos.org.au/centric/home_page/cases/determinations_and_adjudications_search.jsp

⁴ Note significant increase in FOS complaints in 2008-2009, compared to 2007-2008 (2008-2009 FOS Annual Report).

⁵ See for example National Legal Aid submission to Senate Committee 14 August 2009

- **National Credit Code**

Part 8 of the *National Credit Code* (contained in the *National Credit Protection Act 2009* (Cth)) will regulate credit-related insurance contracts (credit-related insurance contracts include insurance over mortgaged property, consumer credit insurance, or insurance prescribed by the regulations, in connection with a credit contract) by placing restrictions on the financing or premiums of certain regulated insurance policies and the amount of commission paid to insurers. Additionally, the *National Credit Code* will impose obligations on insurers to supply documentation to debtors and, where relevant, inform debtors of rejections for cover. It will also operate to link the termination of credit contracts to the termination of insurance.

- **Corporations Act & ASIC Act**

Furthermore, the consumer protection provisions in both the *Corporations Act 2001* (Corporations Act) and the ASIC Act apply to most insurance products, including contracts of insurance and life policies, and financial services in respect of the provision of such products. For example, there are provisions prohibiting misleading or deceptive conduct, unconscionable conduct, and the making of false or misleading representations. The Corporations Act also imposes an extensive licensing, disclosure and conduct regime in respect of the issue, sale and distribution of financial products, including contracts of insurance and life policies.

These provisions above apply notwithstanding section 15 of the IC Act, because the relief under these legislative regimes are not of the kind contemplated under section 15.

- **The Financial Ombudsman Service**

The Financial Ombudsman Service (FOS) has recently amended its Terms of Reference. Important changes in enhancing consumer protection include increasing the monetary limit of FOS's jurisdiction to \$500,000 from 1 January 2012.

Further, it is important to note that FOS, in resolving disputes, is required by its Terms of Reference (TOR) to have regard to legal principles (including common law and the terms of relevant legislation such as the IC Act and the Corporations Act) when deciding disputes but is not bound to strictly apply such legal principles. FOS must decide what, in its opinion, is fair in all the circumstances (TOR paragraph 8.2). Accordingly, it is not necessary to include additional remedies under the IC Act to assist FOS in deciding the cases which come before it as it already has a mandate to decide what is fair in all the circumstances regardless of other available legislative and common law rights and remedies. Further, FOS will not be bound by any unfair terms provisions in the IC Act in deciding the disputes before it.

- **Life Insurance Act**

Section 32 of the *Life Insurance Act 1995* requires a life company, in its investment, administration and management of the assets of a statutory fund, to give priority to the interests of policyholders and prospective policyholders referable to that fund. In addition, section 48 of the *Life Insurance Act 1995* requires a director of a life company to take reasonable care and to use due diligence to ensure that the life company gives priority to the interests of policyholders and prospective policyholders in preference to those of its shareholders, where these are in conflict, and imposes personal liability on directors for loss suffered where a breach of this statutory rule

has occurred.

4. Intermediation in life risk business

Life insurance is commonly issued through intermediaries such as financial advisers, brokers, trustees of superannuation funds and employers in group cover schemes.

Both for reasons of commerciality and, where applicable in compliance with their trustee, fiduciary or other consumer interest obligations, these intermediaries scrutinise contract terms closely and provide a strong commercial deterrent to the use of unfair terms in contracts.

These intermediaries may also be involved in the claims assessment process, providing a further level of consumer protection against the use of harsh and/or unfair terms, or the harsh and/or unfair interpretation and application of terms by insurers.

Most flagship life insurance products offered by major insurers are rated by rating agencies, who analyse policy definitions, benefit designs, exclusions and other aspects of the life insurance contract in great detail in formulating their ratings. Life insurers have a strong commercial incentive to obtain a good rating for their products, as the rating is an important factor to obtaining support and confidence from intermediaries.

The role and importance of all of these groups, whose commercial interests are served by ensuring the best possible consumer experience to the introduction and maintenance of business to life insurers, provide a further valuable means of consumer protection in life risk insurance.

5. Terms in life policies

The assessment and pricing of risk is the very essence of life insurance business. These core activities are intended to maintain the long term sustainability of life insurance companies, in the interests of policy holders and other stakeholders.

This is recognised in the principal object of the *Life Insurance Act 1995* (LIA) which is to:

...protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry (sub-section 3(1)).

The statutory scheme established by the LIA and prudential standards issued in accordance with the Act, regulate the conduct of registered life insurers in order to meet this objective. The scheme provides for registration of life insurance companies, the establishment and management of statutory funds, capital and solvency standards, governance standards, actuarial investigations and risk management requirements. The prudential framework for life insurance recognises that the assessment of risks and the setting of premium rates play a central role in the prudential management of life companies.

In particular, before a life insurance company can issue a life insurance policy, it must receive the advice of its appointed actuary as to the “proposed terms and conditions” of the policy (paragraph 17, *Prudential Standard LPS 320 Actuarial and Other Matters*. Prudential standards are issued by the Australian Prudential

Regulation Authority under s230A of the LIA and have the force of law).

In providing this advice, the appointed actuary undertakes investigations of the financial viability of the proposed policy, to determine whether the risks being undertaken are appropriately priced, taking into account the policy terms, benefit design, targeted demographic group and projected claims experience.

One technique used to allocate risk in policy terms is the use of exclusion clauses or other policy limitations (for example, a term that excludes cover for self-inflicted acts, or a term that the policy expiry date is the insured's 65th birthday).

IFSA is of the view that, although an individual policyholder may feel aggrieved when an exclusion or limitation clause is applied to decline or reduce a claim payment, the existence of such clauses is necessary for the prudent management of insurance risk, in order to protect the financial viability of life insurers in the long term interests of policyholders as a whole.

6. Cost v benefit analysis

IFSA submits that, for the reasons discussed above, the 'status quo' (importantly allowing for the recent amendments to the IC Act and the variation of the FOS Terms of Reference) provides sufficient and appropriate protection for consumers against harsh and/or unfair terms in life risk policies.

Given the existing legal obligations of life insurers and industry practice, we consider that it is very unlikely that extending unfair contract terms legislation to life insurers would have any real effect on the terms of such contracts and therefore provide little, if any, benefit to consumers.

The Australian Consumer Law contains a list of examples of the kinds of terms of a consumer contract that may be unfair. We have considered each in the context of life insurance contracts below.

ACL example	Life insurance contract experience
A term that:	
permits one party only to avoid or limit performance of the contract	The IC Act (as amended) prescribes the circumstances in which a life insurance company can avoid or limit the performance of a life insurance contract.
permits one party only to terminate the contract	New s59A of IC Act will limit the circumstances in which a life company can terminate a life insurance contract.
penalises one party only for breach or termination of the contract	Provisions of this kind are not included in life insurance contracts.
permits one party only to vary the terms of the contract	Industry practice is such that life companies reserve to themselves very limited powers to vary the terms of life insurance contracts - for example to increase premiums in respect of a class of policyholders. Limited powers of amendment are necessary to ensure the continued viability of a life company's business.

permits one party only to renew the contract	Only a policyholder (the consumer) will have the right to renew a life insurance contract.
permits one party only to vary the upfront price of the contract without giving the other party the right to terminate the contract	As for the power to vary the terms of the contract. Also, policyholders will always be able to terminate a life insurance contract.
permits one party to unilaterally vary services supplied under the contract	As for the power to vary the terms of the contract.
limits one party's vicarious liability for its agents	Provisions of this kind are not included in life insurance contracts.
Permits one party to assign the contract to the detriment of the other party without their consent	It is not possible for a life company to assign a policy or its rights under a policy. It would require the policyholder's consent or court approved scheme.
Limits one party's right to sue another party	Provisions of this kind are not included in life insurance contracts.
Limits the evidence that can be adduced in proceedings relating to the contract	Provisions of this kind are not included in life insurance contracts.
Imposes the evidential burden on one party in proceedings relating to the contract	Provisions of this kind are not included in life insurance contracts.

As is evidenced by considering these examples, the introduction of a new legislative regime to supplant the existing measures of protection would not, in IFSA's submission, add any material or meaningful level of protection for consumers.

However the introduction of a new legislative regime would, inevitably, result in increased compliance costs for life insurers. The costs would primarily relate to responding to complaints and defending claims that particular terms of insurance contracts are unfair, irrespective of the fact that a complaint or claim is without merit. It is possible that whenever a claim is denied, the policyholder will, as a matter of course, allege that one or more terms of the insurance contract are unfair. It is also possible that a policyholder (or a beneficiary of a life insurance policy) whose claim is denied because an exclusion applies, will, as a matter of course, claim that the exclusion is unfair. In addition to creating new claims, an allegation that a term of a contract is unfair could be added to every claim against a life insurer for breach of contract, breach of the insurer's duty to inform and misleading and deceptive conduct. There will be the potential for a policyholder to bring multiple claims in multiple forums based on a single complaint. The life insurer will expend money, time and resources in responding to these complaints and in many cases, defending the claims in a tribunal or court.

These costs would, in the ordinary commercial course, be passed on to consumers, who will not have gained any advantage or greater protection for the cost imposed upon them. Where a claim has merit, it is submitted that the current law (together with amendments to the IC Act) provides consumers with more than adequate remedies.

7. Conclusion

The Options Paper puts forward, in effect, 5 options, namely:

- Maintain status quo
- Option A – Permit the unfair contract terms provisions of the ASIC Act to apply to insurance contracts
- Option B – Extend IC Act remedies to include unfair terms provisions
- Option C – Enhance existing IC Act remedies (in particular s 14)
- Option D – Encourage industry self-regulation to better prevent use of unfair terms by insurers

For the reasons discussed above, IFSA submits that the best option to achieve the objective of preventing consumers from suffering detriment due to terms in insurance contracts that are harsh or unfair is, with respect to life risk insurance, to maintain the status quo, allowing for the amendments proposed to the IC Act and recent FOS amendments.

If statutory amendments are deemed necessary, Option C is IFSA's preferred option as it will best enable amendments that can be specifically tailored for issues arising with insurance contracts, and thereby maintain a targeted regulatory regime with minimal costs being passed on to consumers.

If you have any questions concerning this submission, please contact me on (02) 8235 2531, or via email at vmullen@ifsa.com.au.

Yours sincerely

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