

Extending unfair contract terms protections to insurance

AFCA submission

August 2019

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The Australian Financial Complaints Authority¹ (AFCA) is the independent external dispute resolution scheme for the financial sector. We welcome the opportunity to provide comments on the exposure draft of the Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019 released for consultation by the Treasury on 30 July 2019.

Fairness is AFCA's primary focus in complaint resolution. This submission² draws on the experience of AFCA and its predecessors – organisations that have handled financial services complaints, including complaints about insurance, for more than 25 years.

AFCA strongly supports the reforms made in the Bill. However, we believe that the provisions tailoring the existing unfair contract terms regime to insurance could also be further strengthened to ensure consumers who are third party beneficiaries receive adequate protection.

1. Support for reform

AFCA strongly supports the reform to extend unfair contract terms provisions in the ASIC Act³ (UCT Regime) to insurance contracts governed by the Insurance Contracts Act⁴. In our view, the existing exception for insurance is not justified and the UCT Regime should apply consistently across the full range of financial services.

AFCA has experience in dealing with unfair contract terms in the context of insurance policies.

Our operating rules – the [AFCA Rules](#) – require us to decide complaints by doing what is fair in all of the circumstances, having regard to:

- legal principles
- applicable industry codes or guidance
- good industry practice
- previous determinations by AFCA or predecessor schemes.⁵

AFCA has scope to make a decision based on fairness that involves a departure from a strict application of the terms of a contract. Our fairness jurisdiction has allowed us

¹ The Appendix provides a brief overview of AFCA. For comprehensive information about AFCA, see our website www.afca.org.au.

² This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

³ *Australian Securities and Investments Commission Act 2001*.

⁴ *Insurance Contracts Act 1984*.

⁵ See rule A.14.2. The [Operational Guidelines](#) to the AFCA Rules, on pages 82 and 83, explain how AFCA has regard to these factors in decision making. We also provide guidance on how we decide complaints in given situations through other material published on our website including 'AFCA Approach' documents and determinations.

to provide remedies to significant numbers of consumers who would otherwise be bound by unfair contract terms – for example:

- in home insurance, we have found that insurers are unable to rely on policy terms allowing them to cash settle a customer for the cost of completing repairs to their home based on a quotation provided by the insurer’s panel builder when that quotation is not actionable by the customer, who will incur a higher costs
- in trauma insurance, we have found that insurers are unable to rely on outdated policy definitions of medical conditions.

Existing law and industry codes offer limited protection from unfair contract terms. For example, the duty of utmost good faith in the Insurance Contracts Act has rarely been used to prevent reliance on an unfair contract term. While the Life Insurance Code of Practice includes minimum standard medical definitions, these are very limited.

The extension of the UCT Regime to insurance will provide enhanced protection for consumers, which will also assist AFCA in reaching fair outcomes in external dispute resolution. For example, the UCT Regime may help in complaints about travel insurance with very broad exclusions for medical conditions, where the exclusions are not supported by actuarial data. Existing discrimination laws provide important protection in this context, but only in respect of specified protected characteristics. The UCT Regime would apply more widely than these existing laws.

We would expect the extension of the UCT Regime to benefit internal dispute resolution as well as external dispute resolution. Complaints may be resolved earlier and more satisfactorily if the extension of the regime causes insurers, when handling complaints, to focus more strongly on whether terms are fair.

Since its introduction, the UCT Regime has resulted in the review of standard form contracts in many sectors (including small business lending) to identify and remove unfair terms. We expect similar results from the extension of the regime to insurance policies. We hope the extension, combined with the new product design and distribution obligations, will encourage insurers to undertake a fulsome review of their policies and ensure they do not include terms that may be unfair to consumers.

2. Definition of main subject matter of contract

AFCA supports the approach taken in the Bill to define the main subject matter of an insurance contract narrowly, as the terms of the contract that describe what is being insured. We note that the Royal Commission recommended this approach and the Government accepted the recommendation.⁶ We consider a narrow definition is appropriate to give full effect to the UCT Regime.

⁶ Recommendation 4.7.

3. Upfront price

The Bill would not extend the UCT Regime to **all** insurance contracts on which consumers rely. A small business contract with an upfront price of over \$300,000 (or over \$1,000,000 if the contract lasts more than a year) is not covered.⁷ Many group life insurance policies held by superannuation funds for the benefit of their members will cost more than these thresholds and will not be covered.

4. Effect of other laws

Paragraph 12BI(1)(c) of the ASIC Act provides that contract terms which are required, or expressly permitted, by a law of the Commonwealth or a State or Territory will not be subject to the UCT Regime.

It has been suggested that the effect of this clause in the insurance context is that any term which is contained in the 'standard cover' provisions of the Insurance Contracts Regulations would be effectively excluded from the operation of the UCT Regime.

We query whether this is the intended effect of the Bill.

5. Third party beneficiaries

The Insurance Contracts Act recognises that third party beneficiaries of insurance contracts can bring actions in place of the contracting party. Tailoring provisions in the Bill amend the ASIC Act to enable these beneficiaries to also bring actions against insurers under the UCT Regime.

As the Explanatory Memorandum to the Bill highlights in paragraph 1.41, there would be significant limitations on this extension for third party beneficiaries. The party who negotiated the contract, rather than the ultimate consumer who is the third party beneficiary, is taken into account when applying the tests of unfairness in section 12BG of the ASIC Act and the definitions in sections 12BF and 12BK.

As a result, some third party beneficiaries who themselves fall within the definition of consumer or small business in section 12BF would not have the protection of the UCT Regime. Coverage would hinge on the characteristics – including the size - of the policyholder and not the beneficiary. The notes in 5.1 and 5.2 below provide examples of specific situations where this would arise.

In AFCA's view, the present reforms should extend the UCT Regime so that it applies as consistently as possible for the benefit of all insurance consumers. We believe the tailoring provisions in the Bill should be reviewed to ensure third party beneficiaries receive adequate consumer protection, regardless of the structure through which their insurance cover arises.

⁷ ASIC Act section 12BF.

5.1 Life insurance provided through superannuation

Most Australians obtain their life insurance through their superannuation. For superannuation fund members covered by a group life policy, their insurance is, in effect, a standard form contract. It is not safe to assume that a superannuation fund can bargain effectively with an insurer on behalf of their members. Fund members with group insurance may need the protection provided by the UCT Regime.

First, superannuation funds can make mistakes. If a mistake results in an insurance policy having unfair terms then the best way to deal with that is through the UCT Regime, rather than through complex, uncertain and expensive court action against the superannuation trustee.

Second, a superannuation fund might not always discharge its obligations to its members. For example, it might not properly deal with a conflict of interest, and agree to unfair terms in an insurance policy as a result. Again, the best way to deal with that problem is through the UCT Regime, rather than through complex, uncertain and expensive court action against the superannuation trustee.

Even if an action against a superannuation trustee for agreeing to unfair insurance terms does succeed and compensation is paid, that result is not optimal. The superannuation trustee (or its professional indemnity insurer) would have to pay, rather than the group life insurer that gets the benefit of the unfair contract terms.

5.2 General insurance

The table below provides information about three common scenarios involving third party beneficiaries under general insurance contracts.

Category of beneficiaries	Policy holders
Unit owners insured under a residential strata policy	A body corporate holds the policy.
Eligible credit card holders that have complimentary travel cover and no policy is issued to them directly	A credit card provider holds the policy.
Beneficiaries under a group personal accident and sickness policy	An employer or association holds the policy.

In important respects, beneficiaries referred to in the table are in the same position as consumers who purchase insurance directly. For example:

- The policies, or parts of them, are clearly designed to benefit the beneficiaries.
- The beneficiaries often have little say in the terms of the policies.
- The policies are used for personal or domestic purposes.

It may be difficult for consumers to understand and accept their position if the application of the UCT Regime depends on whether they purchased a policy directly or are third party beneficiaries under a policy held by another party.

Appendix – About AFCA

AFCA is the independent external dispute resolution scheme for the financial sector. It replaces the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

AFCA sees its purpose as providing fair, independent and effective solutions for financial complaints. It does this not only by providing complaint resolution services free to consumers, but also by working with its members to improve their processes and drive up industry standards of service, thereby minimising complaints.

More broadly, AFCA will play a key role in restoring trust in the financial services sector.

In addition to providing solutions for financial complaints, AFCA has responsibilities⁸ to identify, resolve and report on systemic issues and to notify ASIC, and other regulators, of serious contraventions of the law.

On 23 April 2018, AFCA was authorised pursuant to the *Corporations Act 2001*. The AFCA Rules, which govern our operations, were approved by ASIC in September 2018. We began to receive complaints under these rules on 1 November 2018.

AFCA's service is offered as an alternative to tribunals and courts to resolve complaints consumers and small businesses have with their financial firms. We consider complaints about:

- credit, finance and loans
- insurance
- banking deposits and payments
- investments and financial advice
- superannuation.

AFCA's role is to assist consumers and small businesses to reach agreements with financial firms about how to resolve their complaints. We are impartial and independent. We do not act for either party to advocate their position.

If a complaint does not resolve between the parties, we will decide an appropriate outcome, including awarding compensation for losses suffered or substituting the trustee's decision in the case of a superannuation complaint. Examples of the outcomes AFCA can provide for non-superannuation complaints are:

- payment of a sum of money
- forgiveness or variation of a debt
- release of security for a debt

⁸ See [ASIC's Regulatory Guide 267](#), *Oversight of the Australian Financial Complaints Authority*.

- repayment, waiver or variation of a fee or other amount paid to, or owing to, the financial firm or to its representative or agent including a variation of the interest rate on a loan
- reinstatement, variation, rectification or setting aside of a contract
- meeting of a claim under an insurance policy by, for example, repairing, reinstating or replacing items of property
- in relation to a default judgment, not enforcing the default judgment
- an apology.