INSURANCE COUNCIL OF AUSTRALIA

17 March 2020

Manager, Consumer Policy Unit
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: uctprotections@treasury.gov.au

Dear Sir/Madam

ENHANCEMENTS TO UNFAIR CONTRACT TERM PROTECTIONS

The Insurance Council of Australia[1] (Insurance Council) appreciates the opportunity to comment on the Treasury Consultation Regulation Impact Statement (RIS) on enhancements to unfair contract term (UCT) protections for small business and whether these should be extended to consumer and insurance contracts.

The Insurance Council recognises that the reforms contemplated as part of the RIS follow the recent extension of UCT protections to insurance contracts under the *Financial Sector Reform (Hayne Royal Commission Response-Protecting Consumers (2019 Measures)) Act 2020* (Protecting Consumers Act 2020).

This submission focuses on issues relevant to Insurance Council members including definition of a small business, flexible remedies, penalties and terms 'required, or expressly permitted' (in the context of whether minimum standards can be challenged as unfair).

Definition of small business and value threshold

Under the Protecting Consumers Act 2020, the UCT regime applies to insurance contracts where at least one party to the contract is a consumer or the contract is with a small business. Small business contracts are defined by subsection 12BF(4) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) as contracts with:

---

[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. December 2019 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of $50.2 billion per annum and has total assets of $129.7 billion. The industry employs approximately 60,000 people and on average pays out about $152.3 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

- businesses employing fewer than 20 persons; **and**
- either the upfront price payable under the contract does not exceed:
  - $300,000; or
  - $1 million if the contract has a duration of more than 12 months.

In previous submissions to Treasury on the appropriate application of UCT protections to insurance contracts, the Insurance Council has argued that the monetary value of the contract is inappropriate for defining the scope of small business UCT protections in general insurance contracts. This is due to the annual premium paid by a small business being unlikely to exceed the stipulated monetary thresholds. By way of example, the annual average gross premium on property insurance for small **and** medium enterprises was $751 as at June 2019.[2]

Another reason why it would be inappropriate to use premiums paid under a contract to determine application of the UCT provisions is that premiums reflect the level of hazard, not the size of business. For example, a high hazard industry/business may have significantly higher premiums than a lower hazard one so this is not a direct indication of the size or sophistication of the business.

Within insurance the first prong of the test (where a business employees fewer than 20 persons) generally determines whether a contract is subject to the UCT regime. There would be many major businesses with less than 20 employees, for example in financial services, with insurance premiums less than $300,000. Additionally, it is not uncommon for standard form contract provisions to be utilised in insurance contracts with larger commercial policyholders with the notable example of marine insurance where provisions are a codification of long-established maritime law.

Given that the small business definition used in the general UCT regime is unsuitable for general insurance, the insurance Council advocates that Treasury consider limiting insurance contracts reviewable under the UCT regime to those policy types which are listed in subsection 761G(5)(b) of the *Corporations Act 2001* (excluding medical indemnity as discussed below at heading 'Application of protections to medical indemnity insurance').

Therefore, small business insurance contracts under subsection 12BF(4) of the ASIC Act would be defined as contracts with:

- businesses employing fewer than 20 persons (100 for manufacturing); **and**
- where the contract is for an insurance policy as listed in subsection 761G(5)(b) of the Corporations Act.

This would have the advantage of harmonising the application of UCT protections to small business insurance with other protections available under the Corporations Act. Another advantage of this approach is that it would exclude stand-alone contracts such as industrial and specialised risk and liability and others that are typically individually price negotiated contract. It is appropriate these types of contracts are excluded since these are purchased by

[2] Insurance Statistics Australia Limited, Data Compendium prepared for ICA, Report as at June 2019

sophisticated buyers of insurance. The typical commodity products as defined in the Corporations Act, both personal and commercial, are typically purchased by small business.

Proposed reforms

The RIS suggests two alternative policy options, either to:

> (a) replace the employee headcount threshold with a turnover threshold of less than $10 million (Option 2, Para 6.4 of the RIS); or
>
> (b) treat contracts as a small business contract if at least one party to the contract is a business that employs less than 100 employees **or** has an annual turnover of less than $10 million (Option 3, Para 6.5 of the RIS).

The Insurance Council considers a turnover threshold is problematic because it reflects the gross cost of service rather the size of a company. For example, $10 million of consultancy work will require a much larger size of company than $10 million for an importing business wholesaling heavy machinery where one item might be worth several million but requires only a small number of employees.

Related parties

The Insurance Council submits that it is impractical to aggregate headcount or annual turnover thresholds for a business and its related bodies corporate to determine whether the UCT regime thresholds apply, where that business is part of a large corporate group (Option 2, Para 6.6.2 of the RIS). This is because that information is fluid and non-transparent.

Legality and penalties

The RIS considers a number of options to provide stronger deterrence, other than voidance of an UCT, for the use of UCTs in standard form contracts. The RIS cites issues experienced in specific sectors where UCTs continued to be used despite court findings that a similar term was unfair. We note that it is difficult to assess the prevalence of UCTs, given whether a term is unfair would depend on the context and the specific circumstances in which it was used. A court may find that a term that is unfair in one set of circumstances is not unfair in another, particularly given the need to consider whether the term was necessary to protect the legitimate interests of the party enforcing the term.

Furthermore, the RIS also acknowledges the success that the ACCC has had in targeting enforcement efforts on sectors of concern. For this reason, the Insurance Council favours Option 2 (strengthened compliance and enforcement activities). In line with the Government's commitment to minimum effective regulation[3], Option 3 (making UCTs illegal) should not be considered unless strengthened compliance and enforcement by the regulators proves to be ineffective.

Flexible remedies

With insurance contracts, the voiding of a term may prevent the insured from being able to bring a claim under the policy. Therefore, the Insurance Council favours the Option that a term declared by a court to be unfair should not be automatically void. The courts should have the power to determine the most appropriate remedy.

---

[3] The Australian Government Guide to Regulation, March 2014, p 2

Option 4 considers amending the law to prevent contract terms that a court has declared 'unfair' from repeatedly being used in similar circumstances. A rebuttal presumption provision would effectively mean that a court could declare a term to be unfair on the basis that the same or substantially similar term has been used by the same entity or in the same industry sector. It is unclear to us how such a provision would interact with the available defence that the term was reasonably necessary to protect the legitimate interests of the party enforcing the contract.

The UCT regime provides that a term is not to be taken as unfair if it is reasonably necessary to protect the legitimate interests of the insurer. As stated in the Explanatory Memorandum for the legislation extending UCT protections to insurance contracts, examples of such terms would be those required for an insurer to obtain reinsurance from a third party or which appropriately reflect the underwriting risk accepted by the insurer. Given these factors would differ between insurers, whether an insurance term is unfair would depend on the facts and circumstances of each individual case. Even for a term which has been found to be unfair for a specific insurance product, the same insurer could reasonably argue that a similar (or same term) is necessary to protect its legitimate interest under another product.

While the Insurance Council understands the desire to explore remedies that reduce the use of UCTs, we would caution against this option being adopted without further consideration to the issues we have raised.

Minimum standards

The Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill (the EM) states that terms required, or expressly permitted, by a law of the Commonwealth or a State or Territory are not covered by the unfair contract terms regime (by virtue of section 12BL of the ASIC Act). The EM states that for insurance contracts, this would include terms defined in the standard cover regime and the definition of 'flood' in regulation 34 of the *Insurance Contracts Regulations 2017*. The Insurance Council strongly supports the ongoing exclusion of terms expressly permitted under law, notably the standard cover regime, under any policy reforms discussed within the RIS.

Application of protections to medical indemnity insurance

The EM states that contracts of medical indemnity insurance are not subject to the unfair contract terms regime. The Insurance Council supports the ongoing exclusion of medical indemnity insurance from the unfair contract terms regime for the reasons outlined in our submission of 28 August 2019. Medical indemnity insurance is subject to separate and specialised regulation under the *Medical Indemnity Act 2002* and other related Acts.

Marine insurance

As noted in the Insurance Council's submission to the Unfair Contract Terms Review, marine insurance is regulated under the *Marine Insurance Act 1909* (MI Act) while other insurance contracts are regulated under the Insurance Contracts Act 1984 (IC Act).[4] Both marine insurance contracts and other insurance contracts are now subject to UCT regime while only marine insurance contracts were subject to the regime before the enactment of the Protecting Consumers Act 2020. Now that all insurance contracts are subject to the UCT

[4] Insurance Council of Australia Submission on Unfair Contract Term Protections for Small Business, 21 December 2018

regime, the Insurance Council advocates for like treatment of all insurance contracts, including marine insurance contracts, under the UCT provisions. Therefore, all of the above policy arguments advanced in relation to the insurance industry apply equally to marine insurance contracts.

Of particular note is the need for ongoing exclusion of terms expressly permitted under law recognising that the MI Act is a codification of marine law that is practised globally and well-understood and accepted by industry participants and the legal and judicial profession.

If you have any questions or comments in relation to our submission please contact Mr John Anning, the Insurance Council's Head of Policy, Regulation Directorate, on telephone: 02 9253 5121 or email: janning@insurancecouncil.com.au

Yours sincerely

Robert Whelan
Executive Director & CEO