Insurance Council of Australia

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Director
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Submitted via email: UCTprotections@treasury.gov.au

To whom it may concern

STRENGTHENING PROTECTIONS AGAINST UNFAIR CONTRACT TERMS

The Insurance Council of Australia (ICA) welcomes the opportunity to comment on the exposure draft legislation *Treasury Laws Amendment Bill 2021: Unfair Contract Terms Reforms.*

The ICA 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 As a foundational component of the Australian economy, the general insurance industry employees approximately 60,000 people, generates gross written premium of $55.9 billion per year and has total assets of $149.7 billion. The industry employs approximately 60,000 people and on average pays out $169.6 million in claims each working day ($42.4 billion per year).

Our submission makes a range of points on a variety of matters included in the exposure draft. The ICA notes that the proposal removes the use of upfront price payable threshold as a metric for determining scope of the contract. As noted in earlier submissions, the ICA supports this change.

Given the potential breadth of the impact, we suggest that deeper consideration of the draft legislation be undertaken before Parliamentary introduction. The ICA further notes that unfair contract terms (UCT) protections have only recently been applied to insurance contracts (from April 2021). We therefore suggest that a reasonable period is needed for the current regime to be bedded down before it is amended (for example, extending the transition period to 18 months). We further suggest that this deeper consideration include market and prudential impacts, and flow-on effects to insurance affordability. The ICA has below noted some initial areas of the proposed changes that may raise such issues. Given ongoing affordability pressures within some insurance lines, these impacts require further analysis.

Definition of Small Business and Monetary Value of Contracts

The ICA understands that the intent of the proposed expansion is to align the definition with AFCA's jurisdiction. The ICA notes its concern that the proposed definition will extend to sophisticated buyers (for example, local subsidiaries of multinational corporations, financial services firms or tech firms) who will effectively become unintended recipients of UCT protections. The proposal exacerbates already-

existing discrepancies within Australian law regarding the definition of small business. We draw Treasury's attention to the following examples:

- The *Australian Securities and Investments Commission Act* s12BC(2): definition of 'small business' in the context of 'consumer' definition (business employs less than 20 employees or, if the business is a manufacturing business, the business employs less than 100 employees);
- The *Corporations Act* s761G(12): definition of 'small businesses' in the context of retail client definition (business employs less than 20 employees, or, if the business is a manufacturing business, the business employs less than 100 employees);[1] and
- The *Australian Small Business and Family Enterprise Ombudsman Act* (the *ASBFEO Act*) s5: definition of small business as less than 100 employees or the business has less than $5 million in revenue in a year.
- The Australian Securities and Investments Commission Amendment (Deferred Sales Model) Regulations 2021: Via regulations, the deferred sales model will not apply to commercial add-on insurance products sold to businesses where the price of the add-on insurance product exceeds $1000. This followed advocacy and data submitted by the ICA which showed median premiums for a range of business insurance products such as general property and machinery sold to small businesses (with less than 20 employees).

The ICA has long advocated harmonising regulatory definitions of small business. Conflicting definitions create confusion for businesses and insurers. Further, current definitions are difficult for insurers to administer as insurers often do not collect those definitional characteristics for many types of insurance (eg. property insurance does not require consideration of employee headcount or turnover). Further, businesses may fall into and out of the category boundary during normal business cycles. As outlined in earlier submissions, our preferred scope is the following:

- *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 (excluding medical indemnity insurance, which is already excluded from the unfair contract terms regime).*

This would have the additional advantage of excluding stand-alone contracts such as industrial, professional indemnity, specialised risk and liability and others that are typically individually price negotiated. In the alternative, the ICA suggests the following options:

- Adopt the definition outlined in the ASBFEO Act (above), which would limit the impact of the definition of small business; or
- Modify the proposed definition of small business to require ***both*** that the business employee fewer than 100 persons ***and*** that it has a turnover of less than $10 million (noting that the policy rationale for separating these two limbs is unclear).

[1] This definition is also consistent with the definition of small business in the General Insurance Code of Practice

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Additional Remedies Available to the Court

Injunctive Remedies

A court currently has the power to make injunctions to prevent an insurer from applying, relying on or purporting to rely on a contractual provision that has been declared an UCT. The proposed amendments would extend this injunctive power to prevent insurers from including such terms in future contracts. This would mean that any future contract would have to comply irrespective of any future business need.

Insurers tailor products to meet a particular market demand, in line with their own risk appetites. One way of tailoring products is to exclude identified risks. If a risk cannot accurately be priced, then including that risk within the insurance contract may prohibitively raise the cost of the contract. The ability to injunct exclusion clauses raises questions of both insurance affordability and prudential impacts.

A practical example is combustible cladding exclusions in building insurance. Combustible cladding related fires at Grenfell Tower in London and the Lacrosse Building in Melbourne highlighted previously understated risks. While such events can have potentially catastrophic impacts, the full extent of exposure has not been clear. Insurers have therefore used exclusions to tailor their exposure which, in turn, incentivised building owners to conduct remediation works. It is possible to envisage a scenario where prior to those events, a court may have determined that such exclusion terms were unfair. Under the proposed amendments, insurers can be injuncted from using similar exclusion terms in future contracts. The inability to use exclusion clauses of that nature would force insurers to price in those risks (prohibitively raising the cost of insurance) or withdraw from that market.

There are also flow-on implications for prudential standing. Insurers are required to maintain capital adequacy, in accordance with guidelines issued by the Australian Prudential Regulation Authority.[2] As a simplified statement, capital adequacy requirements for general insurance require consideration of the risk profile of the insurer's portfolio. Significant changes to portfolio risk profile may impact capital adequacy requirements.

The ICA suggests that, before issuing an injunctive remedy, the court should be required to consider whether a legitimate business need for relying on the term may arise in future. Further, there should be a clearly defined process to allow insurers to challenge such injunctions. An alternative solution is that the court isn't provided the power to issue injunctions.

The Rebuttable Presumption

The ICA further seeks clarification around the scope of the rebuttable presumption. The Explanatory Memorandum (EM) notes that the rebuttable presumption would cover terms that are "subsequently included in relevant contracts in similar circumstances".[3] However, Part 3 of the Draft Bill and later parts of the EM contemplate a different scope. For example, the EM and proposed legislation refers to other standard form contracts within "the same industry".[4] This is an arguably wider scope, and raises the question of which "industry" is the point of reference – the insurance industry or the industry of the insured?

If the relevant industry is considered to be the insurance industry, then the rebuttable presumption could be interpreted as applying to all relevant insurance contracts irrespective of legitimate differences. For

[2] https://www.apra.gov.au/industries/2/standards
[3] Paragraph 1.12
[4] Explanatory Memorandum, Paragraph 1.41; Proposed Legislation s12BG(5)(d)(ii)

example, a term deemed to be unfair in a retail insurance contract could apply to a professional indemnity insurance contract. The ICA does not believe that this is the intended outcome and suggests that this be clarified. Greater clarity would also provide entities with more certainty in correctly identifying UCTs that must be changed. The ICA also notes that insurers require greater certainty in this definition to meet breach reporting obligations, given that relying on or proposing to rely on a substantially similar clause would be deemed a reportable breach.

The ICA also notes that our understanding is that the rebuttable presumption will apply to past reliance. We therefore request further clarification regarding the usage of the wording "subsequently" (above).

Other Practical Considerations

There are other practical considerations that may require further clarification. These include:

- **Standing:** In many instances a contractual term under consideration by a Court will be based on shared wording across the industry. Accordingly, multiple insurers may have an interest in the outcome of the case. This raises the question as to standing and the ability for non-parties to make submissions. While noting that such matters are typically dealt with in Court rules, the ICA requests further consideration of whether additional clarity is needed. For example, whether to grant all potentially impacted insurers automatic standing in proceedings.

- **Exemptions:** Further clarity is needed regarding the exemption of terms "that are read into a contract by the operation of a law of the Commonwealth, a State or Territory". The ICA queries whether this would extend to non-statutory legal requirements. For example, many insurance terms are aligned with legally recognised self-regulatory regimes such as Law Society Rules. The ICA suggests further clarity in the proposed legislation, or additional clarifying examples be inserted in the Explanatory Memoranda.

- **Effect of a Court Order:** Should a court have the power to make orders to void, vary or refuse to enforce part or all of a contract, clarity is needed as to how such contracts should be dealt with (e.g. amendment, removal from market, remediation), the timeframe available to address these issues and how this would interact with the proposed penalty regime. Further, as renewals are sent six or more weeks in advance, insurers may be put in an unavoidable breach in that instance. The ICA suggests that entities be given a reasonable opportunity to review their documentation and remediate terms where necessary. This is particularly important for larger insurers, who may have hundreds of documents or complicated distribution channels to review.

- **Effect of a Court Order During Appeals:** The ICA notes that the status of terms during the appeals process may need additional clarification, with respect to breach reporting obligations. The ICA suggests that the requirement to not rely or propose to rely on those terms (including any related breach reporting obligations or application of penalties) should not be triggered during the appeal process.

- **Rebuttable Presumption and Pecuniary Penalties:** The ICA notes it is unusual to have a rebuttable presumption in a case where the respondent is facing a civil penalty. The ICA further notes that additional clarity may be needed around some aspects of the rebuttable presumption. For example,

  whether the civil penalty applies for each version of the standard contract. If there is a breach in one standard-form contract, there may need to be clarity around whether the civil penalty apply for every affected customer.

- **Other Prudential Issues:** The proposed amendments allow an application for remedies to be made up to six years after a term has been declared an UCT. The resulting uncertainty in the intermediate period has prudential ramifications for larger insurers with high turnovers and similar wording across potentially

hundreds of products. This uncertainty is compounded by the high potential penalties (up to 10% of turnover for each unfair contract term) and may mean that these matters would need to remain provisioned on the balance sheet in case orders were made in future.

- **Co-Insurance:** Further clarity on remediation orders is needed where a co-insurance arrangement has been used, that is where one insurer or group of insurers participations in a proportion of the risk under the lead insurer's wording. For example, the lead insurer may be held wholly responsible for the wording and associated remedies as they own the wording (and therefore have proposed the potentially unfair term in question).
- **Reinsurance:** The ICA notes that terms in insurance contracts are often required for the purposes of reinsurance. The potential of a Court to make orders affecting reinsurance availability, or to make orders varying the terms of a class of contracts in a way that results in a reinsurance gap, will have potentially significant ramifications for insurers and will raise prudential issues.
- **Impacts Across Classes of Contracts:** The ICA notes a potential unintended consequence where a court remedy in relation to an UCT within one class of contracts (e.g. home insurance) could potentially apply to similar terms within contracts of a different class (e.g. motor vehicle insurance). The ICA suggests that the proposal be clarified to ensure that this does not occur.

Definition and Scope of Standard-Form Contracts

The unfair contracts regime sets out matters that a court must take into account in determining whether a contract is a standard form contract, including repeat use of a standard form contract and effective opportunity to negotiate. With respect to the effective opportunity to negotiate, the draft legislation proposes to introduce the following changes:

- *The court is also to disregard that a party to another similar contract has been given an effective opportunity to negotiate the terms of that contract. This clarifies that even if a small subset of consumers or small businesses are able to negotiate the terms of a contract that is issued to a broader group of consumers or small businesses, the court is not to take this into consideration when determining whether the contact issued to the broader group is a standard form contract.*[5]

The proposed change imposes a much higher standard than has previously been considered. It would move the regime closer to the situation where a court would look at whether actual negotiation had occurred, rather than whether there had been opportunity to negotiate.

Next Steps

We thank Treasury for the opportunity to provide input and trust that our submission has been of assistance. If you have any questions in relation to our submission, please contract Aparna Reddy, ICA General Manager, Policy – Regulatory Affairs, on 02 9253 5176 or areddy@insurancecouncil.com.au.

Yours sincerely

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[5] Explanatory Memorandum, Paragraph 1.53

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