



FINANCIAL
SERVICES
COUNCIL

FSC Submission

**TREASURY CONSULTATION:
Extending Unfair Contract Terms
legislation to insurance contracts**

28 August 2019



About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies.

Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses. The financial services industry is responsible for investing almost \$3 trillion on behalf of more than 14.8 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

FSC Feedback

Introduction

On 30 July 2019, Treasury released an Exposure Draft of the *Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019 (Exposure Draft)* for consultation. The Draft Bill proposes to amend the *Insurance Contracts Act 1984 (Cth) (Insurance Contracts Act)* to enable the Unfair Contract Terms laws to apply to contracts of insurance.

The FSC supports extending the Unfair Contract Terms legislation to insurance contracts, provided the three amendments described below are made to the Exposure Draft to reduce uncertainty for life insurers and avoid unintended consumer detriment.

Our primary concern is that, without the three amendments below, life insurance companies are likely to need to increase premiums for new policyholders in the short term as a contingency against potential premium increase restrictions, and for all policyholders in respect of unexpected claims costs in the future. It is also possible that some types of cover may no longer be made available, reducing consumer choice.

The three amendments are important to protect the interests of consumers in other ways too. Life insurance contracts are not currently renewable and are long-term in nature, with no medical or other assessments other than at the outset of the policy. This is an important characteristic to protect because it allows Australians to keep their life insurance cover for as long as they need it, without having to apply for a replacement policy each year (when their health or circumstances may have changes and, as a consequence, they may no longer be insurable or insurable at an affordable price).

In requesting the three amendments below, the FSC notes that life insurance is already subject to extensive consumer protections in the Insurance Contracts Act, unlike other financial products. One important protection is that, whilst policyholders can cancel their long-term life insurance policy at any time, the life insurance company cannot without due cause (such as where the policyholder makes a fraudulent claim).

These three amendments go to the heart of maintaining the sustainability of life insurance, as noted by APRA in its submission to Round 6 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) in response to Question 29, reproduced in the Appendix below.

1. Premium review clauses for long-term contracts

Section 9A(5) of the *Life Insurance Act 1995* (Cth) (**Life Insurance Act**) specifically contemplates premium rate increases for continuous disability policies, provided that the increase applies at a cohort level, and not to individual policyholders. However, the wording of section 9A(5) means that it may not come within the exception to the application of the Unfair Contract Terms laws for “a term required, or expressly permitted, by a law of the Commonwealth, a State or a Territory.”

Premium rates are determined by reference to all the people in the risk pool, and not to any one individual. Pricing falls within the valuation of policy liabilities of the life insurance company. APRA applies standards for the valuation methodology and rules regarding actuarial accountability for the methodology, valuation and reporting.

The FSC believes that life insurance pricing should therefore be a matter for the regulator, and not be open to challenge by any one individual in the risk pool under the Unfair Contract Terms legislation.

The extremely long-term nature of life insurance contracts mean that the “price” of a life insurance contract should be immune from challenge, rather than just the “upfront price”, noting that a life insurance contract can last for 50 years or more.

The FSC notes that the Explanatory Memorandum to the Draft Bill at paragraph 1.23 suggests that premium reviews might not be unfair. However, the wording provides no more safe harbour than the legislation itself due to the inclusion of the reference to the Court and the word “if” in the section “... would not be considered unfair **if** that term was used to protect the legitimate interests of the insurer ...”.

This approach would be consistent with the European Union and New Zealand models and the broader policy objectives of the Unfair Contract Terms legislation which is not to regulate the price of goods and services.

We therefore propose that the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) be amended to provide a safe harbour for the price of life insurance policies, in line with section 9A(5) of the Life Insurance Act such that price changes are permitted if they are made on a “simultaneous and consistent” basis across all contracts of the same kind.

This consistency with the Life Insurance Act can be achieved in one of the following two ways:

- A. The following could be added at the end of Item 3 in Schedule 1 of the Exposure Draft, to expand section 12BI(1) of the ASIC Act:

...; or

(e) if the contract is a life policy within the meaning of the *Life Insurance Act 1995* (Cth) – is a term that:

- (i) adjusts the premium applicable to the life policy; or
- (ii) allows the insurer to adjust the premium applicable to the life policy, provided that the terms of all contracts of the same kind as the life policy only permit such alterations if they are made on a simultaneous and consistent basis.

B. At the end of section 12BG of the ASIC Act, add:

(5) For the purposes of paragraph (1)(b), a term of a contract will be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term if the contract is a life policy within the meaning of the *Life Insurance Act 1995* (Cth), and the term:

- (i) adjusts the premium applicable to the life policy; or
- (ii) allows the insurer to adjust the premium applicable to the life policy, provided that the terms of all contracts of the same kind as the life policy only permit such alterations if they are made on a simultaneous and consistent basis.

2. Main subject matter

The FSC's position is that the definition of the main subject matter should be extended beyond the description of what is covered (for life insurance, this is the person who is insured – essentially their identity). It should additionally include terms that define what the person is insured for under the contract. This would include:

- The amount they are insured for.
- The terms that determine when the policy does and does not pay out, such as the definition of disability in a disability insurance policy, any waiting period, and any individually agreed exclusions resulting from the underwriting process.

Terms such as these concern the basis for the existence of the contract and are material to determining the premium payable across a portfolio of policies, and in relation to a specific policy. They therefore need to be immune from challenge. Indeed, the continuing policy would make no sense if terms such as the definition of disability in a disability insurance policy or the amount of cover were struck out if found to be unfair. In these cases, the life insurance contract would offer no protection to the policyholders.

The terms we propose should be included in the main subject matter are required to be provided to each customer before they start their insurance. Of course, customers would continue to be able to challenge whether or not those terms are satisfied in an individual claim, for example, based on the available medical and other evidence; just not that the term itself is “unfair”.

As an alternative, the main subject matter could be left undefined so that it is left as a matter for the Court. This would bring life insurance contracts into line with all other types of contracts and create a level playing field.

3. Jurisdiction

The FSC notes that paragraph 1.23 of the Explanatory Memorandum states that matters of fairness would be decided by the Court. FSC strongly supports this but suggest that the Explanatory Memorandum goes further to state that such matters should **only** be determined by a Court.

Apart from individually agreed exclusions, by definition, all other terms in a standard form contract apply to all the customers who hold the contract. A finding of unfairness would therefore be likely to set a precedent for all other customers. Such matters of fairness are therefore always systemic, and would affect every customer in the portfolio, as opposed to individual customers depending on their circumstances.

We therefore agree that such matters should **only** be determined by a Court, and should be outside the scope of dispute resolution bodies whose role is to resolve individual disputes for customers in specific circumstances.

We would like to meet with Treasury to discuss this submission. In the meantime, please contact me on 0432 670 178 or at nkirwan@fsc.org.au.

Yours faithfully,

Nick Kirwan
Senior Policy Manager, Life Insurance

Appendix – APRA’s response to Question 29 in its submission to round 6 of the Royal Commission

Question 29: Is there any reason why unfair contract terms protections should not be applied to insurance contracts in the manner proposed in “Extending Unfair Contract Terms Protections to Insurance Contracts”, published by the Australian Government in June 2018?

APRA’s response

Questions 5, 6 and 29 raise issues around the design of insurance products and the setting of terms and conditions.

APRA notes that:

- setting terms and conditions (such as definitions) is one lever available to an insurer to manage its business. Constraints on that ability can involve prudential trade-offs, and can also be expected to increase reliance by insurers on other levers, such as pricing; and
- while insurers operate in an environment of pervasive uncertainty, they need sufficient certainty to be able to price insurance accurately, assess appropriate levels of reserves and capital and access reinsurance capacity.

Regarding question 29, APRA agrees that the terms of insurance contracts should be fair to consumers and supports the extension of an appropriately designed unfair contract terms regime to insurance contracts. In designing the detail of the regime, it will be important to minimise the amount of uncertainty created, particularly around the key terms and conditions that underpin the pricing of the policy.