

1 April 2020

Manager, Consumer Policy Unit
The Treasury
Langton Crescent
Parkes ACT 2600

By email: uctprotections@treasury.gov.au

Dear Manager

Enhancements to Unfair Contract Term Protections

The Financial Services Council¹ (**FSC**) welcomes the opportunity to comment on Treasury's Consultation Paper² in relation to enhancements to the unfair contract terms (**UCT**) protections for small businesses, consumers and insurance contracts. We acknowledge and broadly support Treasury's intention to have the UCT regime apply across the whole economy consistently.

Importantly, the implementation of the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures)) Bill 2019 will mean that from 5 April 2021 the current UCT protections will be extended to insurance contracts. We have previously made two submissions³ to Treasury during the consultation process in support of this legislation.

Our submission focuses on the enhancements of unfair contract term protections in the context of life insurance contracts. We note that life insurance is also subject to extensive consumer protections in the Insurance Contracts Act, and unlike other financial products is a long-term contract for which the life insurer is required to provide cover over a long period, potentially decades. One important protection is that, whilst policyholders can cancel their long-term life insurance policy at any time, the life insurance company can only do so in exceptional circumstances (such as where the policyholder makes a fraudulent claim or for

¹The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, 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 \$3 trillion on behalf of more than 15.6 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.

² See <https://consult.treasury.gov.au/consumer-and-corporations-policy-division/enhancements-to-unfair-contract-term-protections/consultation/download>

³ See <https://www.fsc.org.au/resources/1845-fsc-submission-extending-unfair-contract-terms-legislation-to-insurance-contracts/file>, <https://www.fsc.org.au/resources/1000-070928-fsc-response-to-treasury-uct-consultation-final/file>

non-payment of premium). This is unique to life insurance and different from other financial products.

Our detailed comments in response to Treasury's Consultation Paper are attached in the Appendix.

We would be happy to discuss this submission further. I may be contacted on nkirwan@fsc.org.au or +61 (2) 9299 3022.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nick Kirwan', with a large, sweeping flourish extending to the right.

Nick Kirwan
Senior Policy Manager, Life Insurance

ATTACHMENT: DETAILED FSC COMMENTS

LEGALITY AND PENALTIES

In the Consultation Paper, Treasury has proposed three options to strengthen the legality and penalty framework of the current UCT regime. These are:

- *Option 2 - strengthened compliance and enforcement activities*
- *Option 3 - making UCTs illegal and attaching penalties*
- *Option 4 - strengthened powers for regulators*

The FSC does not support *Option 3* or *Option 4*.

- *Option 3* – Proposal to apply the current civil penalty regime in the Corporations Act and the ASIC Act to the UCT regime, which will allow a court to use 10% of annual turnover as a limit on a penalty (with a maximum penalty exceeding half a billion dollars - \$525 million). In our view, a civil penalty regime which is a penal sanction of the state, is not appropriate for unfair contract term obligations which involves judgement and subjectivity as to whether a term is reasonably necessary to protect the legitimate interests of the insurer. In any event, the civil penalties proposed are not commensurate to the subject matter of the contravention. Prior period turnover bears little or no relationship to the conduct involved in contravening the UCT regime. This may result in a very large amount which may not correlate in any way to the seriousness of the offence or the actual benefit obtained and is therefore inappropriate. We further note that APRA would be likely to have prudential concerns if a large penalty based on annual turnover were to be imposed on a prudentially regulated entity.
- *Option 4* – Decisions to issue infringement notices and make decisions of UCT enter into a highly complex area of law for insurance contracts. In our view, these must be assessed by a court, particularly for life insurance contracts. In our view, the application of infringement notices is inconsistent with the *AGD Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers* – see page 58 which states:

“The efficacy of an infringement notice scheme depends on the reliability of the assessments made by the enforcement officers as to whether an offence has occurred. To ensure accuracy, these assessments should be based on straightforward and objective criteria rather than complex legal distinctions.”

In our view, infringement notices or determinations are suitable for relatively minor offences of the strict or absolute liability type (which the UCT provisions are not), and where a high volume of contraventions may be expected and/or it is easy, and objectively incontrovertible to assess guilt/innocence (see the AGD Guide above). We note that infringement notices issued by ASIC are not provable in court and ASIC may issue an infringement notice if ASIC believes (in its view) on reasonable grounds that a term is an unfair contract term. In an insurance context, the UCT regime is not appropriate for ASIC issued infringement notices as complex actuarial and pricing, and detailed factual and legal analysis (by a court) is required to assess whether a term is fair or unfair in light of the UCT legislation. Given the complexity and potential for subjective analysis in UCT cases, we believe these should be assessed by a court and therefore the infringement notice regime is not appropriate for unfair contract terms.

FLEXIBLE REMEDIES

In the Consultation Paper, Treasury has proposed three options in relation to seeking flexible remedies where there is determined to be an unfair contract term. These are:

- *Option 2 - UCTs not automatically void*
- *Option 3 - align remedies for non-party small businesses*
- *Option 4 - UCTs used in similar circumstances*

The FSC supports *Option 2* and does not support *Option 4*.

- *Option 2* – In our view, UCTs should not be declared automatically void and that the court should have other remedies available for the court to determine the appropriate remedy. For insurance contracts, the remedy of automatic voidance of a term is not always an ideal outcome from a customer perspective, as it may mean that a customer has paid all their premiums and then cannot rely on the contract if it is automatically voided because of a UCT.
- *Option 4* – We have significant concerns that this Option presents serious prudential implications for life insurance companies. From the life company's perspective, voidance of a term would have implications for the product design and ongoing sustainability of entire cohorts of in-force policies (refer to APRA's submission to the Royal Commission in response to Question 29, reproduced in the Appendix below).

We also do not support the rebuttable presumption. The Consultation Paper states:

*"This option involves amending the current law to prevent contract terms that a court has declared 'unfair' from repeatedly being used in similar small business contracts. This would involve creating a **rebuttable presumption provision** where a contract term would be declared unfair if, in a separate case, the same or a substantially similar term has been used by the same entity or in the same industry sector and declared by a court to be unfair."*

There are several features of the current UCT regime that would result in dissonance with using a rebuttable presumption to determine whether a term is "unfair":

- The degree of "transparency", which the ASIC Act defines as being expressed in "reasonably plain language", legible, presented clearly and "readily available" to affected parties. Creating a rebuttal presumption would ignore other relevant information under the principle of "transparency" such as disclosure activities during the marketing, underwriting and point of sale.
- Whether the term in the contract was considered "reasonably necessary to protect the legitimate interests" of the issuing party. This will depend on the particular set of circumstances of the case.

As part of its contemplation of Option 4, we recommend Government reviews and takes into account comparable jurisdictions (for example, New Zealand or the United Kingdom). Such a comparison should consider whether a rebuttal presumption exists in those jurisdictions, and if so, the experience and impacts of such a feature.

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.