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Your Ref:

Quote in reply: Competition and Consumer Law Committee: 21000857/5

17 February 2012

Manager
Financial Services Unit
The Treasury
Langton Crescent
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By email [redacted]

Dear Manager

UNFAIR TERMS IN INSURANCE CONTRACTS

The Queensland Law Society, assisted by its Competition and Consumer Law Committee, make submissions to the Honourable Parliamentary Secretary to the Treasurer, Mr David Bradbury MHR. Thank you for the opportunity to make submissions to you in relation to the consultation draft RIS, unfair terms in insurance contracts.

The issue

The problem is stated in paragraph 2.1 in the following terms:

> *The problem sought to be addressed is the current imbalance between protections offered under the existing regulation of insurance contracts and that which currently applies to other financial products and services, which may result in actual or potential disadvantage or loss to consumers due to insurance contracts containing terms that are harsh and/or unfair.*

The summary of the existing regulation and protections available begins in paragraph 2.10 and groups the current rules into three bands: those relating to pre-contractual disclosure, to the doctrine/principle of utmost good faith, and those rules relating to reliance on specific terms.

"Standard cover" rules – section 35 of the *Insurance Contracts Act 1984*

One of the key laws in the area of pre-contractual disclosure is the "standard cover" rules, which apply to certain classes of insurance contracts, most notably home buildings insurance and home contents insurance. These rules stipulate the standard cover provided under those policies, including the causes of loss that are covered. The example given in paragraph 2.15 is that the standard cover in home contents insurance includes loss caused by "storm, tempest, flood…"

Under section 35(2) of the *Insurance Contracts Act 1984* ("IC Act"), an insurer may deviate from these standard terms, only if the insurer can prove that before the contract was entered into:

(a) the insurer clearly informed the insured in writing, or
(b) that the insured knew, or
(c) a reasonable person in the circumstances could be expected to have known of the limitation or exclusion.

This is significant because the onus is placed on the insurer, not the insured, to prove that the deviation from standard conditions was acceptable in the circumstances. If the insurer does not satisfy the reverse onus, then the exclusion or limitation does not apply. By placing the onus of proof on the insurer, this would appear to provide better protection for an insured than to place the onus on the insured to prove that the term of the contract was unfair.

What does it mean to "clearly inform"?

The consultation draft RIS in paragraphs 2.18 – 2.20 discusses how courts have interpreted the requirement for an insurer to "clearly inform" the insured that the standard cover is limited or excluded. It is accepted practice, following judicial interpretation, that the providing of a policy document to an insured containing exclusions and limitations meets the required standard to "clearly inform", provided it is not overly complex or confusing.

Paragraph 2.20 notes that "a large proportion" of insureds do not actually read policy documents provided, and so are not informed about the limitations or exclusions. This note appears to imply that the government should act to protect those who have so little regard for their rights that they do not bother to read important terms on major assets. We do not agree with this implication.

The approach of the law has been to assume the position of a reasonable person. That is consistent with the third leg of permitted exclusions from the standard terms of cover which is an obligation imposed on the insurer to prove that a reasonable person in the circumstances could be expected to have known of the limitation or exclusion.

The suggestion that we should approach the matter by reference to a lesser standard is, we think, unfair to the insurer. Whilst it is necessary to provide appropriate protection for those who take out insurance products, it is reasonable to expect that the persons taking those products will act with reasonable competence. That is not to say that insurance policies should deal with exclusions or limitations in language that is not clear. Indeed to do so runs the risk for the insurer that it will not satisfy the exclusion or limitation requirements. We support that position as being fair and balanced.

The provisions relating to the standard cover rules were enacted following the advice of the Australian Law Reform Commission, with the express intention "to improve the flow of information from the insurer to the insured so that the insured can make an informed choice." Making regulatory and statutory changes to protect policyholders who fail to take reasonable steps to inform themselves of what is contained in an insurance policy seems to greatly exceed the aims of the legislation, to the detriment of the insurers.

Interaction with the *Corporations Act 2001*

Further, as noted in paragraph 2.24, the current pre-contractual disclosure obligations under the IC Act synchronise with provisions under the *Corporations Act 2001* ("Corporations Act") that require insurers to provide clients with a PDS. These provisions require a PDS to include information required under section 35 of the IC Act, and section 1013C(3) of the Corporations Act requires information included in a PDS to be "worded and presented in a clear, concise and effective manner". These provisions strengthen the requirements of the IC Act to "clearly inform" the insured of any limitations or exclusions.

Specific terms under the IC Act

Other provisions in the IC Act are also aimed at limiting the ability of insurers to act to the detriment of another party. Section 53 prevents the insurer from amending the terms of a policy if such a change would disadvantage anyone other than itself, and section 54 limits the situations in which an insurer may rely on a clause requiring an insured to do, or not to do, some act. These sections may also be relied on by policyholders to challenge these specific types of unfair terms. There are clearly a number of protections against unfair contract terms already available in legislation.

Interaction with *the Australian Securities and Investments Act 2001*

As considered in paragraphs 2.45 – 2.46 the protections against unfair contract terms found in the *Australian Securities and Investments Act 2001* ("ASIC Act") may also be used to challenge the validity of contracts. However, it is not clear how a court may choose to apply them. For example, under section 12BG(1)(a) a term is considered unfair if it would cause a significant imbalance in the parties' rights and obligations arising under the contract. However, there is some difficulty in seeing how this may be applied for insurance contracts because it may be said, for example, that if any party is denied cover under a householder's insurance policy, that party's rights may have a significant imbalance under the contract.

Conclusion

We acknowledge that there is a divergence of views amongst consumer advocates and insurance representatives about whether the current law effectively deals with the issue of the possibility of unfair terms in insurance contracts. The committee accepts that such is the case and indeed different members of the committee have different views on the preferred course of conduct.

This divergence of views centres on the common practice, as discussed in paragraphs 2.41 – 2.44, that parties rarely read and understand the full policy document, before agreeing to the terms. This failure to read and understand the terms is at the heart of almost every dispute between insurers and policyholders. We do not believe that insurers be put in a higher position than they now are as a result of law reform referred to in this submission.

Preferred option

The committee's view is the preferred option E or, if the government believes that is insufficient, option B. To have industry self-regulate is to be preferred.

Having industry set a bar for self-regulation which meets government expectations is to be preferred against a "big brother" approach. It enables responsible members of the insurance industry to promote

standards that fairly meet government expectations.

The history of the development of appropriate standards of insurers and insureds is an evolutionary one. The Queensland Law Society urges the Government to proceed towards a satisfactory outcome in consultation with industry.

If industry fails to self-regulate within a satisfactory standard within a period of, say five years, the Queensland Law Society recommends the option B approach.

Thank you for the opportunity to provide comments on the draft regulation impact statement.

If you have any queries regarding the contents of this letter, please do not hesitate to contact our Policy Solicitor, Louise Pennisi on [redacted] or [redacted]

Yours faithfully

[redacted]

Dr John de Groot
President