

## INDUSTRY NEWS

# Extending Unfair Contract Terms to Life Insurance Contracts

The unfair contract terms reforms were introduced into Federal Parliament last week under the *Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures)) Bill 2019* (the Bill). Schedule 1 to the Bill gives effect to recommendation 4.7 of the Financial Services Royal Commission to extend the existing protections under the *Australian Securities and Investment Commission Act 2001* (ASIC Act) to insurance contracts governed by the *Insurance Contracts Act 1984* (ICA).

The extension of the UCT regime to life insurance contracts has been anticipated for some time. The key issue for the insurance industry has always been how the regime will apply to insurance contracts, which are a different form of contract to the typical contracts to which the UCT regime applies.

The key takeaways from the Bill<sup>1</sup> are summarised below.

### Proposed Commencement Date

5 April 2021. The UCT regime will then apply to insurance contracts made or varied after 5 April 2021 (but only to the extent of the variation).

### UCT regime under ASIC Act to apply

The draft Bill proposes to amend the ICA to enable the UCT regime under the ASIC Act to apply to insurance contracts covered by the ICA. In other words, the central elements of the existing UCT regime under the ASIC Act will apply to insurance contracts where:

- at least one party to the contract is a consumer (as defined in subsection 12BF(3) of the ASIC Act) or a small business (as defined in subsection 12BF(4) of the ASIC Act); and
- the contract is a standard form contract (as defined in section 12BK of the ASIC Act).

### What types of life policies will fall under the UCT regime?

A standard form contract is essentially a contract that sets out its terms on a “take it or leave it basis” such that the consumer cannot negotiate its terms. The Explanatory Memorandum (EM) to the Bill makes it clear that an insurance contract will be a standard form contract even if a consumer can choose between several options such as levels of cover provided the consumer does not have the ability to negotiate the underlying terms and conditions.

As such, the UCT regime under the Bill would generally apply to retail life contracts and direct life contracts.

The Bill will also amend the ASIC Act to allow for third party beneficiaries of insurance contracts to bring actions against insurers under the UCT regime.

However, the EM to the Bill has outlined that group insurance contracts with superannuation trustees should be exempt from the UCT regime given they are negotiated contracts and owned by a superannuation trustee i.e. these types of group contracts should not meet the threshold requirements of at least one party being a consumer or small business as well as not being a standard form contract.

### Main subject matter exemption

A term which defines the “main subject matter” is exempt from the UCT regime.

The most contentious issue for the industry has been whether the UCT regime would recognise that it is in the nature of insurance that the subject matter includes terms which establish the scope of what is covered, when it is covered and the extent of coverage.

As it stands, the Bill has defined “main subject matter” narrowly as the description of what is being insured i.e. the person insured under a life policy and the sum insured. The net effect is that all terms in retail contracts will essentially be subject to the UCT regime including the insured event definitions (such as TPD, total disability) if the Bill passes in its current form.

### Meaning of unfair

A term is unfair if:

- It causes a significant imbalance to the parties rights; **and**
- it is not reasonably necessary to protect legitimate interest; **and**
- it would cause detriment.

In determining whether a term is unfair based on the above factors, a Court may take into account such matters as it thinks relevant, but must take into account the transparency of the term and the contract as a whole.

The likelihood is that the main factor in determining if a term is unfair for a life insurance contract will be whether or not the term is “reasonably necessary to protect a legitimate interest.” The EM to the draft Bill has provided some examples of terms of a life policy that may be considered “unfair” as well as limited commentary on factors relevant to an assessment of what is reasonably necessary to protect an insurer’s legitimate interest such as if the term reflects the underwriting risk or is required to obtain reinsurance.

### What happens if a term is deemed unfair?

A term will be void if it is deemed “unfair”. However, this may be problematic in circumstances where the term challenged is a term which defines the insured event, such as a TPD definition. In such circumstances, declaring the term “unfair” may not provide a consumer with the remedy they seek of being paid a TPD benefit.

### Duty of Good Faith

The duty of good faith will continue to operate independently of the UCT regime, despite the potential for overlap.

### Implications

A narrow “main subject matter” definition means nearly all terms of a retail and direct insurance contract will be subject to the UCT regime.

Whilst the EM to the Bill provides some more guidance about the type of term in a life insurance contract which may be “unfair”, there remains limited overall guidance as to the types of terms that can be considered as “reasonably necessary to protect” an insurer’s legitimate interest.

Unfortunately, as such, life insurers may face periods of uncertainty from 5 April 2021 if the Bill passes in its current form regarding the extent of risk it is taking on as various exclusions, limits and restrictions could be tested against the UCT regime. It would be helpful for all if there was more certainty about the practical operation of the unfairness test in the context of insurance contracts before the Bill is passed.

<sup>1</sup>The Bill essentially reflects the exposure draft legislation released on 30 July 2019 by the Government in the Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019.