

# UNFAIR CONTRACT TERMS LAWS TO BE EXTENDED TO INSURANCE CONTRACTS

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Legal Briefings - By **Philip Hopley and Sky Kim**

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On 30 July 2019, the Government released exposure draft legislation in the Treasury Laws Amendment (Unfair Terms in Insurance Contracts) Bill 2019 for consultation.

The draft legislation extends the protections that are currently available under the existing Unfair Contract Terms (**UCT**) regime to insurance contracts and, in doing so, tailors the application of the UCT regime to accommodate specific features of insurance contracts.

Consultation on the exposure draft Bill is open until **28 August 2019**. The exposure draft Bill is available [here](#) and the explanatory memorandum is available [here](#). Following this consultation, a final Bill will be introduced into Parliament and it is proposed that the new law will apply to all new issues and renewals of insurance contracts after an 18 month transition period.

## KEY IMPLICATIONS

- The government is moving quickly to introduce the UCT regime for insurance contracts and set a hard date for the industry to work towards for the review and rationalisation of existing policy terms and conditions.
- Attention is likely to be on policy exclusions and limitations where an insured cannot otherwise rely on section 54 Insurance Contracts Act (**ICA**) to avoid or limit their application.
- Lack of detailed legislative guidance on what constitutes unfairness will be of concern as minds may differ in the assessment of whether a term will be reasonably necessary to

protect the legitimate interests of an insurer.

- The experience of the banking sector in dealing with the UCT regime and broader issues, such as the role of community expectations, are likely to be helpful in guiding insurers.

## EXISTING UCT LEGISLATION

The UCT regime currently applies to most financial products and financial services through the *Australian Securities and Investments Commission Act 2001 (ASIC Act)*. The effect of the legislation is that a term in a consumer or small business contract which is unfair is void. A term is unfair where:

- it causes a significant imbalance in the parties' contractual rights and obligations;
- the term is not reasonably necessary to protect the legitimate interests of the advantaged party; and
- the term would cause it detriment if it were to be relied on.<sup>1</sup>

The current UCT regime does not apply to insurance contracts, as section 15 of the ICA expressly provides that a contract of insurance is not capable of being made the subject of relief under any other Act, a State Act, or an Act or Ordinance of a Territory. The rationale for this exclusion has been that insurance contracts are a special category of contracts that have their own protections, such as the duty of utmost good faith under the ICA and insurance contracts have special characteristics which make them unsuitable for protections under the UCT regime.<sup>2</sup>

## EXTENSION OF THE UCT REGIME

The extension of the UCT regime to insurance contracts has been considered and supported by a number of inquiries, including the 2017 Senate Economics References Committee's inquiry into the general insurance industry, the 2017 Australian Consumer Law Review, and the 2018 Parliamentary Joint Committee on Corporations and the Financial Services' inquiry into the life insurance industry. The rationale for the extension of the UCT regime to insurance contracts included the following:

- Symmetrical nature of good faith duty is incompatible with the highly asymmetrical nature of the relationship between an individual or small business dealing with large,

powerful life insurance companies.<sup>3</sup>

- The duty of utmost good faith connotes fair dealing and community standards of fairness, but it is generally seen as being restricted to operating within the four corners of the contractual bargain, and the UCT regime offers the prospect of re-writing the contractual bargain.
- There are a number of terms prevalent in the insurance industry which are potentially problematic and unfair. These include:
  - terms that allow a claim to be denied on the basis of a blanket mental health exclusions in travel insurance;
  - terms that prevent an insured from making a disability claim if they were not diagnosed with the disability prior to leaving work with respect to consumer credit insurance; and
  - total permanent disability provisions that offset policy benefits against those paid under other policies held.

In June 2018, the Government issued a Proposal Paper which outlined a proposed model for the extension of the UCT regime to insurance contracts and sought stakeholder views. On 4 February 2019, the Government confirmed that it would extend the UCT regime to insurance contracts in response to Recommendation 4.7 of the Royal Commission Final Report which endorsed the move to introduce the UCT regime to insurance contracts.

## **PROPOSED LEGISLATION**

A summary of the key terms in the new exposure draft Bill are as follows:

- The UCT regime will apply to standard form insurance contracts issued to consumers and small businesses to which ICA currently applies. A policy will be treated as being standard form even where it provides options for levels of premium, excess and sum insured.
- Terms that describe the insured risk (such as a house, a car or a person) will be excluded

from the UCT regime, as will terms that define the upfront price of the contract and the excess or deductible amounts (provided these are transparently disclosed).

- Third party beneficiaries will enjoy the right to bring a direct claim under the UCT regime, consistently with their existing rights to make a direct claim against an insurer under Part V of the ICA.

The existing statutory duty of utmost good faith is not impacted by the proposed legislation and will continue to apply to insurance contracts.

## WHAT HAS CHANGED SINCE THE PROPOSED MODEL LAW IN 2018?

Notably, a number of proposals in the proposed model law from June 2018 have since been omitted or amended. A summary of the key changes are as follows:

Proposed model law	Current exposure draft Bill
The proposed model previously sought to introduce a new standard for determining whether an insurance contract is unfair which referred to whether a term reasonably reflects the underwriting risk accepted by the insurer. Some stakeholders expressed concern in relation to this proposal during the 2018 consultation, as the meaning behind “reasonably reflects the underwriting risk” was unclear.	The draft Bill does not introduce a new tailored definition of unfairness to insurance contracts and the current approach to unfairness in the ASIC Act will continue to apply.
The proposed model sought to include examples specific to insurance to the list of examples of kinds of terms that may be unfair. Stakeholders in the 2018 consultation generally opposed the inclusion of specific examples on the basis that the legislation needs to be principles based.	The draft Bill does not seek to add any specific examples with respect to insurance contracts to the list of examples of kinds of terms that may be unfair.
The proposed model previously sought to include an alternative remedy where a term is found to be unfair other than the term being declared void, as to allow the court to make other orders if it deems that more appropriate.	The draft Bill does not refer to any alternative remedies with respect to an unfair term.

## NEXT STEPS

This streamlined version of the original proposed model law enables the government to move quickly to introduce the UCT regime for insurance contracts and sets a hard date for the insurance industry to work towards for the review and rationalisation work of existing policy terms and conditions.

A focus of attention is likely to be on policy exclusions and limitations where an insured cannot otherwise rely on section 54 ICA to avoid or limit their application. However, the lack of any detailed legislative guidance of what constitutes unfairness will be of concern to the industry, as minds may differ in the assessment of whether a term will be reasonably necessary to protect the legitimate interests of an insurer.

In dealing with this, the experience of the banking sector in dealing with the UCT regime will be relevant. Insurers may also want to take into account the broader expectations on them in the post-Royal Commission environment where notions of community expectations are now generally accepted as forming part of their operational and risk landscape.

## ENDNOTES

1. Section 12BG of the *Australian Securities and Investments Commission Act 2001* sets out the meaning of 'unfair' and the matters a court may take into account in determining whether a term is unfair, and section 12BH of the *Australian Securities and Investments Commission Act 2001* provides examples of unfair terms.
2. Australian Government (2017), *Australian Consumer Law Review*, Final Report, page 52.
3. Parliamentary Joint Committee on Corporations and Financial Services (2018), *Life Insurance Industry*, page 47.

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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