

21 December 2018

Manager
Unfair Contract Terms Review
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

REVIEW OF UNFAIR CONTRACT TERM (UCT) PROTECTIONS FOR SMALL BUSINESS

The Insurance Council of Australia¹ (Insurance Council) appreciates the opportunity to comment on Treasury's discussion paper *Review of Unfair Contract Term Protections for Small Business*. The Insurance Council supports the objectives underpinning the extension of UCT protections to small business, namely that:

“Small businesses, in dealing with other businesses through standard form contracts, should have confidence that the contract they are offered is fair and reasonable and that the risks are allocated efficiently” (Explanatory Memorandum to the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015*).

Under s12BF(4) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), small businesses entering into contracts for the supply of goods and services to general insurers enjoy UCT protections where:

- at least one party employs fewer than 20 persons; and
- either of the following is met:
 - the upfront price payable does not exceed \$300,000; or
 - if the contract has a duration of more than 12 months, the upfront price payable is less than \$1,000,000.

However, the headcount approach to defining a small business is impractical given that such information is fluid and non-transparent. The definition of small business as a business of

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. September 2018 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$47.2 billion per annum and has total assets of \$121.2 billion. The industry employs approximately 60,000 people and on average pays out about \$124.8 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

less than 20 employees is difficult to verify, and contributes substantially to compliance costs. The Insurance Council therefore proposes that the Government reconsider coupling an appropriately set transaction threshold with an exclusion of publicly listed companies to eliminate businesses that are obviously not small businesses.

In addition, as you would be aware, insurance contracts subject to the *Insurance Contracts Act 1984* (the IC Act) are currently not subject to review for UCT. However, in view of the Government's decision to remove this exemption, the Insurance Council submits that two matters need to be addressed in order for the UCT regime to work effectively.

Firstly, the Insurance Council proposes that there needs to be an appropriate approach to small business general insurance contracts which recognises that the monetary value of the contract provides little indication of the demarcation between a small and large business. Secondly, when UCT protections are extended to most general insurance contracts, there will be two approaches to dealing with insurance contracts since marine insurance contracts are subject to the current UCT regime. Consequently, the Insurance Council advocates that marine insurance contracts should be brought within the same UCT regime applicable to other insurance contracts. Consistency of regulation could be achieved without any loss of consumer protection.

Small Business Threshold

Contracts supplying goods and services to general insurers

The headcount approach to defining a small business currently employed in the ASIC Act is impractical given that such information is fluid and non-transparent. The experience of our members is that the definition of small business as a business of less than 20 employees is difficult to verify, and contributes substantially to compliance costs given the large number of small business suppliers they contract with.

The Insurance Council had previously suggested that an appropriately set transaction threshold should be coupled with an exclusion of publicly listed companies to eliminate businesses that are obviously not small businesses. We suggest that reconsideration is given to this aspect of the small business definition.

General Insurance contracts

The Insurance Council submits that the monetary value of the contract should not be used in defining the scope of small business UCT protections in general insurance contracts. As noted in the Explanatory Memorandum to the *Financial Services Reform Bill 2001*:

“General insurance is treated differently from other financial products for two reasons. First, it is difficult to identify a meaningful monetary limit for insurance, as either the premium or sum insured could be used. Secondly, if the premium were relied upon, few (if any) policies would exceed the product-value test outlined below, with the result that all purchasers of general insurance policies would be retail clients.” (2.28)

This is supported by data from our members which indicates that the average annual premium for a small business customer is \$2,500.

Further, under the monetary value of the contract approach, identically sized small businesses may fall into or out of the UCT regime simply because of their risk profile. A high

hazard small business which would have a higher premium compared to a lower hazard small business of the same size would have different UCT outcomes.

Preferred solution: s761G Corporations Act 2001 – Retail Client Approach

There are strong arguments that standard form contracts reviewable for UCT should be limited to those that can be sold to a retail client under s761G of the *Corporations Act 2001*, namely:

- Motor vehicle insurance products;
- Home building insurance products;
- Home contents insurance products;
- Sickness and accident insurance products;
- Consumer credit insurance products;
- Travel insurance products;
- Personal or domestic property insurance products; and
- Kinds of general insurance products prescribed by regulations made for the purposes of s761G(5)(b).

This approach, which builds upon the regulatory regime in the IC Act, would obviate the need to distinguish between small and large business contracts on the basis of premiums. It would also avoid the introduction of yet another small business definition that is potentially inconsistent with the existing definitions in tax, privacy, and statistical collection legislation.

Further, the retail client approach would promote consistency across the various regulatory regimes, including the recently introduced *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018*, and reflects the intention that:

“consumer protection provisions will apply only to retail clients, as it is recognised that wholesale clients do not require the same level of protection, as they are better informed and better able to assess the risks involved in financial transactions.”
Explanatory Memorandum to the *Financial Services Reform Bill 2001* (2.27)

This addresses the rationale for extending UCT protections to small businesses that:

“Small businesses, like consumers, are vulnerable to unfair terms in standard form contracts as they are often offered contracts on a ‘take it or leave it’ basis and lack the resources to understand and negotiate contract terms.” Explanatory Memorandum to the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015* (1.2)

A potential concern with the retail client approach is that there is uncertainty over whether some types of insurance such as add-on insurance sold through motor-dealerships, warranty insurance and gap insurance, are within the scope of s761G. It is not our intention to exclude these policies from UCT protections and we suggest that this could be addressed through regulations made under s761G(5)(b)(viii) in the case of doubt.

Under regulation 7.1.17A of the Corporations Regulations 2001, the definition of a retail general insurance product extends to medical indemnity insurance. However, this occurred in a particular context following reforms to stabilise the medical indemnity insurance market. All other professional indemnity products, including those provided to other healthcare practitioners such as dentists and optometrists, are not defined similarly as retail products. As such, and consistent with its exemption from the product disclosure provisions under regulation 7.9.95 of the *Corporations Act 2001*, medical indemnity insurance contracts should not be caught as a standard form contract.

Alternative solution: Matters that AFCA can hear

An alternative approach which also doesn't depend on an inappropriate monetary ceiling, would be to limit the insurance contracts reviewable for UCT to those within the product category jurisdiction of the Australian Financial Complaints Authority (AFCA). This approach, like the retail client approach, has the merit of offering protection to parties that are vulnerable to unfair terms in standard form contracts. Additionally, it offers a potentially broader scope of UCT protections than the retail client approach outlined above.

In particular, under the AFCA rules (sC.1.4), AFCA must exclude a complaint about a general insurance policy other than a:

- (i) Retail General Insurance Policy;
- (ii) Residential Strata Title Insurance Product;
- (iii) Small Business Insurance Product;
- (iv) Medical Indemnity Insurance Product; or
- (v) Title Insurance Policy.

The AFCA rules and operational guidelines specify retail general insurance policies by reference to s761G(5)(b) of the *Corporations Act 2001*, and list small business insurance products as:

- Computer and electronic breakdown;
- Fire or accidental damage;
- Glass;
- General Property;
- Loss of profits/business interruption;
- Machinery breakdowns;
- Land transit;
- Money; and
- Theft

Under the AFCA rules, a small business insurance product also includes general insurance policies between a small business and a general insurance broker. However, as highlighted in our submission of 30 November 2018, where contracts are sold through a broker, they should not be dealt with as a "standard form" contract. This would reflect the intent of the

UCT regime which applies to contracts where one of the parties has lacked the bargaining power to negotiate or change the terms of the contract when agreeing to it.

Consistent with the reasons outlined under the retail client approach, medical indemnity insurance should also be excluded from review for unfair terms under this approach.

Exemptions and regulatory inconsistency

As a result of s9(d) of the IC Act, marine insurance is currently subject to the UCT regime in the *ASIC Act* and treated differently from other insurance contracts. However, given that the Government has committed to extending UCT protections to general insurance contracts, we suggest that marine insurance should be subject to the same UCT model that applies to general insurance contracts. This would allow small business parties to marine insurance contracts to continue to challenge contractual terms for unfairness, consistent with the intention in the *ASIC Act* while avoiding duplication (clause 1.30 Explanatory Memorandum to the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015*).

Furthermore, this approach would avoid regulatory inconsistency across insurance classes and its associated consequences. For example, many marine policies cover mixed risks, part of which are subject to the IC Act (e.g. inland movements, marine liabilities), and part of which are subject to the *Marine Insurance Act*. The legal complications and uncertainty around these contracts would be alleviated if the mixed risks are subject to the same UCT regime.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely



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