



OUT19/11356

The Manager
Financial System Division, Markets Group
Treasury
By email: InsuranceConsultations@treasury.gov.au

Dear Sir or Madam

Re: Extending the protection from unfair contract terms to insurance contracts

The New South Wales Small Business Commission ('NSWSBC') is focused on supporting and improving the operating environment for small businesses throughout NSW. The NSWSBC advocates on behalf of small businesses, provides mediation and dispute resolution services, speaks up for small business within government, and makes it easier to do business through policy harmonisation and reform.

We thank Treasury for affording stakeholders the opportunity to comment on the proposed extension of the unfair contract terms ('UCT') regime to insurance contracts. Ensuring small businesses are able to access insurance on fair terms is a matter of the utmost importance to the Commission. Too many small operators fall foul of unfair provisions in policies they had relied on, but had no capacity to negotiate. Protections afforded to small business under the *Insurance Contracts Act 1984* (Cth) and the *Corporations Act 2001* (Cth) do not deter insurers to prescribe and enforce terms that are unfair to small businesses.

Our engagement suggests that these issues are of particular concern to small businesses affected by natural disasters. The Commission is proud to have been at the forefront of NSW Government initiatives to support businesses struck by disaster. In 2017, we provided ongoing assistance to small businesses in the Northern Rivers affected by Cyclone Debbie. We supported operators to lodge insurance claims and apply for Australian Government Disaster Recovery Payments, and lodged 84 disputes to the Financial Ombudsman Service for review.¹ Ultimately, a substantial number of businesses received payouts, despite refusal by their insurer in the first instance. During the recovery process, we also reached out to over 20 insurance companies, to raise issues regarding the timely assessment and fair processing of claims following Cyclone Debbie.

We provided similar support to Tathra and Bega Valley businesses devastated by the 2018 bushfires. Earlier this year, we also lent a hand across state lines - assisting the Queensland Small Business Champion's response to the tragic Townsville flood. Our team worked with the local business community to assist with their recovery, focusing again on issues concerning insurance given its importance to successful recovery.

The Commission therefore welcomes the proposed extension of the UCT regime to insurance contracts in Recommendation 4.7 of the report to the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* ('the Royal Commission')² – as well as earlier finding of similar effect.³ We commend the Commonwealth for its commitment to implement Recommendation 4.7.⁴

We are pleased to offer the following commentary and recommendations in support of the extension of the UCT regime – and, ultimately, to advance a fairer insurance landscape for small businesses forced into positions of acute vulnerability.

Preferred reform option

The NSW SBC strongly supports the extension of the UCT regime in the manner detailed in Option 3 of the draft Regulation Impact Statement ('RIS'). Unfair contract terms protections in the *Australian Securities and Investments Commission Act 2001* (Cth) must be applied to insurance contracts regulated by the *Insurance Contracts Act*. Plainly, such reform goes to the heart of Recommendation 4.7.⁵

Likewise, it is imperative that this extension of UCT regulations prescribes a narrow definition of terms which describe the 'main subject matter' of a policy, and are thus excluded from the regime. That is, this definition should be limited to terms that describe what is being insured – with other terms thus subjected to UCT regulations. Such a definition is both consistent with the preference expressed by Commissioner Hayne⁶ and, we suggest, congruent with the lay understanding of 'main subject matter' in this context.

We also support the position, advanced in the draft RIS, that the extended UCT regime should allow third party beneficiaries to take action under its provisions.⁷ This is a necessary practical measure – particularly given that some insurance contracts provide that the small business that sought coverage is a third party beneficiary at law.⁸

Furthermore, it is appropriate that ASIC be afforded the power to enforce UCT regulations in relation to insurance contracts.⁹ The overwhelming majority of resource-strained small businesses are unlikely to have the capacity to pursue a legal determination in their own right. In addition, the regulator is already afforded a general capacity to litigate on behalf of small businesses and consumers.¹⁰

These reforms are necessary not only to address the serious issues detailed in the Royal Commission, and by earlier inquiries. We submit that the extension of the UCT regime to insurance will also increase small business confidence in the industry. The initiative should induce underinsured or uninsured small businesses to purchase coverage - with operators satisfied that they can obtain a product providing a genuine safeguard against risk. As McKinsey has identified, reforms of this type could generate a significant new market for insurers:

*"Nearly three-quarters of small business owners are dissatisfied with, or are not loyal to their insurance provider...This suggests there could be significant rewards for insurers who are able to better meet the needs of small business owners."*¹¹

So as to provide consistency with the general UCT regime, we support the amendment of the definition of the 'upfront price payable' in the *Insurance Contracts Act* to include excesses and deductibles, when disclosed transparently.¹²

The Commission acknowledges that extending UCT protections may increase risk for insurers - as policyholders and the regulator will be in a much stronger position to challenge terms of standard policies. In turn, this may influence policy design - with new risk passed on to small businesses through increased premiums or reduced coverage. However, we suggest that the benefit of legitimately fair coverage for small businesses comfortably outweighs any such detriments. If small businesses are presently afforded lower premiums only by virtue of unfair and therefore inadequate coverage, this represents a pyrrhic victory at most.

Recommendation 1: The Commonwealth should extend unfair contract terms regulation to insurance contracts in the manner outlined in Option 3 of the draft Regulation Impact Statement.

Implementation period

The draft RIS does not provide, or even suggest, evidence of considerations that would justify the proposed delay of 18 months between assent of the relevant Act and its implementation.¹³ It is unclear why such an abnormally long delay to implementation should be warranted – particularly given the current and pressing need for reform in this space outlined in both the report to the Royal Commission¹⁴ and elsewhere.¹⁵ Indeed, Commissioner Hayne does not support an implementation period beyond 12 months – the report suggesting that any greater delay is likely to be ‘unreasonable’.¹⁶

In addition, it cannot be credibly suggested that insurers have not anticipated an extension of the UCT regime to their industry. Six major reports, dating back more than eleven years, have recommended reforms to this effect.¹⁷ The proposed measure is also consistent with a range of recent initiatives to extend the protections afforded by UCT regulations¹⁸ - and with equivalent international regulations.¹⁹ In light of this protracted and well-publicised path to change, the industry should have already planned for the proposed extension of the UCT regime.²⁰

Thirdly, legislation implementing UCT regulations to date has not imposed any implementation period greater than 12 months. The *Trade Practices Amendment (Australian Consumer Law) Act (No. 1) 2010* (Cth), prescribing the unfair contracts terms regime for consumer contracts, was assented to on 14 April 2010.²¹ Its provisions commenced no later than 1 July 2010²² - a transition period of less than seven weeks. Furthermore, the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth), extending unfair contract provisions to small business contracts, was implemented within 12 months of assent.²³

For these reasons, we submit that a delay of no more than 12 months between assent of the relevant Act and implementation of its provisions is appropriate. Consideration should be given to the form of these transitional arrangements, to ensure that UCT provisions apply to all new, renewed and varied standard form contracts by the end of this transition period.

Recommendation 2: The Act extending the unfair contract terms regulation to insurance contracts should provide that its provisions commence operation no more than 12 months from the date of assent.

Further reform

In addition to extending UCT regulations to insurance, the NSW SBC strongly supports the Commonwealth’s ongoing review of the effectiveness of the wider regime protecting small business against unfair terms.²⁴ The Commission has a longstanding interest in strengthening the unfair contract term protections for small businesses. We have participated in major inquiries concerning or touching on UCT laws including: the consultation on extending unfair contract term protections to small businesses (2014);²⁵ the Parliamentary Inquiry into the operation and effectiveness of the Franchising Code of Conduct (2018);²⁶ and the review of unfair contract term protections for small business (2018).²⁷

Most particularly, we continue to advocate reforms that would make unfair contract terms illegal, and allow for regulators to impose infringement notices and seek civil penalties against organisations that impose them on small businesses and consumers. Such measures are crucial to improve deterrence – particularly given the vast practical barriers faced by any small businesses or consumer seeking to enforce UCT provisions in their own right. In our submission, ACCC Chair Rod Sims aptly and succinctly conveyed these deficiencies in his address to the Council of Small Business Organisations Australia’s 2018 National Small Business Summit:

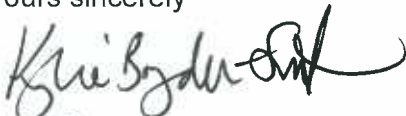
*"The [law] currently allows a potentially unfair contract term to be challenged in a court so it can be declared void, but it does not prohibit such a term being included in a contract in the first place...The regime has two significant flaws: first, unfair contract terms are not illegal, and second the ACCC cannot seek penalties when the court has declared an unfair contract term void, nor can we issue infringement notices for contract terms that are likely to be unfair. The law simply isn't strong enough. Unfair contract terms should be illegal. As it stands, no real incentive exists for businesses to ensure their standard contracts do not contain such terms, which really means they have incentive to include them and see if they can get away with it."*²⁸

Equally, we support the Commonwealth's instruction to the House of Representatives Standing Committee on Economics to examine progress made by financial institutions in implementing recommendations of the Royal Commission.²⁹ With the culture of financial institutions as much a concern of the Royal Commission as the adequacy of regulation,³⁰ it is imperative that insurers themselves heed the call for change alongside government.

Next steps

The Commission would welcome further engagement with the Commonwealth on both the extension of the unfair contract terms regime to insurance, and additional measures to protect small business from the imposition of unfair terms. To discuss any issues raised in this submission, please contact Cathy Suryasumirat, Advisor, Advocacy and Strategic Projects, on (02) 8650 6119 or Cathy.Suryasumirat@smallbusiness.nsw.gov.au.

Yours sincerely



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- ¹ Financial Ombudsman Service (2018), 'Annual Review 2017-18', p. 49; <https://www.fos.org.au/public/file/FOSAnnualreview2017-18.pdf>
- ² Australian Government (2019), 'Restoring trust in Australia's financial system, The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', p. 25; <https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf>
- ³ Draft Regulation Impact Statement, pp. 5-6
- ⁴ Australian Government (2019), 'Restoring trust in Australia's financial system, The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', p. 25; <https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf>
- ⁵ Hayne, K.M. (2019), 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report', p. 308; <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>
- ⁶ Hayne, K.M. (2019), 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report', pp. 306-307; <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>
- ⁷ Draft Regulation Impact Statement, pp. 7-8
- ⁸ Financial Ombudsman Service (2012), 'Notifying third party beneficiaries of derogations from prescribed terms of insurance contracts', <https://www.fos.org.au/the-circular-10-home/the-fos-approach/notifying-third-party-beneficiaries-of-derogations-from-prescribed-terms-of-insurance-contracts/>
- ⁹ Draft Regulation Impact Statement, p. 9
- ¹⁰ Australian Securities and Investments Commission Act 2001 (Cth), s12A; Australian Securities and Investments Commission (2017), 'ASIC Small Business Strategy 2017-2020', p. 2; <https://download.asic.gov.au/media/4422503/asic-small-business-strategy-online-2017-2020.pdf>
- ¹¹ McKinsey & Company (2017), 'SME Insurance in Australia – A market ripe for change', p. 2; <https://www.mckinsey.com/~media/McKinsey/Industries/Financial%20Services/Our%20Insights/SME%20Insurance%20in%20Australia%20a%20market%20ripe%20for%20change/SME-insurance-in-Australia-A-market-ripe-for-change.ashx>
- ¹² Draft Regulation Impact Statement, p. 7
- ¹³ Draft Regulation Impact Statement, p. 13
- ¹⁴ Hayne, K.M. (2019), 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report', pp. 303-308; <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>
- ¹⁵ Draft Regulation Impact Statement, pp. 5-6
- ¹⁶ Hayne, K.M. (2019), 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report', P. 307; <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>
- ¹⁷ Draft Regulation Impact Statement, pp. 5-6
- ¹⁸ Commonwealth Treasury (2016), 'Extending unfair contract terms protections to small businesses'; <https://treasury.gov.au/consultation/extending-unfair-contract-term-protections-to-small-businesses-2>; Robert, S.R. (2019) 'Further strengthening the unfair contract term protections for small businesses', Australian Government; <http://ministers.treasury.gov.au/ministers/stuart-robert-2018/media-releases/further-strengthening-unfair-contract-term-protections>
- ¹⁹ Commonwealth Treasury (2018), 'Extending unfair contract terms protections to insurance contracts – Proposals paper', p. 2; https://treasury.gov.au/sites/default/files/2019-03/t284394_UCT_Insurance_Contracts_Proposals_Paper_Aug.pdf
- ²⁰ Consumer Action Law Centre (2018), 'Submission to Treasury's consultation on extending unfair contract terms protections to insurance contracts', p. 4; https://treasury.gov.au/sites/default/files/2019-03/Consumer-Action-Law-Centre_0.pdf
- ²¹ Trade Practices Amendment (Australian Consumer Law) Act (No. 1) 2010 (Cth), s2
- ²² Ibid., s2
- ²³ Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (Cth), s2
- ²⁴ Robert, S.R. (2019) 'Further strengthening the unfair contract term protections for small businesses', Australian Government; <http://ministers.treasury.gov.au/ministers/stuart-robert-2018/media-releases/further-strengthening-unfair-contract-term-protections>
- ²⁵ Office of the NSW Small Business Commissioner (2014), 'Submission – Extending Unfair Contract Term Protections to Small Businesses'; https://treasury.gov.au/sites/default/files/2019-03/C2014-025_NSW-Small-Business-Commissioner.pdf
- ²⁶ Office of the NSW Small Business Commissioner (2018), 'Supplementary information to the Inquiry into the operation and effectiveness of the Franchising Code of Conduct'; <https://www.aph.gov.au/DocumentStore.ashx?id=13f7f684-649a-40e1-987d-6316b08a5c1b>
- ²⁷ Office of the NSW Small Business Commissioner (2018), 'Submission – Review of Unfair Contract Terms Protections for Small Business'; https://consult.treasury.gov.au/market-and-competition-policy-division-internal/c2018-t342379/consultation/view_respondent?uuld=845296682
- ²⁸ Sims, R. (2018), 'Major changes needed to get rid of unfair contract terms – COSBOA National Business Summit', Australian Competition & Consumer Commission; <https://www.accc.gov.au/speech/major-changes-needed-to-get-rid-of-unfair-contract-terms>

²⁹ Frydenberg, J. (2019), '*Standing Economics Committee to expand inquiry into financial services sector and Royal Commission implementation*', Australian Government; <http://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/086-2019>

³⁰ Hayne, K.M. (2019), '*Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report*', pp. 15-16; <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>