Insurance Contracts Amendment Bill

The Insurance Contracts Amendment Bill (the Bill) re-introduces the measures contained in the Insurance Contracts Amendment Bill 2010 (the 2010 Bill) with some minor refinements.

The 2010 Bill arose out of recommendations made in the review of *Insurance Contracts Act 1984* "Review of the Insurance Contracts Act 1984 (CTH)" (the Review) undertaken by Mr Alan Cameron and Ms Nancy Milne in 2004. The measures contained in the 2010 Bill gave effect to a number of the recommendations made in the Review.

On 17 February 2012, Treasury held a roundtable with key stakeholders to discuss the potential re-introduction of the measures in the 2010 Bill. As a result of the roundtable discussion and after further targeted consultation some minor refinements have been made to the 2010 Bill measures.

The minor refinements that have been made to overcome issues identified in respect to measures contained in the 2010 Bill. These refinements include:

- the insertion of an additional factor to which the court should give consideration in respect to the duty of disclosure;
- improving the structure of the measures relating to remedies available to life insurers in respect to both traditional and non-traditional life insurance contracts; and
- extending the timing of the application of the duty of disclosure measures.

In addition to these refinements, the drafting approach taken in respect to bundled contracts in section 27A has been changed to be in keeping with the approach taken in respect to bundled contracts more generally.

The re-introduction of the measures in the 2010 Bill with the minor refinements, takes into account market developments and judicial interpretations since the enactment of the *Insurance Contracts Act 1984* (ICA).

To facilitate informed comment on the Bill a discussion on the measures in the 2010 to which refinements have been made and the new approach for the unbundling of life insurance contracts, is provided in the following paragraphs.

Insured's duty of disclosure

Recommendation 4.1 in the Review provided that, section 21 of the ICA should be amended to include non-exclusive factors that can be taken into account when determining the application of the duty of disclosure test. In practical terms the recommendation involved amending the mixed objective/subjective test that applied in relation to the insured's duty of disclosure to include a list of non-exhaustive factors to help in the section's interpretation.

In 2007 exposure draft legislation giving effect to number of recommendations in the Review was released for public consultation. The draft amendments to section 21 of the ICA included three factors (consistent with the proposed factors outlined in the Review) to which the court should give consideration, these included:

- the nature and extent of cover provided by the contract of insurance;

- the class of persons who would ordinarily be expected to apply for cover of that type; and

- the circumstances in which the contract of insurance is entered into including the nature and extent of any questions asked by the insurer.

As a result of consultation with consumer representatives and industry on the 2007 exposure draft legislation, two of the three factors contained were removed during the development of the 2010 Bill. As a result of the removal of the two factors only the nature and extent of cover provided by the contract of insurance was considered appropriate for inclusion.

After extensive consultation and further consideration both the class of persons who would ordinarily be expected to apply for cover of that type and the nature and extent of cover provided by the contract of insurance will be inserted to the subjective/objective test in section 21 of the ICA. The inclusion of these two factors is considered to provide appropriate outcomes for consumers and insurers alike.

Remedies of the insurer: Life insurance contracts

Recommendation 7.3 in the Review provided that all contracts of life insurance (including parts of a contract of life insurance) excepting those that cover mortality or contain a surrender value, should be subject to section 28 of the ICA, subject to any necessary modifications.

The Review made this recommendation on the basis that while the operation of section 29 of the ICA was in keeping with the outcomes suggested by the Australian Law Reform Committee in 1983, in some situations its application was no longer in alignment with current practices.

- The Review was of the view that the remedies section 29, continued to be appropriate for traditional life insurance contracts such as those contracts that have a surrender value but was no longer appropriate for other non–traditional types of life insurance contracts such as income protection insurance contracts.

Life insurance products include products that offer both traditional and non-traditional life cover. Traditional life products may be seen to be products that have a surrender value or provide insurance cover in respect of a life insured. Non-traditional insurance contracts may be seen to be life products that are more in keeping with general insurance products such as income protection and Total and Permanent Disability (TPD) policies.

Section 29 of the ICA currently provides remedies for life insurers when an insured makes a misrepresentation or fails to comply with their disclosure requirements. Subsection 29(2) provides that an insurer can avoid an insurance contract at any time if the failure to comply with the duty of disclosure was fraudulent or the misrepresentation was made fraudulently.

Subsection 29(3) provides that where a misrepresentation or breach of the duty of disclosure is discovered within three years of a contract being entered into and an insurer would not have been prepared to enter into a contract of life insurance with the insured on any terms the insurer is entitled to avoid the contract. However, if an insurer discovers that an insured made a misrepresentation or breached the duty of disclosure any time after three years of the contract being entered into, the insurer is provided with no remedy in respect to that misrepresentation or breach unless the misrepresentation or breach of the duty of disclosure was fraudulent.

Subsection 29(4) provides that an insurer may vary a contract of insurance by substituting for the sum insured an amount as worked out under the formula SP/Q[1] if they provide notice in writing to the insured before the expiration of three years after the contract was entered into.

In order to give effect to Recommendation 7.3 of the review, the 2010 Bill inserted a narrow definition of a contract of life insurance that restricted the operation of section 29 of the ICA to traditional life insurance contracts. As non-traditional life insurance contracts did not fall within the new definition, they were as a result, subject to the remedies in section 28 of the ICA.

After extensive consultation and further consideration, an alternative approach has been taken in respect of Recommendation 7.3. Under the new approach all life insurance contracts (both traditional and non-traditional) will continue to be subject to the remedies provided in section 29 of the ICA. However, some minor refinements have been made to provide insurers with more flexibility in respect to the remedies for misrepresentation and breaches of the duty of disclosure.

The new section 29 of the ICA will provide that a life insurer cannot avoid a life insurance contract after three years (consistent with the current law). However, an insurer can at any time vary a life insurance contract in accordance with the formula (as contained in the current subsection 29(4)) SP/Q.

In addition, if the insurer does not avoid the contract in the first three years under subsection 29(3) or vary the contract in accordance with the formula in subsection 29(4), the insurer may under new 29(6) vary the contract to place them in the position they would have been had the misrepresentation or breach of the duty of disclosure had not occurred (this remedy is consistent with the remedy provided to general insurers in section 28(3) of the ICA).

In order to ensure insureds are not unfairly disadvantaged, an insurer must (when varying a contract under new 29(6)) have regard to contracts of life insurance entered into by other reasonable and prudent insurers that are similar to the relevant contract. A contract will be considered to be similar to the relevant contract if:

- the insurance cover provided was the same as, or similar to, the kind of insurance cover provided by the relevant contract; and
- the other contract had been entered into at, or close to, the time the relevant was entered into.

In keeping with the recommendation made in the Review, insurance contracts that have a surrender value or a contract of life insurance that provides insurance cover in respect of the death of the life insured will continue to have those remedies available under the current law. That is an insurer is able to avoid a contract under subsection 29(2) and subsection (3) in the

[1] SP/Q where S – is the number of dollars that is equal to the sum insured (including any bonuses), P – is the number of dollars that is equal to the premium that has, or to the sum of the premiums that have become payable under the contract and Q – is the number of dollars that is equal to the premium, or to the sum of the premiums, that the insurer would have been likely to have changed if the duty of disclosure had been complied with or the misrepresentation had not been made.

first three years or can vary the contract of insurance by substituting for the sum insured an amount as worked out under the formula provide they provide notice in writing to the insured before the expiration of three years after the contract was entered into.

Transitional period - application of duty of disclosure changes

The 2010 Bill proposed changes to duty of disclosure obligations on insurers (as recommended in the Review) were to take effect 18 months from the date of Royal Assent. The delay in commencement of the proposed changes was to allow insurers an opportunity to amend their business practices in response to the new rules regarding the operation of the duty of disclosure and notification of that duty.

After considering the practical impact of the proposed amendments to the duty of disclosure, it was evident that the transitional period did not provide sufficient time for industry to comply with the new requirement.

- The 18 month timeframe is not sufficient, as insurers are obliged to give notice of the duty of disclosure <u>before</u> a contract is entered into. This has ramifications for any insurance contract that is renewed between six and twelve months after Royal Assent.
  - For example, if a standard 12 month insurance contract is renewed seven months after Royal Assent, the contract will be subject to the old disclosure regime for the first 11 months of the contract and then the new regime for the remaining month of the contract. However, insurers will have failed to meet their obligations under the new regime to give notice of the duty of disclosure <u>before</u> a contract is entered into, and will thus fall foul of the new disclosure obligations in this situation.
    - In practice (and in the absence of other relief available), insurers would need to update all Product Disclosure Statements within 6 months to ensure that they meet their disclosure obligations in situations where renewals occur between six and twelve months after Royal Assent.

In discussing this issue in the recent consultations with key stakeholders, the extension of the transitional period to 30 months was supported by industry and consumer representatives. Therefore, the transitional period for the commencement of the duty of disclosure measures is 30 months.

Bundled Contracts

When two or more types of cover are contained in a contract of insurance, the contract is commonly referred to as a bundled contract. In an attempt to overcome potential issues that may arise when applying provisions of the ICA to bundled contracts the Review made a number of recommendations regarding the ability for insurers to unbundle contracts.

Part 3 of Schedule 1 of the 2010 Bill, provides that it is appropriate to unbundle insurance contracts when they contain provisions that provide when separated into groups could form standalone contracts of insurance. In contrast to Part 3 of Schedule 1, Part 1 of Schedule 5 of the 2010 Bill (unbundling of life insurance contracts) uses an approach that looks at the “kind of insurance” provided. While using this approach is consistent with the approach taken in the *Corporations Act 2001*, a number of key stakeholders have indicated that by taking this approach in the ICA the extent to which contracts should or could be unbundled is unclear.

After further consideration the proposed measures in Part 1 of Schedule 5 of the 2010 Bill have been refined to move from the “kind of insurance” provided to an approach which more closely aligns with Part 3 of Schedule 1 of the 2010 Bill.

- Bundled contracts will be unbundled into separate contracts for the purpose of applying remedies in section 29 of the ICA when the provisions contained in the bundled contracts can be separated into groups of provisions that would constitute a standalone contract that provides a particular type of cover.