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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INSURANCE CONTRACTS AMENDMENT BILL 2010

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Financial Services, Superannuation and
Corporate Law, the Hon Chris Bowen MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ALRC	Australian Law Reform Commission
ASIC	Australian Securities and Investments Commission
Bill	Insurance Contracts Amendment Bill 2010
ET Act	<i>Electronic Transactions Act 1999</i>
IC Act	<i>Insurance Contracts Act 1984</i>
Review Panel	The Panel appointed to review the IC Act

General outline and financial impact

Outline

1.1 The Insurance Contracts Amendment Bill 2010 (the Bill) arose out of recommendations made by a review of the *Insurance Contracts Act 1984* (the IC Act). This review was conducted by a Panel comprising Mr Alan Cameron AM and Ms Nancy Milne (the Review Panel). The Review Panel's main conclusion was that the IC Act was generally working satisfactorily to the benefit of insurers and insureds. However, the Review Panel found that some changes would be beneficial, given the passage of time since the Act was originally enacted, developments in the insurance market since that time and judicial interpretation of IC Act provisions.

1.2 The Review Panel made detailed recommendations for changes to the IC Act to address issues that had been identified as arising from the above factors. This Bill gives effect to a number of the Review Panel's recommendations. In several areas the Review Panel's recommended approach was modified to take account of subsequent consultations with stakeholders on the details of the proposed amendments.

Major elements

1.3 The following is a brief summary of the measures included in the Bill, outlined under their particular Schedule number.

Schedule 1 — Scope and application

1.4 Schedule 1 to the Bill contains amendments that relate to the scope and application of the IC Act. It amends the IC Act so that:

- failure to comply with the duty of utmost good faith is a breach of the IC Act;
- contracts of insurance that are entered into or proposed to be entered into for the purposes of workers' compensation law continue to be exempt under the IC Act, notwithstanding that they also include cover against employer liability at common law to pay damages for employment-related personal injury; and
- contracts of insurance that include elements of cover that are exempted from the IC Act as well as cover that falls under the IC Act, are treated as exempt from the Act only in respect of the exempt elements.

Date of effect: On Royal Assent.

Schedule 2 — Electronic communication

1.5 It is proposed that the regulations under the *Electronic Transactions Act 1999* will be amended so that the IC Act will no longer be exempt from that Act. Schedule 2 to the Bill amends the IC Act to make technical changes to provisions in the IC Act regarding the giving of notices, documents and information, including a note that the *Electronic Transactions Act* will apply to permit electronic communication of notices or documents required to be given in writing.

Date of effect: Schedule 2 will take effect on a day to be fixed by Proclamation. This will permit coordination of the commencement with the proposed amendment to the *Electronic Transactions Regulations*.

Schedule 3 — Powers of ASIC

1.6 Schedule 3 to the Bill amends the IC Act to give the Australian Securities and Investments Commission (ASIC) a statutory right to intervene in any proceeding relating to matters arising under the IC Act and under Part 3 of the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003*.

Date of effect: On Royal Assent.

Schedule 4 — Disclosure and misrepresentations

- 1.7 Schedule 4 to the Bill amends the IC Act so that:
- the mixed objective/subjective test in section 21 of the IC Act, which is used to determine if an insured has met their duty of disclosure, is clarified;
 - the requirement to ask proposed insureds specific questions under section 21A as a condition of enforcing the insured's duty of disclosure will apply on renewal of an eligible contract of insurance (proposed new section 21B) as well as at inception (but not for a variation, a reinstatement or an extension), and 'catch all' questions will no longer be permitted;
 - on renewal, insurers may choose to seek updates to answers previously provided by insureds, rather than asking specific questions again;
 - an insurer must notify the insured, before the contract of insurance is entered into, that the duty of disclosure obligations continue until the time the policy is actually entered into;
 - the IC Act provides that a form of words may be prescribed by regulation for use by insurers to inform persons of their duty of disclosure obligations; and
 - any person who is not the insured but proposes to become a life insured under a contract of life insurance is subject to a duty to disclose, as well as a duty not to misrepresent, and the insurer must give this person notice of the duty before the contract is entered into;
 - a failure to disclose by the proposed life insured will be imputed to the insured.

Date of effect: The amendments take effect 18 months after the date of Royal Assent. This delay in commencement is 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.

Schedule 5 — Remedies of insurers: life insurance contracts

1.8 The IC Act contains provisions that prescribe remedies for insurers that may be used where a person who became insured under a contract of insurance either misrepresented or did not disclose matters that should have been disclosed prior to entering into the contract. Section 28 deals with general insurance and section 29 deals with life insurance.

1.9 In some cases, the remedies in respect of bundled contracts of life insurance are inappropriate. Schedule 5 to the Bill amends the IC Act so that:

- the remedies in section 29 are limited to contracts of life insurance that contain, or will contain, a surrender value or provide cover in respect of the death of a life insured — other types of life insurance are dealt with under a new subsection 28(1A) that offers similar remedies to section 28 in its current form;
- life insurance contracts that combine more than one type of cover and more than one life insured are ‘unbundled’ for the purpose of applying the relevant remedies for non-disclosure or misrepresentation;
- the insurer can avoid a life insurance contract to which section 29 applies on the basis of non-disclosure or misrepresentation only if the insured would not have entered that particular contract (as opposed to the current standard of *any* life insurance contract) on any terms;
- insurers are entitled to change the expiration date of a life insurance contract (all types of life insurance, whether governed by new subsection 28(1A) or by section 29) where that date has been calculated by reference to the insured’s incorrectly-stated date of birth; and
- the statutory framework in the IC Act for cancellation of general insurance contracts will be extended to life insurance contracts (subject to forfeiture rights for non-payment of premiums under the *Life Insurance Act 1995*).

Date of effect: The amendments regarding unbundling of life insurance contracts and entitlement of insurers to change expiration dates and to cancel contracts of life insurance take effect on Royal Assent. The amendments regarding changes to the remedies for particular contracts of life insurance commence 12 months after the date of Royal Assent. The

delay in commencement is to allow insurers an opportunity to factor into their affairs the changes to available remedies.

Schedule 6 — Third parties

1.10 Schedule 6 to the Bill amends the IC Act so that:

- individuals who have rights under a contract of insurance ('third party beneficiaries') but who are not the insured, have access to particular rights and obligations currently held by insureds;
- third parties with damages claims against an insured or third party beneficiary who has died or cannot be found may recover directly against the insurer;
- ASIC will have powers to bring representative actions on behalf of third party beneficiaries;
- remedies for misrepresentation and non-disclosure are available in relation to contracts of life insurance that are offered as part of a group scheme that is unrelated to superannuation; and
- remedies are available in respect of any misrepresentation or non-disclosure that occurs between when an insured became a member of a superannuation or other group scheme and when the life insurance cover takes effect.

Date of effect: ASIC's powers to bring representative actions commence on the date of Royal Assent. The remainder of Schedule 6 commences 12 months after the date of Royal Assent. The delay in commencement is to allow insurers a reasonable opportunity to factor the new rights and obligations of third party beneficiaries into their business operations.

Schedule 8 — Subrogation

1.11 Schedule 7 to the Bill amends the IC Act so that:

- section 67 of the IC Act, which deals with the allocation of moneys recovered when an insurer exercises a right of subrogation in relation to an insurance claim, is revised to reflect wording of a draft provision dealing with subrogation proposed by the Australian Law Reform Commission in its Review of the *Marine Insurance Act 1909* (Cth); and

- Part VIII of the IC Act, which relates to subrogation, applies to claims made by third party beneficiaries as well as by insureds.

Date of effect: Schedule 7 commences six months after the date of Royal Assent. The delay in commencement is to allow insurers an opportunity to factor the new rules regarding subrogation into their business operations.

Financial impact statement

1.12 The Insurance Contracts Amendment Bill 2010 will have no financial impact on the Commonwealth.

Chapter 1

Notes on clauses

Schedule 1 — Scope and application

2.1 Schedule 1 to the Bill contains a range of provisions to change and/or clarify the scope and application of the IC Act. The provisions relate to:

- breaches of implied terms and the duty of utmost good faith (including extending the duty to third party beneficiaries);
- including a definition of ‘third party beneficiary’;
- exemptions for ‘bundled’ workers’ compensation contracts; and
- application of exemptions to ‘bundled’ contracts generally.

Part 1 — Duty of utmost good faith

Breach of the duty of utmost good faith

2.2 There is implied into all contracts of insurance, pursuant to section 13 of the IC Act, a provision that requires each party to that contract of insurance to act with the utmost good faith towards the other party in respect of any matters arising under or in relation to the contract.

2.3 Under the current law, parties to a contract of insurance may enforce compliance with this implied duty of utmost good faith through private legal action. However, this may present too great an expense for some parties and does not provide long-term solutions to systemic breaches of utmost good faith committed over time.

2.4 Item 4 in Part 1 of Schedule 1 inserts a subsection (2) in section 13 of the IC Act to address this issue by making a breach of the duty of utmost good faith a breach of the IC Act. The amendment allows ASIC to commence or continue representative action on behalf of an insured against an insurer, pursuant to section 55A of the IC Act. Pre-conditions to ASIC undertaking representative action on behalf of an insured are that the insured or insureds have suffered damage or there has been a breach of the IC Act.

2.5 The amendments to section 13 will also have the result that breaches of the duty of utmost good faith (and consequently of the IC Act) by an insurer may enable ASIC to access various remedies under the *Corporations Act 2001* in relation to Australian Financial Services Licence holders. These remedies include a banning order under section 920A of the Corporations Act, suspension or cancellation of the insurer's financial services licence, the imposition of conditions on the licence or the acceptance of an enforceable undertaking not to act in a particular manner. Item 5 will insert new section 14A in the IC Act, to avoid any doubt that the remedies are available for breaches of the duty of utmost good faith by an insurer in the handling or settlement of a potential claim. Arguably, regulations made under the Corporations Act in relation to the treatment of claims handling and settlement for the purposes of Chapter 7 of the Corporations Act may imply otherwise.

2.6 Banning orders made by ASIC have the effect of prohibiting the affected person from providing all financial services, or one or more specified types of financial service. They may be permanent or last only for a specified period. An example of the type of conduct leading to a permanent banning order is a pattern of persistent contraventions that indicate systemic failures or a general lack of understanding of, and regard for, compliance. Isolated breaches of the duty would not be expected to result in ASIC pursuing a banning order.

2.7 A breach of the IC Act for failure to comply with the duty of utmost good faith implied into all contracts of insurance is not an offence against the IC Act, nor does it attract any penalty under the IC Act.

Third party beneficiaries

2.8 Third party beneficiaries are not the insured under a contract of insurance but may be specified or referred to in its terms, either individually or as part of a class, as persons to whom any benefits provided by the contract extend. It follows therefore that they should have access to some of the rights and obligations under the IC Act that extend to insureds.

2.9 As third party beneficiaries are not parties to the contract of insurance, they do not benefit from the duty of utmost good faith, which is implied by the current section 13.

2.10 New subsections 13(3) and 13(4) (see item 4 in Part 1 of Schedule 1) address this by extending the duty of utmost good faith to third party beneficiaries; however, the duty only commences after the contract is entered into. This is because applying the duty pre-contractually would be impractical. Further, the duty of utmost good faith will be of most relevance for third party beneficiaries where they

wish to make a claim under a contract of insurance, as countenanced by subsection 48(2).

2.11 Item 2 of Part 1 of Schedule 1 inserts a definition of ‘third party beneficiary’ in subsection 11(1) of the IC Act.

Application

2.12 By operation of item 6 in Part 1 of Schedule 1, the amendments in Part 1 apply as follows:

- (a) to a contract of insurance that was originally entered into after the commencement of item 6;
- (b) to a contract of general insurance that was originally entered into before the commencement of item 6 and is renewed after that commencement; and
- (c) if the contract is a contract of life insurance that was originally entered into before the commencement of this item and is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover; then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of item 6, and the amendments apply to the contract to the extent of the variation.

2.13 By operation of clause 2 of the Bill, item 6 in Part 1 of Schedule 1 commences on the day the Act receives the Royal Assent.

Part 2 — ‘Bundled’ workers’ compensation contracts

2.14 Paragraph 9(1)(e) of the IC Act exempts from the scope of the Act actual or proposed contracts of insurance that have been entered for the purposes of a state or territory law that relates to workers’ compensation or compensation for death or injury to a person arising from the use of a motor vehicle.

2.15 In practice, some contracts of insurance offer employees cover of the type described in paragraph 9(1)(e) and another type of cover. A particular example is contracts of insurance that bundle both cover for compulsory workers’ compensation purposes and cover for liability to employees at common law arising from employment-related personal injury.

2.16 The question arises as to whether such ‘bundled’ contracts of insurance are exempt or not from the scope of the IC Act. The Review

Panel recommended that, in the case of the example described above, the most effective solution to overcome uncertainty about application is to make the entire contract exempt from the scope of the IC Act. In other examples of contracts of insurance that bundle exempt and non-exempt types of cover, the Review Panel considered it not desirable to rule the entire contract either in or out of the scope of the Act. That situation is dealt with in Part 3 of Schedule 1.

2.17 Item 7 in Part 2 of Schedule 1 includes a new paragraph 9(1)(f) that exempts from the operation of the IC Act insurance contracts entered into (or proposed to be entered into) that bundle compulsory workers' compensation cover together with cover for an employer's liability at common law for damage suffered due to employment-related personal injury.

2.18 By operation of item 8 in Part 2 of Schedule 1, the amendments in Part 2 apply as follows:

- (a) to a contract of insurance that was originally entered into after the commencement of item 8; and
- (b) to a contract of general insurance that was originally entered into before the commencement of item 8 and is renewed after that commencement.

2.19 By operation of clause 2, item 8 in Part 2 of Schedule 1 commences on the day the Act receives the Royal Assent.

Part 3 — 'Bundled' contracts generally

2.20 A contract of insurance may contain one or more types of cover to which the IC Act would *not* apply if they were contained in individual contracts, together with one or more types of cover to which the IC Act would apply if they were contained in individual contracts.

2.21 As was the case for the bundled contracts of insurance dealt with specifically in Part 2 of Schedule 1 described above, the Review Panel recommended that the exemption from the scope of the IC Act in subsection 9(1) of the Act be applied to each type of cover in a bundled insurance policy as if it were a separate contract.

2.22 Item 9 in Part 3 of Schedule 1 inserts new subsections 9(1A), 9(1B) and 9(1C). Under the new subsections, contracts of insurance that contain more than one type of cover, one of which is exempted and one of which is not (for this discussion called Cover A and Cover B respectively), would contain some terms that relate solely to Cover A,

some that relate solely to Cover B and some that relate to both Cover A and Cover B.

2.23 To create ‘unbundled’ contracts for the purposes of applying the exemption provisions, two notional contracts would be constructed. The first notional contract would comprise only those terms of the initial contract that are relevant to Cover A. The notional contract would also contain, as a consequence of subsection 9(1C), any terms of the initial contract that are relevant to both Cover A and Cover B.

2.24 Similarly, the second notional contract would comprise those terms of the initial contract that are relevant to Cover B only and the terms that are relevant to both Cover A and Cover B.

2.25 When the contents of the notional contracts are determined, the exemption provisions in subsection 9(1) are applied to each as if that contract were a separate contract of insurance or proposed contract of insurance.

2.26 It may be that there are more than two types of cover bundled within a contract of insurance, in which case more than two notional contracts of insurance will need to be developed at the first stage. However, irrespective of whether there are two or more kinds of exempt covers, or two or more kinds of non-exempt covers, or both, the result of applying the unbundling process in subsections 9(1A) and 9(1C) is that only those contractual terms that relate to the exempt cover type(s) are exempt from the operation of the IC Act.

2.27 New subsection 9(1B) applies a different rule for unbundling if one of the types of cover is a cover that is referred to in new paragraph 9(1)(f) (described in paragraph 3.17 above). This different treatment is necessary to ensure that directors’ liability cover (subparagraph 9(1)(f)(ii)) would only be exempted from the scope of the IC Act where it was bundled with compulsory workers’ compensation cover (subparagraph 9(1)(f)(i)).

2.28 By operation of item 10 in Part 3 of Schedule 1, the amendments made by Part 3 apply as follows:

- (a) to a contract of insurance that was originally entered into after the commencement of item 8 (the day the Act receives the Royal Assent);
- (b) to a contract of general insurance that was originally entered into before the commencement of item 10 and is renewed after that commencement; and

- (c) if the contract is a contract of life insurance that was originally entered into before the commencement of item 10 and is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover; then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of this item, and the amendments apply to the contract to the extent of the variation.

2.29 By operation of clause 2, item 10 in Part 3 of Schedule 1 commences on the day the Act receives the Royal Assent.

Schedule 2 — Electronic communication

2.30 The Review Panel analysed the increasing use of electronic communications in the context of the IC Act. Currently, the IC Act is exempt from the coverage of most of the operative parts of the *Electronic Transactions Act 1999* (the ET Act), which provides that, in general, where a Commonwealth law requires a notice to be given in writing, then it may be given by electronic communication if certain conditions are met.

2.31 For example, subsection 9(1) of the ET Act provides that any communication required by a Commonwealth Act may only be done electronically if:

- at the time the information was given, it was reasonable to expect that the information would be readily accessible so as to be useable for subsequent reference; and
- the person to whom the information is required to be given consents to the information being given by way of electronic communication.

2.32 Section 14 of the ET Act contains rules about time and place of receipt and dispatch of electronic communications.

2.33 The Review Panel expressed support for the notion of updating the IC Act to allow for communication by electronic means. A proposed amendment to the *Electronic Transactions Regulations 2000* is expected to remove the current exemption, so that communications under the IC Act are subject to the ET Act. Schedule 2 to the Bill amends various provisions of the IC Act to recognise that the IC Act will be subject to the ET Act.

2.34 For the sake of consistency of terms in sections 70, 71 and 72 of the IC Act dealing with notices, items 2 to 6 of Schedule 2 remove references to ‘statement’ (wherever occurring). The concept of a ‘statement’ is covered by the term ‘notice or other document’.

2.35 Item 7 of Schedule 2 repeals the current section 72 of the IC Act (which is concerned with legibility of writing) and substitutes an expanded section 72. The purpose of this expansion is so that the regulation-making power in section 72 may deal not only with the content and legibility of the notice or other document itself, but also with material that may accompany the notice or other document or information. The power is intended to permit the making of regulations to ensure that the content of statutory notices under the IC Act is able to be digested by the recipient without interruption or distraction by other material provided with the notice.

2.36 Current section 77 of the IC Act applies generally in relation to notices or other documents or information that are required or permitted to be given by the IC Act. The section sets out the methods that may be used depending on whether the person to whom the notice or other document is to be given is a body corporate or a natural person. Subsection 77(2) also includes a rule regarding the time of receipt of a notice of cancellation of a contract of insurance.

2.37 Item 8 of Schedule 2 repeals current section 77 of the IC Act and Item 1 is a consequential amendment to subsection 62(1). Item 7 largely replicates the content of section 77 as new section 72A, but removes the rule regarding notice by post of cancellation. Section 29 of the *Acts Interpretation Act 1909* deals with that subject. Section 72A is not intended to affect the operation of subsection 71(1), which covers situations where insurance is arranged by brokers acting for the insureds.

Application

2.38 By operation of item 9 of Schedule 2, the amendments in Schedule 2 apply to a notice or other document or information given to a person under the IC Act after the commencement of item 9 of Schedule 2.

2.39 By operation of clause 2, item 9 of Schedule 2 commences on the day the Act receives the Royal Assent.

Schedule 3 — Powers of ASIC

2.40 Part IA of the IC Act gives the Australian Securities and Investments Commission (ASIC) responsibility for the general administration of the IC Act and vests in ASIC a number of specific powers to support this role, such as the power to obtain documents.

2.41 Item 1 of Schedule 3 inserts a new section 11F into the IC Act that gives ASIC powers to intervene in matters arising under the Act. The provision is similar in form to the existing power that ASIC has to intervene in proceedings begun by other persons about matters arising under the *Corporations Act 2001* (section 1330). It allows ASIC to be represented in the proceedings by a staff member, a delegate, a solicitor or counsel.

2.42 By new section 11F, ASIC may also intervene in a matter arising under Part 3 of the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003*. Part 3 of the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* enables ASIC (and also other parties) to make application to the court to enforce product standards for medical indemnity insurance. The expanded power would enable ASIC to intervene in any proceeding relating to matters arising under Part 3.

Application

2.43 By operation of item 2 of Schedule 3, the amendment made by Schedule 3 applies to a proceeding that is commenced after the commencement of item 2.

2.44 By operation of clause 2, item 2 of Schedule 3 commences on the day the Act receives the Royal Assent.

Schedule 4 — Disclosure and misrepresentations

2.45 Schedule 4 amends the manner in which the IC Act deals with particular types of disclosure and misrepresentations. The changes:

- clarify how the duty of disclosure test is applied;
- in relation to eligible contracts of insurance, amend the law to make the duty of disclosure apply on renewal of a contract of insurance and remove the option for insurers to ask ‘catch all’ questions’;
- amend the law regarding circumstances in which an insurer must provide an insured with a reminder as to when their duty of disclosure obligation applies; and
- in relation to contracts of life insurance, amend the law so insurers must give a potential life insured, who is not the insured under the relevant contract of insurance, notice of their duty of disclosure.

2.46 The changes made by Schedule 4 will require insurers to adjust various their business practices. This will take time to implement. Accordingly, the commencement of Schedule 4 is delayed by 18 months from Royal Assent in order to allow insurers time to implement the necessary changes to their systems and documents as required.

Part 1 — Insured’s duty of disclosure

2.47 Sections 21 and 21A of the IC Act are key provisions that govern the insured’s duty of disclosure obligations. Section 21 imposes a requirement on an insured, before a contract is entered into, to disclose various matters. What must be disclosed is determined by reference to a test that contains both subjective elements (what the insured knows to be relevant to the insurer’s decision) and objective elements (what a reasonable person in the circumstances could be expected to know would be relevant to the insurer’s decision).

2.48 The mixed subjective/objective test has not been applied consistently. To help clarify its interpretation, item 1 in Part 1 of Schedule 4 expands the objective element of the test in paragraph 21(1)(b) of the IC Act to include a non-exclusive factor to which the court may have regard when determining whether a reasonable person in the circumstances could be expected to know a matter was relevant to the decision of the insurer whether to enter the contract of insurance. The

factor is the nature and extent of the insurance cover to be provided under the relevant contract of insurance.

Application

2.49 By operation of item 2 in Part 1 of Schedule 4, the amendment in Part 1 of Schedule 4 applies as follows:

- (a) to a contract of insurance that was originally entered into after the commencement of item 2;
- (b) to a contract of general insurance that was originally entered into before the commencement of item 2 and is renewed after that commencement; and
- (c) if a contract is a contract of life insurance that was originally entered into before the commencement of item 2 and is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover; then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of this item, and the amendment applies to the contract to the extent of the variation.

2.50 By operation of clause 2, item 2 in Part 1 of Schedule 4 commences on the day after the end of the period of 18 months beginning on the day the Act receives the Royal Assent.

Part 2 — Eligible contracts of insurance

2.51 Section 21A of the IC Act supplements the general provisions regarding the duty of disclosure in section 21, but only in relation to certain ‘eligible contracts of insurance’. ‘Eligible contracts of insurance’ are prescribed by regulations made under the IC Act. They include contracts that provide cover commonly sought by individual consumers, such as motor vehicle, home contents and travel insurance.

2.52 For an insurer to be able to rely on compliance by an insured with their duty of disclosure, section 21A requires the insurer to ask the insured specific questions that are relevant to the insurer’s decision whether to accept the risk and, if so, on what terms. However, it is also currently permissible for the insurer to ask the insured a ‘catch all’ question, which requires an insured to disclose ‘exceptional circumstances’ that a reasonable person could be expected to know would be relevant to the insurer’s decision whether to accept the risk, and about which would be unreasonable for the insurer to ask a specific question (subparagraph 21A(4)(b)(iii)). The current ability to ask ‘catch all’

questions tends to undermine the benefits for insureds of the framework for eligible contracts of insurance. Insurers should be in a position to decide what matters are material to their decision to provide eligible contracts of insurance and formulate specific questions accordingly. In the event that an insurer is unable to foresee a matter that is relevant to their decision whether to accept the risk of a particular contract, then it is difficult to justify expecting an unsophisticated insured to realise its relevance.

2.53 Section 21A only applies when a contract is first entered into — it currently has no application to renewals (subsection 21A(1)). However, for the purposes of other provisions, a renewal is treated as entry into a new contract (subsection 11(9)). Accordingly, renewal of an eligible contract of insurance would trigger the general duty of disclosure provisions under section 21. This can be onerous for insureds in comparison with, for example, the framework for eligible contracts under section 21A.

2.54 The provisions in Part 2 of Schedule 4 are designed to:

- remove the ability of insurers to ask ‘catch all’ questions in relation to eligible contracts; and
- apply enhanced rules for the duty of disclosure on original inception and renewal of eligible contracts.

2.55 Item 4 in Part 2 of Schedule 4 substitutes a new section 21A and inserts a new section 21B.

2.56 In relation to the original entering into of an eligible contract of insurance, new section 21A provides that the insurer is required to ask the insured to answer one or more specific questions that are relevant to the insurer’s decision whether or not to accept the risk, and is taken to have waived compliance with the insured’s duty of disclosure if it does not do so. Further, asking ‘catch all’ questions covering any other matter outside the specific requests will result in a waiver of the duty of disclosure with respect to the other matters. The operation of new section 21A is not triggered by a variation, reinstatement or extension of a contract of insurance.

2.57 New section 21B applies in relation to the renewal of an eligible contract of insurance (new subsection 21B(1)). New subsections 21B(2) to (5) deal with the position of the insurer — in particular in what circumstances they are taken to have waived compliance with the duty of disclosure. In relation to the renewal of an eligible contract of insurance, new section 21B(2) requires an insurer wishing to rely on the insured’s duty of disclosure to:

- ask specific questions, just as they may on the original entering into of a contract; and/or
- provide the insured, prior to renewing the contract, with a copy of any matters previously disclosed by the insured in relation to the contract, and request the insured to disclose any changes to those matters or to indicate if there are no such changes.

If the insurer does neither of those things, new subsection 21B(3) provides that they are taken to have waived compliance with the duty of disclosure in relation to the renewed contract (subject to new subsection 21B(11), which deals with the effects of non-disclosures and misrepresentations that occurred on previous renewals or original inception).

2.58 New subsections 21B(4) and 21B(5) deal with ‘catch all’ questions. Asking ‘catch all’ questions covering other matters addition to asking specific questions and/or seeking updates to information previously disclosed will result in waiver of compliance with the duty of disclosure with respect to the other matters.

2.59 New subsections 21B(6) to (8) deal with the position of the insured — in particular, in what circumstances they are taken to have complied with the duty of disclosure.

2.60 Subsection 21B(6) deals with an insured who is only asked specific questions. In that case, to be taken to have complied with the duty of disclosure in relation to the renewed contract if they disclose, in response to each specific question, matters that are known to them and matters that a reasonable person in the circumstances would be expected to have disclosed in answer to the question.

2.61 Subsection 21B(7) deals with an insured who is only asked to update matters previously disclosed. In that case, to be taken to have complied with the duty of disclosure in relation to the renewed contract the insured must disclose any change to the matter or inform the insurer if there is no change.

2.62 Subsection 21B(8) deals with an insured who is both asked specific questions and asked to update answers previously provided. In that case, the insured must both disclose responses to the specific questions (similar to the requirements of subsection 21B(6)) and advise the insurer of any change/no change to the matters (similar to the requirements of subsection 21B(7)).

2.63 Subsections 21B(6) to 21B(8) are all subject to new subsection 21B(11), which provides that compliance by an insured with

the duty of disclosure on a renewal does not mean that a failure to comply with the duty of disclosure on original inception or a previous renewal is negated. For example, suppose when originally applying for a home buildings policy, an insured breaches the duty of disclosure in relation to providing information on the main construction materials used in the home. At a subsequent renewal, the insurer seeks updates to various matters but does not ask the insured to update the information previously provided on main construction materials, because they are unlikely to change between inception and renewal. In such a case, even though the insured may be taken to comply with the duty of disclosure in respect of the renewed contract by providing all updates as requested, the effect of subsection 21B(11) is that compliance with the duty under the renewed contract does not operate to negate the earlier failure. The intention of this provision is to permit insurers to continue to rely on the accuracy, *as at the time of inception or the previous renewal*, of matters disclosed on inception and previous renewals. Otherwise, insurers seeking to rely on any information previously provided by an insured (such as, for example, what a home is constructed of) would need to seek updates to every such matter at every renewal, which would be onerous and time consuming for both insurers and insureds. For the sake of clarity, the rule in subsection 21B(11) should not be taken to imply that an insured who has complied with the duty of disclosure previously is under a continuing obligation to update matters that have changed at renewal, unless specifically requested to do so. If an insurer wishes to ensure that information is updated at renewal, they will need to either ask the insured a specific question regarding the matter, or ask the insured to update the information previously provided.

2.64 Some insureds may not respond to request to update matters previously provided, but nevertheless pay the renewal premium. If an insurer seeks an update to a matters previously provided but the insured provides no response before the contract is renewed, then new subsection 21B(9) operates so that the insured is taken to have advised the insurer that there is no change to the matter. New subsection 21B(10) disappplies the provisions of subsections 21(3) and 27, which would otherwise provide for some consequences of an insured's failure to answer questions. Subsection 21B(10) also applies if the insured advises the insurer that there is no change to a matter.

Application

2.65 By operation of subitem 4(1) in Part 2 of Schedule 4, the amendments in Schedule 4 relating to the insertion of proposed new section 21A apply to an eligible contract of insurance originally entered into after the commencement of item 3.

2.66 By operation of subitem 4(2), the amendments in Schedule 4 relating to the insertion of proposed new section 21B apply to an eligible contract of insurance that is renewed after the commencement of item 3, regardless of when the contract was originally entered into.

2.67 By operation of clause 2, item 3 in Part 2 of Schedule 4 commences on the day after the end of the period of 18 months beginning on the day the Act receives the Royal Assent.

Saving of regulations

2.68 Item 5 in Part 2 of Schedule 4 provides for the saving of existing regulations made for the purpose of the definition of ‘eligible contract of insurance’ in current subsection 21A(9), as if they had been made for the purposes of the definition of ‘eligible contract of insurance’ (as inserted in subsection 21A(6)). By operation of item 3 in Part 2 of Schedule 4, the definition of ‘eligible contract of insurance’ is inserted in subsection 21A(6) of the IC Act.

Part 3 — Insurers’ duty to inform of duty of disclosure

Notification that the duty exists until contract begins

2.69 The insured has a duty of disclosure until the time at which the relevant contract of insurance is entered into. In normal circumstances this presents no difficulty because the insured provides information to the insurer a short time before the contract begins. This is not always the case.

2.70 In some instances, particularly where long term contracts of life insurance are involved, there may be a significant time lag (sometimes months) between the time a prospective insured submits information to an insurer — usually when making an application — and the time the policy is actually issued. During this period, circumstances may change, or events may occur, that need to be disclosed to the insurer in order for the insured to comply with the duty of disclosure.

2.71 If the insured fails to disclose those circumstances or events before the contract is entered into, then any claim they later make could be at risk due to their failure to comply with the duty of disclosure. The Review Panel recommended, in order to minimise the possibility of harsh outcomes, that prospective insureds should be reminded that the duty of disclosure extends until the time the relevant policy is entered into.

2.72 Current subsection 22(1) of the IC Act requires insurers to notify insureds about the duty of disclosure any time ‘before the contract is entered into’. Item 8 in Part 3 of Schedule 4 substitutes a new section 22,

providing that the insurer must clearly inform the insured of the general nature and effect of the duty of disclosure, and where relevant, the general nature and effect of sections 21A or 21B.

2.73 New subsection 22(2) requires insurers to inform proposed life insureds that they have a duty of disclosure. This includes information on the effect of proposed new section 31A (see below). Item 6 in Part 3 of Schedule 4 provides that the definition of a 'life insured' includes a proposed life insured.

2.74 New subsection 22(1) also makes it clear that any notification given to the insured pursuant to the section should explain that the duty of disclosure obligation applies until the time that the proposed contract is entered into (Item 8 in Part 3 of Schedule 4).

2.75 Item 8 also provides in new subsection 22(3) that where the insurer's acceptance, or counter-offer, in relation to the proposed contract of insurance, is made more than two months after the insured's most recent disclosure for the purposes of complying with their duty of disclosure, then along with the acceptance or counter-offer, the insurer must also provide the insured with a reminder that the duty of disclosure applies until the proposed contract (or, in the case of a counter-offer, the other contract) is entered into.

2.76 The addition of this reminder requirement in cases where there is a significant delay between the initial disclosure and the contract commencing is intended to promote disclosures being made current as at the contract date, so that the insurer is fully informed, and there can be an early renegotiation of the contract if necessary.

2.77 The additional reminder requirement imposed by new subsection 22(3) is not extended to a life insured, unless the life insured is also the contracting insured.

2.78 Item 8 in Part 3 of Schedule 4 provides under new subsection 22(4) that the form of writing used to inform a person of the matters referred to in subsection 22(1), and also for the reminder notice referred to in subsection 22(3), may be in accordance with the prescribed form, where the regulations prescribe a form of writing to be used for the purposes of section 22.

2.79 New subsection 22(5) applies such that an insurer that fails to comply with subsection 22(1) and, if applicable, subsection 22(2) will be precluded from exercising a right in respect of a failure by the insured to comply with their duty of disclosure under the contract, unless the particular failure is fraudulent. This is consistent with the current position in respect of insureds.

2.80 New subsection 22(6) and (7) deals with an insurer that fails to comply with subsection 22(3), which is the provision requiring a reminder notice in cases of delay between initial disclosure and the contract commencing. In those circumstances, the insurer is precluded from exercising a right in respect of a failure to disclose any 'new matter', defined as a matter that the insured first become aware of after their most recent disclosure (and which, therefore, may not have been disclosed as a result of the failure to provide the reminder notice).

2.81 Item 7 in Part 3 of Schedule 4 amends paragraph 11(10)(b) of the IC Act with the effect that section 22 (in the case of both general and life insurance) and section 40 (in the case of general insurance) does not require an insurer to give information to the insured at or before a variation of the relevant contract of insurance, except where the variation is involved in a renewal, extension or reinstatement of the contract, or if the varied contract will provide a kind of insurance cover that was not provided by the contract immediately before the variation. Section 22 will also continue to apply in the case of variation of a contract of life insurance if the variation will increase a sum insured in respect of the insured.

2.82 Subsection 11(10) operates notwithstanding subsection 11(9) of the IC Act, which provides that a reference in the Act to the 'entering into' of a contract of insurance includes a reference to, in the case of life insurance, the making of an agreement by the parties to extend or vary the contract, and in the case of any other contract of insurance, the making of an agreement by the parties to the contract to renew, extend or vary the contract, or to the reinstatement of any previous contract.

2.83 Under paragraph 11(10)(a) or (b) (as amended), the insurer may be taken to have satisfied the requirements of section 22 in relation to a renewal, extension or reinstatement if the insurer has previously given the information required by that section to the insured and certain other conditions are met. After the commencement of new section 22, the references in paragraphs 11(10)(a) and (b) to the information required under section 22 are to the information required under the new section 22. This means that, in most cases, the insurer will be required to comply with new section 22 in the case of a renewal, extension or reinstatement of a contract that was originally entered into before the commencement of new section 22, and also with respect to a variation of the kind referred to in amended paragraph 11(10)(b) (that is, new subparagraph 11(10)(b)(ii)).

Application

2.84 Item 9 in Part 3 of Schedule 4 provides that the amendments in Part 3 apply to a contract of insurance whether entered into after commencement of item 9, and to a contract of insurance that was

originally entered into before commencement of item 9 that is renewed, extended, varied or reinstated after that commencement.

2.85 By operation of clause 2, item 9 in Part 3 of Schedule 4 commences on the day after the end of the period of 18 months beginning on the day the Act receives the Royal Assent.

Part 4 — Non-disclosure by life insured

2.86 Contracts of life insurance are often entered into by one person to cover the life of another. A life insured under a contract of insurance may include persons who are not the insured and, therefore, not subject to duty of disclosure obligations under current law. Although not a contracting party, the person whose life is proposed to be insured (known as the 'life insured') will usually provide the insurer with information about matters such as their state of health, in order to assist the insurer to make a decision about whether, and on what terms, to issue the policy.

2.87 Section 25 of the IC Act provides that if, during the negotiations on a life insurance contract, a prospective life insured makes a misrepresentation, the IC Act takes effect as if the misrepresentation has been made by the contracting insured. However, the existing wording of section 25 only extends to misrepresentations

2.88 Non-disclosure can be similar in result to misrepresentation, in terms of the potential detrimental impact on an insurer's decision to enter into the contract. Accordingly, item 10 in Part 4 of Schedule 4 inserts a new section 31A in the IC Act, which is similar in its effect to section 25, except that it covers non-disclosures by lives rather than misrepresentations made by them. The life insured's duty of disclosure under new section 31A is similar to that applying to insureds under section 21, except any non-disclosure by a life insured is imputed to the insured. Like existing the duty of disclosure under section 21 for insureds, there is an exception applied for non-disclosure of matters that diminish the risk, are common knowledge, that the insurer knows or ought to know in the ordinary course of its business, or for which compliance with the duty is waived by the insurer.

Application

2.89 By operation of item 11 in Part 4 of Schedule 4, the amendment made by Part 4 of Schedule 4 applies as follows:

- (a) to a contract of life insurance that was originally entered into after the commencement of item 11; and

- (b) if a contract of life insurance that was originally entered into before the commencement of item 11 is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover; then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of item 11, and the amendment applies to the contract to the extent of the variation.

2.90 By operation of clause 2, item 11 in Part 4 of Schedule 4 commences on the day after the end of the period of 18 months beginning on the day the Act receives the Royal Assent.

Schedule 5 — Remedies of insurers: life insurance contracts

2.91 Schedule 5 amends the way in which the IC Act deals with remedies for life insurers in cases of misrepresentation or non-disclosure by insureds prior to entry into the contract of life insurance. The amendments, which are designed to make the remedies more flexible and tailored than those that are currently available, apply to:

- contracts of life insurance that provide two or more kinds of insurance cover, or a single kind of cover that is provided on different terms (for example, an element that is underwritten and another element that is not) or cover for two or more life insureds;
- allow the remedies to be applied to each different element of a bundled life insurance contract as if each element or aspect were a separate policy;
- introduce a distinction between the remedies applying to different forms of life insurance cover, so that the remedies applicable under section 29 would only apply to ‘traditional’ life insurance policies (that is, life insurance contracts with a surrender value or that provide cover in respect of death) and remedies similar to the remedies applying to general insurance contracts would apply to all other forms of life insurance, that is, contracts other than contracts with a surrender value or providing death cover; and
- expand the range of remedies that are available to a life insurer in cases where the misrepresentation involves a misstatement of the date of birth of a life insured under the contract.

Part 1 — ‘Unbundling’ of contracts

2.92 Contracts of life insurance often ‘bundle’ different types of protection against more than one type of insurable event resulting from death, sickness or accident in the one contract. An application seeking cover for each type of insurable event will be ‘unbundled’ for separate consideration by an insurer in relation to each type of risk, and different factors will be taken into account as part of the underwriting process.

2.93 For example, an applicant may present with a family medical history of a condition that is well recognised as a risk factor in the development of a debilitating disease, but a disease that is unlikely to result in premature death. In those circumstances, the insurer is likely to accept a death cover component without a loading or exclusion, but the income protection cover would be offered with a modification to the policy terms or with a premium loading, in response to the additional risk caused by the family history of the condition.

2.94 Any misrepresentation or non-disclosure that affects one aspect of the insurance cover may not be relevant to the other. However, as currently drafted, the remedies that are available, such as for avoidance or variation of the contract, must be applied to the contract as a whole. This can be to the significant disadvantage of an insured and unnecessarily restrict the remedial options for an insurer.

2.95 Item 1 in Part 1 of Schedule 5 inserts a new section 27A into the IC Act, which provides that if a contract of life insurance contains two or more kinds of insurance cover or two or more life insureds, the remedies in Division 3 of Part IV for misrepresentation and non-disclosure apply to each type of cover or each life insured, as if the contract contained only the one kind of cover or provided cover in relation to only one life insured. Therefore, if a contract contains cover in respect of death and cover in respect of total and permanent disability, the remedies for misrepresentation or non-disclosure would apply to each type of cover and each life insured, separately, as required.

2.96 Similarly, new subsection 27A(3) provides that where a life insurance contract contains an element of cover that is underwritten on particular terms and another element that is either not underwritten or is underwritten on different terms, the elements are to be regarded as separate kinds of cover for the purposes of unbundling in section 27A. The intention of that provision is to permit unbundling under section 27A in circumstances such as where a person has cover under a group life scheme that is automatically provided to all members of the scheme and which is either not underwritten at all, or underwritten by, for example, a short-form questionnaire, in addition to additional ‘top up’ cover that is underwritten through, for example, a comprehensive questionnaire and

full medical examination. This allows any remedies in respect of non-disclosure and misrepresentation in relation to obtaining the top-up cover to be utilised by a life insurer in relation to the top-up only, without affecting the person's automatic cover.

Application

2.97 By operation of item 2 in Part 1 of Schedule 5, the amendments made by Part 1 of Schedule 5 apply to a contract of life insurance whether originally entered into before or after commencement of item 2.

2.98 By operation of clause 2, item 2 in Part 1 of Schedule 5 commences on the day the Act receives the Royal Assent.

Part 2 — Remedies for non-disclosure and misrepresentation

2.99 The current section 29 of the IC Act lists remedies that may be applied by life insurance providers in cases of misrepresentation and non-disclosure. Whilst suitable for 'traditional' kinds of life insurance policy (that is, those with a surrender value or providing death cover), the current provision is not well-suited to many types of life insurance that are now made available (for example, short-term cover for income protection or total and permanent disability). In many cases, misrepresentation or non-disclosure in respect of non-traditional types of life insurance policy would be better dealt with through remedies akin to those available for general insurance policies.

2.100 Surrender value refers to the cash amount payable by the life insurance company to the policy owner in the event a policy is voluntarily terminated before its maturity or the death of the insured person. They are common in traditional 'whole of life' and 'endowment' investment-style insurance policies. The *Life Insurance Act 1995* sets the minimum standard for the calculation of a surrender value.

2.101 Item 5 in Part 2 of Schedule 5 inserts a new subsection 29(1A), which will define contracts of life insurance, for the purposes of applying the remedies in section 29, as contracts of life insurance that either have a surrender value or provides insurance cover in respect of the death of a life insured.

2.102 Item 4 in Part 2 of Schedule 5 inserts new section 28(1A) into section 28 of the IC Act to provide the same remedies for life insurance contracts, which do not have a surrender value or provide death cover, as are available with respect to general insurance policies under section 28. Notes to items 4 and 5 indicate that new headings are inserted for section 28 and in relation to subsection 28(1), new subsection 28(1A) and revised section 29.

2.103 Item 8 in Part 2 of Schedule 5 amends the reference to ‘a contract’ in subsection 29(3) of the IC Act to ‘the contract’. This change is in response to a concern that, on one interpretation of the current subsection 29(3), the insurer can only avoid a contract for non-disclosure or misrepresentation if they show that they would not have been prepared to enter *any* contract of life insurance with the insured, had the insurer known the true facts. The intention of this change is to clarify that the insurer should be able to avoid the particular contract if they would not have extended cover of the risk proposed on any terms, had the true facts been known. The fact that the insurer may still have been willing to offer cover of a different type of risk had the true facts been known should not mean their right to avoid the particular contract for misrepresentation or non-disclosure under subsection 29(3) is lost. This issue is avoided by referring to ‘the contract’ rather than ‘a contract’.

2.104 Items 6 and 7 make some minor technical drafting changes to the wording of section 29.

Application

2.105 By operation of item 9 in Part 2 of Schedule 5, the amendments made by Part 2 apply as follows:

- (a) to a contract of life insurance that was originally entered into after the commencement of item 9; and
- (b) if a contract of life insurance that was originally entered into before the commencement of item 9 is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover, then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of item 9, and the amendments apply to the contract to the extent of the variation.

2.106 By operation of clause 2, item 9 in Part 2 of Schedule 5 commences on the day after the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Part 3 — Remedy for misstatement of date of birth

2.107 Section 30 of the IC Act contains specific remedies for life insurers in circumstances where the date of birth of one or more life insureds was incorrectly stated at the time the contract was entered into. It covers situations where age was understated or overstated, and allows the insurer, when the true date of birth is known, to adjust the sum insured or reduce the premium payable. Item 10 in Part 3 of Schedule 5 inserts a

new subsection 30(3A) in the IC Act to establish an additional remedy for an insurer in circumstances addressed by section 30. Under this new option, an insurer may vary the contract by changing its expiration date to a date calculated on the basis of the correct date of birth. This means that neither the amount insured nor the premium payable needs to be modified.

2.108 Item 11 in Part 3 of Schedule 5 amends subsection 30(4), so that a variation of the contract as permitted under the new subsection 30(3A) is taken to have occurred from the time the contract was entered into. This is in accordance with the rule regarding the existing remedies in subsection 30(2).

Application

2.109 By operation of item 12 in Part 3 of Schedule 5, the amendments made by Part 3 apply as follows:

- (a) to a contract of life insurance that was originally entered into after the commencement of item 12; and
- (b) if a contract of life insurance that was originally entered into before the commencement of item 12 is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover, then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of item 12, and the amendments apply to the contract to the extent of the variation.

2.110 By operation of clause 2, item 12 in Part 3 of Schedule 5 commences on the day the Act receives the Royal Assent.

Part 4 — Cancellation of contracts

2.111 Section 60 of the IC Act provides the circumstances in which an insurer may cancel a contract of general insurance. There is no section 60 equivalent for contracts of life insurance, and no provision in the IC Act that allows a life insurer to cancel a policy of life insurance for any reason. Cancellation of life insurance contracts for non-payment of premiums ('forfeiture') is regulated by the *Life Insurance Act 1995*. Rights of cancellation for other reasons (for example, a fraudulent claim) are currently left to the common law.

2.112 In response to court decisions regarding rights of cancellation regarding life insurance contracts under the common law, the Bill will introduce a statutory framework for life insurance cancellation similar to that applying to general insurance. Item 13 in Part 4 of Schedule 5 inserts

after section 59 in Part VII of the IC Act (Expiration, renewal and cancellation) a new section (section 59A — Cancellation of certain contracts of life insurance) providing for a life insurer to cancel a life insurance contract for the same reasons that an insurer may cancel a contract of general insurance, except in relation to non-payment of a premium. A note to new paragraph 59A(d) indicates that section 210 of the *Life Insurance Act 1995* deals with forfeiture of a contract of life insurance because of non-payment of a premium.

2.113 Current section 63 prohibits an insurer from cancelling a contract of general insurance and any purported cancellation in contravention of section 63 is void. Item 14 in Part 4 of Schedule 5 amends section 63 to provide for a mirror contravention in relation to a purported cancellation (contrary to section 63) of a contract of life insurance. Accordingly, a cancellation of a life insurance contract (other than under the *Life Insurance Act 1995*) will have to be effected in accordance with the requirements of section 59A. This change does not affect the notice requirements under existing section 59.

Application

2.114 By operation of item 15 in Part 4 of Schedule 5, the amendments made by Part 4 of Schedule 5 apply to a contract of life insurance that was originally entered into after the commencement of item 15.

2.115 The amendment to section 63 made by item 14 does not alter the law applying to general insurance, so that amendment applies to general insurance contracts entered into before or after the commencement of item 15.

2.116 By operation of clause 2, item 15 in Part 4 of Schedule 5 commences on the day the Act receives the Royal Assent.

Schedule 6 — Third parties

2.117 Third parties may be persons that are specified in a contract of insurance (whether by name or otherwise) as being persons to whom cover provided by the contract extends ('third party beneficiaries') or they may be third parties against whose claims an insured or third party beneficiary has insurance cover. Schedule 6 contains a series of amendments designed to alter the rights and obligations of third parties under the IC Act.

Part 1 — Requests by third party beneficiaries to insurers for information

2.118 Under current section 41 of the IC Act, an insured that has made a claim under a contract of liability insurance may require the insurer to inform them in writing:

- whether the insurer admits that the contract applies to the claim; and
- if the insurer so admits, whether the insurer proposes to conduct, on behalf of the insured, the negotiations and any legal proceedings in respect of the claim made against the insured.

2.119 Item 1 in Part 1 of Schedule 6 substitutes a new section 41 in substantially the same terms as the current section 41, except that it is extended to give third party beneficiaries (as claimants) the same rights as insureds under the section.

Application

2.120 By operation of item 2 in Part 1 of Schedule 6, the amendment made by Part 1 of Schedule 6 applies to a contract of liability insurance that was originally entered into after commencement of item 2. The amendment also applies to a contract of liability insurance that was originally entered into before the commencement of item 2 and is renewed after that commencement.

2.121 By operation of clause 2, item 2 in Part 1 of Schedule 6 commences after the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Part 2 — Insurer's defences in actions by third party beneficiaries

2.122 Section 48 of the IC Act deals with, amongst other things, the defences available to a general insurer against a claim by a third party beneficiary. Section 48AA makes similar provision regarding contracts of life insurance offered in connection with Retirement Savings Accounts (RSAs).

2.123 Items 3 and 4 in Part 2 of Schedule 6 amend (including by repealing and substituting) subsections 48(1) and 48(2) so that they use the term 'third party beneficiary', now defined in section 11 (see item 1 in Part 1 of Schedule 1), but the substance of the subsections is unchanged. There are similar amendments to section 48AA in items 7 and 8 in Part 2 of Schedule 6.

2.124 Section 48AA is worded similarly to section 48, except that it deals with the defences a life insurer has against a claim by third party beneficiaries in relation to a contract of life insurance taken out by an RSA provider. To ensure greater consistency in the wording of sections 48AA and 48, items 5 and 9 amend paragraphs 48(2)(a) and 48AA(2)(a), so that the wording of the two sections mirror each other.

2.125 There has been some doubt as to whether subsection 48(3), and as a consequence subsection 48AA(3), allow for claims by third party beneficiaries to be tainted by the wrongful conduct of an insured. There is also doubt as to whether an insurer may raise pre-contractual conduct, such as a breach of the duty of disclosure, in assessing a claim by a third party beneficiary.

2.126 The intent of sections 48 and 48AA (as amended) is that third party beneficiaries should be in no better position, in terms of their ability to claim, than the insured. An insurer should be entitled to raise defences relating to the conduct of an insured, including conduct occurring prior to the time the contract was entered into.

2.127 To give effect to these intentions, items 6 and 11 in Part 2 of Schedule 6 amend subsections 48(3) and 48AA(3) respectively, to make it clear that, in defending an action by a third party beneficiary:

- an insurer may raise defences relating to the conduct of the insured; and
- the conduct that may be raised may have occurred either after the contract was entered into or before (for example, non-disclosure).

Application

2.128 By operation of subitem 12(1), the amendments made by items 3 to 6 in Part 2 of Schedule 6 apply to a contract of general insurance originally entered into after the commencement of subitem 12(1).

2.129 The amendments also apply to a contract of general insurance that was originally entered into before the commencement of subitem 12(1) and is renewed after that commencement.

2.130 By operation of subitem 12(2), the amendments made by items 7 to 11 in Part 2 of Schedule 6 apply to a contract of life insurance that was originally entered into after the commencement of subitem 12(2). If a contract of life insurance that was originally entered into before the commencement of subitem 12(2) is varied after that commencement to increase a sum insured under the contract, or to increase the number of life

insureds under the contract, or to provide one or more additional kinds of cover, then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of subitem 12(2), and the amendments made by items 7 to 11 apply to the contract to the extent of the variation.

2.131 By operation of clause 2, item 12 in Part 2 of Schedule 6 commences at the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Part 3 — Rights and obligations of third party beneficiaries under life insurance contracts

2.132 Section 48A of the IC Act applies to contracts of life insurance that are effected on the life of one person but expressed to be for the benefit of another person (a third party beneficiary). As part of its review, the Review Panel recommended a series of amendments be made to section 48A in response to recent developments in the insurance industry.

2.133 Item 13 in Part 3 of Schedule 6 amends section 48A by repealing current subsections 48A(1) and (2) and substituting new subsections 48A(1) and (2) to:

- allow for circumstances in which a person whose life is insured under a contract of life insurance may be a third party beneficiary;
- ensure that a third party beneficiary who has a claim over money payable under the contract of life insurance may bring an action against the insurer in respect of the claim without the intervention of the policyholder; and
- ensure that the third party beneficiary is capable of giving a valid discharge to the insurer in relation to the insurer's obligations in respect of the claim.

Application

2.134 By operation of item 14 in Part 3 of Schedule 6, the amendment in Part 3 of Schedule 6 applies to a contract of life insurance that was originally entered into after the commencement of item 14.

2.135 If a contract of life insurance that was originally entered into before the commencement of item 14 is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover, then the contract is treated, to the extent of the variation, as if it

had been originally entered into after the commencement of item 14, and the amendment made by item 13 in Part 3 of Schedule 6 applies to the contract to the extent of the variation.

2.136 By operation of clause 2, item 14 in Part 3 of Schedule 6 commences at the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Part 4 — Rights of third party to recover against insurers

2.137 Section 51 of the IC Act deals with the rights of third parties to recover directly against an insurer in circumstances where the insured under a contract of liability insurance is liable in damages to the third party. The section provides that, where an insured has died or cannot be found, the third party may bring an action against the insurer directly.

2.138 Items 15, 16 and 17 in Part 4 of Schedule 6 expand section 51 so that it not only covers liability of an insured but also liability of a third party beneficiary.

Application

2.139 By operation of item 18, the amendments in Part 4 of Schedule 6 apply to a contract of liability insurance originally entered into after the commencement of item 18. The amendments also apply to a contract of liability insurance that was originally entered into before the commencement of item 18 and is renewed after that commencement.

2.140 By operation of clause 2, item 18 in Part 4 of Schedule 6 commences on the day after the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Part 5 — Representative actions by ASIC on behalf of third party beneficiaries

2.141 Section 55A of the IC Act permits ASIC, if it considers it in to be the public interest, to bring or continue actions against insurers on behalf of one or more insureds in relation to certain breaches by the insurer of the IC Act.

2.142 Items 19 to 24 of Part 5 of Schedule 6 make several amendments to section 55A to extend ASIC's powers to cover bringing or continuing actions against insurers on behalf of third party beneficiaries as well as insureds.

Application

2.143 By operation of item 25, the amendments in Part 5 of Schedule 6 apply to contracts of insurance whether originally entered into before or after the commencement of item 25.

2.144 By operation of clause 2, item 25 in Part 5 of Schedule 6 commences on the day the Act receives the Royal Assent.

Part 6 — Non-disclosure or misrepresentation by members of group life insurance schemes

2.145 Insurers normally have a remedy for non-disclosures and misrepresentations made by insureds only prior to the time the contract was entered into. However, in the case of group contracts of life insurance that are taken out by, for example, superannuation trustees for the benefit of all the scheme members, the contract date will often pre-date the joining of the scheme by fund members. As a consequence, an insurer would ordinarily have no remedy for non-disclosure and misrepresentation in relation to members who join a group scheme and receive cover under the relevant contract of life insurance after the contract date.

2.146 To deal with this situation, current section 32 of the IC Act provides that non-disclosures or misrepresentations made in respect of scheme members of superannuation and retirement schemes are treated as though the contract were an individual contract of life insurance that was entered into at the time when the proposed member joined the scheme.

2.147 In some circumstances, individuals will join a superannuation scheme but there will be some delay before life insurance cover they acquire as part of joining that scheme is commenced. For example, a new employee may join a superannuation scheme and superannuation contributions may be made on their behalf, but before the insurer provides life insurance cover, that employee must undergo a medical examination and/or answer questions about their health.

2.148 In those circumstances, the existing section 32 would still deny the insurer a remedy if non-disclosure or misrepresentation occurred during the interim period, because under current paragraph 32(b), the contract is taken to be entered into when the member joined the scheme.

2.149 Replacement section 32 in item 34 in Part 6 of Schedule 6 addresses this difficulty by providing that, where there is a delay from the time of joining the scheme until the time that cover is actually effected, the relevant contract of life insurance is taken to have commenced (that is, to be 'entered into') at the time the proposed life insured became a life

insured under the scheme, in other words, at the time the life insurance cover under the scheme took effect in relation to the member concerned.

2.150 There are, in addition to ‘blanket’ contracts of life insurance taken out in connection with a superannuation scheme, other circumstances in which life insurance is taken out for a group of people, many of whom may become eligible for cover after the contract date. For example, contracts of life insurance for groups of people linked by a common factor such as employees of a company, or a scheme unrelated to employment such as membership of a health insurance scheme that offers members optional life insurance cover. Those other contracts also present a difficulty with the availability of insurer remedies for non-disclosure and misrepresentation.

2.151 A broader term is to be introduced for the purposes of the new section 32, namely, a ‘group life contract’, which is defined to mean a contract of life insurance that is maintained for the purpose of a superannuation or retirement scheme, or another scheme (including one not related to employment). This definition is inserted into subsection 11(1) by item 27.

2.152 The term ‘blanket superannuation contract’ in subsection 4(2) of the IC Act is replaced by item 2 with the expression ‘superannuation contract (other than an individual superannuation contract)’, and items 29 to 31 make some consequential changes to subsection 11(4).

2.153 Items 28, 32 and 33 change the phrase ‘superannuation or retirement scheme’ to ‘superannuation, retirement or other group life scheme’ in paragraph (b) of the definition of ‘proposal form’ in subsection 11(1) and in paragraphs 23(a) and 26(3)(a). This change enlarges the scope of operation of those provisions to encompass other types of group life schemes.

2.154 Item 35 corrects a typographical error in section 32A.

Application

2.155 By item 36 in Part 6 of Schedule 6, the amendments relating to replacement of the term ‘blanket superannuation contract’ by items 26, 29, 30 and 31 apply to a contract of life insurance whether originally entered into prior to, or subsequent to, the commencement of item 36. The amendment to correct an error in 32A also applies to contracts entered into before or after commencement of item 36.

2.156 The remainder of the amendments in Part 6 apply to a contract of life insurance entered into after commencement of item 36 in Part 6 of Schedule 6.

2.157 Where a contract of life insurance that was originally entered into before the commencement of item 36 in Part 6 of Schedule 6 is varied after that commencement to increase a sum insured under the contract, or to increase the number of life insureds under the contract, or to provide one or more additional kinds of cover, then the contract is treated, to the extent of the variation, as if it had been originally entered into after the commencement of item 36, and the amendments made by items 27, 28 and 32 to 34 apply to the contract to the extent of the variation.

2.158 By operation of clause 2, Part 6 of Schedule 6 commences on the day after the end of the period of 12 months beginning on the day the Act receives the Royal Assent.

Schedule 7 — Subrogation

2.159 In the case of indemnity insurance, unless excluded by the terms of the contract, there is a right for an insurer to bring an action in the name of the insured (that is, the insurer is subrogated to the rights and remedies of the insured in respect of the subject matter insured) to pursue any claims the insured may have against third parties which have contributed to a loss. So if, for example, an insurer pays a claim to an insured arising from a motor vehicle collision, the insurer may, in the name of the insured, pursue actions against the person who caused the collision.

2.160 The amount recovered from the third party is often not equal to the amount the insurer has paid to the insured in respect of the loss. The costs of the action, and any difference between the amount of the loss and the amount insured, must also be considered when deciding to whom any recovered moneys should be paid.

2.161 Section 67 of the IC Act provides rules for how moneys recovered from a third party by an insurer under a right of subrogation should be divided between the insurer and the insured. The Review Panel listed a number of criticisms of section 67 in its review.

2.162 To address some of the difficulties experienced with the existing section 67, item 2 of Schedule 7 introduces a replacement section 67 containing rules that are intended to provide for the division of any proceeds from a recovery action. This provision is based on the following principles.

- First, the party taking the recovery action should be entitled to reimbursement for the administrative and legal costs of that action from any moneys recovered. If both parties contribute, they both should be reimbursed (see new

subsection 67(4)), or share the reimbursement pro rata if there is insufficient recovered money to reimburse both in full (see new subsection 67(5)).

- Secondly, there are three possibilities for distribution of remaining sums depending on who has funded the recovery action.
 - (a) If the insurer funds the recovery action pursuant to its rights of subrogation, it is entitled to an amount equal to the amount that it has paid to the insured under the contract of insurance. The insured is then entitled to any further amount necessary for it to ultimately recover from the insurer under the contract of insurance or the third party in the recovery action, or both in combination, the full amount of its loss (not just the measure of indemnity under the policy). This entitlement does not diminish the insured's right to receive payment under the policy in a prompt manner in accordance with the terms of the contract and the insurer's obligation to pay promptly, subject to any contrary agreement between the parties (see new subsection 67(2)).
 - (b) If the insured funds the recovery action, the order in the preceding paragraph is reversed. The insured is entitled to retain an amount so that the total that it receives from the recovery action and under the policy is equal to its total loss. The insurer is entitled at this point to an amount equal to the amount that it has paid to the insured under the insurance contract (see new subsection 67(3)).
 - (c) If the action is funded jointly by both the insurer and insured, they are both entitled to the same amounts as referred to in (a) and (b) above pro rata if there are insufficient funds to reimburse them in full (see new subsection 67(5)).
- Thirdly, any *excess* or windfall recovery is then to be distributed to both parties in the same proportions as they contributed to the administrative and legal costs of the recovery action (see new subsection 67(7)). Through this process, the party (or parties) that bore most of the cost and risk of the recovery action should receive the benefit of the windfall. Most commonly this would be the insurer — but the insurer only gets the benefit after the insured has received full recovery for all its losses, because the insured would

have been entitled to these losses as damages from the third party, whether or not there was any insurance in place.

- Finally, any separate or identifiable component in respect of interest should be divided fairly between the parties, having regard to the amounts that each has recovered and the periods of time for which each party lost the use of their funds.

2.163 The Review Panel had also recommended, for the purposes of the new section 67, that third party beneficiaries should be treated as insureds and this is the effect of item 1 of Schedule 7. Accordingly, the same principles of subrogation apply whether the person being indemnified is the insured party or a third party beneficiary to whom the indemnity cover extends.

2.164 New subsection 67(9) provides that the rights of the insurer and insured (or third party beneficiary) under section 67 may be modified by the terms of the relevant insurance contract.

Application

2.165 By operation of item 3 of Schedule 7 and clause 2, the amendments made by Schedule 7 apply to a contract of general insurance that was originally entered into after the commencement of item 3. Schedule 7 also applies to a contract of general insurance that was originally entered into before the commencement of item 3 of Schedule 7, and is renewed after that commencement.

2.166 By operation of clause 2, item 3 of Schedule 7 commences on the day after the end of the period of 6 months beginning on the day the Act receives the Royal Assent.

Chapter 2

Regulation impact statement

Background

Definition — Insurance

3.1 Insurance plays a vital role in Australia's economy. Individuals, groups, businesses and governments are able to participate in social and economic activities that they otherwise would not be able to engage in by using insurance as a means to price and transfer risks associated with those activities.

3.2 Insurance is created by an insurer and an insured entering into a contract. Under the contract of insurance, a person facing a risk of loss (the insured) from a possible occurrence pays a contribution known as a premium to an insurer who, in return, promises to compensate the insured in proportion to their loss should the occurrence eventuate.

3.3 There are four main classes of insurance:

- personal — provides benefits if the insured person dies or is disabled by accident or sickness;
- property — provides against loss of or damage to insured property such as buildings or their contents, motor vehicles, ships, cargoes or any other class of property;
- liability — provides against legal liability to pay compensation for injury or damage for which the relevant insured may be sued by some other person; and
- monetary loss — provides against monetary losses due to, for example, embezzlement by employees or failure of a debtor to repay a loan.

3.4 Personal insurance equates to life insurance. The remaining three classes of insurance are categorised as general insurance.

Profile of the Australian insurance market

General insurance

3.5 In the financial years ending in 2008–09, there were 133 private sector insurers accepting general insurance business (i.e. insurance other than life and health insurance). Of these, 116 were direct insurers and 17 were reinsurers. Private insurers reported gross premium revenue of \$31.0 billion. Direct insurers reported gross premium revenue of \$29.2 billion, making up 94.2 per cent of the total. Reinsurers accounted for the remaining 5.8 per cent of the total, or \$1.8 billion. At 22.8 per cent, the domestic motor vehicle class of business accounted for the largest percentage of total direct gross premium revenue.

3.6 In the financial years ending in 200809, private insurers reported total assets of \$94.2 billion, an increase of \$3.1 billion (3.4 per cent) on the previous year. Of these assets, \$84.8 billion (90 per cent) are held by direct insurers. Industry total liabilities were \$65.6 billion, of which \$59.2 billion (89.9 per cent) are held by direct insurers.¹

Life insurance

3.7 As at September 2009, there were 32 life insurance companies operating in Australia. They managed \$239.3 billion in assets and generated \$41 billion in net premiums for the twelve months ended September 2009.²

3.8 The life insurance market is split into ‘superannuation’ and ‘ordinary’, defined by the source of business. In recent years, the superannuation business has become the main focus of life insurers, representing 91.1 per cent of premiums relating to Australian policyholders for the year to 31 March 2008.³

3.9 Traditional life insurance products (such as endowment policies, whole of life policies and level premium insurance policies) have largely been replaced by more modern products, such as term insurance, as these products reduce the longevity risk of insurers and provide flexibility for consumers.

1 Australian Prudential Regulation Authority, *Half Yearly General Insurance Bulletin - June 2009*.

2 Australian Prudential Regulation Authority, *Quarterly Life Insurance Performance – September 2009*.

3 Australian Prudential Regulation Authority, *Life Insurance Trends — March 2008*.

Insurance Contracts Act 1984

3.10 The law governing contracts of insurance has a direct influence on the effectiveness and efficiency of the insurance market in Australia. For some time, the law concerning contracts of insurance was derived from a combination of common law principles and statutes issued by a variety of parliaments.

3.11 In 1982, the Australian Law Reform Commission (ALRC) released Report No 20, *Insurance Contracts* (ALRC 20), which made a number of detailed recommendations for reform of the law concerning contracts of insurance. That report led to the enactment by the Australian Parliament of the *Insurance Contracts Act 1984* (IC Act), which came into operation on 1 July 1986. The IC Act provisions were based largely on the ALRC's recommendations.

Problem identification

3.12 The ALRC identified a series of key principles in ALRC 20 that it considered should be the foundation of the law concerning contracts of insurance. Those principles, outlined below, addressed some issues and deficiencies that had affected the efficiency of the former law.

- *Uniformity and modernisation* — The law should, as far as possible, be uniform throughout Australia. The ALRC noted the law should remove uncertainties and specify acceptable rules for the modern relationship of the insurer and insured.
- *Assurance of fair competition* — The law should ensure that freedom of contract and promotion of competition, so far as compatible with principles of equity and fairness to the insuring public, are basic goals.
- *Promotion of informed choice of insurance* — As far as practicable, insureds should receive sufficient information and be otherwise protected by the law so that they may choose the insurance policy best suited to their needs. The ALRC noted that a lack of information concerning contracts of insurance and the different types of cover available was a serious problem for consumers.
- *Principle of utmost good faith* — The principle of utmost good faith, which has traditionally underlined contracts of insurance, should remain the touchstone of contracts of insurance.

- *Need to avoid unfair burdens* — The remedies available to insurers in respect of misrepresentation, non-disclosure and breach of contract should not place a burden on the insured that is vastly disproportionate to the loss the insured's actions caused to the insurer.
- *Need to avoid catastrophic losses* — As far as practicable, insureds that might otherwise unintentionally be exposed to the risk of catastrophic losses should be protected against losing insurance cover through no fault of their own.⁴

3.13 The IC Act was designed to give effect to those principles. Since its commencement in 1986, the market for insurance in Australia has evolved, both in terms of the type of insurance on offer and the participants in the market. Judicial interpretations of the IC Act have highlighted how it applies in a range of situations, some of which may not have been contemplated when the IC Act was designed. Also, subsequent statutes, such as the *Corporations Act 2001* and *Electronic Transactions Act 1999*, have brought change to the surrounding regulatory environment.

3.14 Those developments, and the experience of applying the IC Act since 1986, has led to a widely held view that, although the IC Act has generally operated effectively to the benefit of the insurance market, there are aspects that would benefit from refinement to prevent inefficiencies and inappropriate outcomes.

Revision of the IC Act: Objectives

3.15 In 2003, the Australian Government commissioned a review panel (the Review Panel) to review the IC Act to ensure it 'continues to meet its original consumer protection objectives and does not discourage insurers from writing policies in Australia.'⁵ The Review Panel was asked to report on whether provisions of the IC Act remained appropriate in the light of developments in the insurance market and whether any amendments were necessary to clarify or remove ambiguity.

3.16 The Review Panel found that the IC Act was generally operating satisfactorily. However, some amendments were recommended to address insurance market developments and judicial interpretation during the

4 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, Canberra, pp xxi-xxii.

5 Press release C087/03, 10 September 2003, issued by the then Minister for Revenue and Assistant Treasurer.

period since its enactment. The Review Panel's recommendations were developed having regard to the need to preserve an appropriate balance between the rights and obligations of insurers and insureds.

Consultation

Review Panel deliberations

Section 54 of the IC Act

3.17 Insurers had particular concerns about the operation of section 54 of the IC Act and its impact on the cost and availability of liability insurance. The Review Panel began its review by releasing an issues paper that explained the operation of section 54 and its current judicial interpretation. In response, 32 written submissions were received from stakeholders, including the insurance industry, consumer representatives, the regulator, and dispute resolution bodies. The Review Panel also met with stakeholders.

3.18 The Review Panel recommended legislative reform of section 54, but only in respect of particular types of insurance policies. Draft amendments that gave effect to the Review Panel's initial recommendations were released for public consultation in 2004. An additional 16 submissions primarily from the insurance industry, the legal profession and the regulator were received on the draft amendments. The Review Panel made further recommendations to revise the draft amendments in response to these submissions and stakeholder consultations.

Provisions of the IC Act other than section 54

3.19 The Review Panel's review of provisions of the IC Act other than section 54 began in November 2003 with a request to stakeholders for written 'submissions at large' on issues that may be affecting the current operation of the IC Act and options to address those issues. This was followed by a series of stakeholder meetings in February 2004 to identify key matters for consideration from those issues raised in written submissions.

3.20 In March 2004, the Review Panel released an issues paper, which outlined the matters raised by stakeholders that the Review Panel intended exploring in the second phase of the Review. The Review Panel noted that it could only address issues that had an adverse impact on the operation of the IC Act and could not analyse some issues that may be of significance but fell outside the review's terms of reference.

3.21 The Review Panel received around 25 submissions from the insurance industry, consumer representatives, dispute resolution bodies and the legal profession in response to the issues paper and used them to develop a proposals paper, which was released in May 2004. The proposals paper included over 40 proposals to amend the IC Act. The Review Panel sought further comments on the contents of its proposals, particularly those that had not been raised in the issues paper but were developed subsequently.

3.22 The proposals paper generated further written submissions from the insurance industry, dispute resolution bodies, consumer representatives and the legal profession. Those were taken into account by the Review Panel in formulating its final recommendations and report, released in January 2005.

Summary of key stakeholder views on the Review Panel's reports

3.23 Insurance brokers, legal specialists, life insurance industry representatives and the regulator expressed general support for the recommendations of the Review Panel, with some reservations on details.

3.24 Consumer representatives indicated that they would have preferred the Review Panel to propose more regulation concerning claims handling processes, and they also have some reservations about the detail of some recommendations. However, generally consumer representatives were satisfied with the review process and considered that the recommendations to be well-reasoned and balanced.

3.25 The industry body representing general insurers expressed some dissatisfaction with the time frame of the consultation process and opposed a number of the Review Panel's recommendations on the basis that they would impose additional costs for their insurers.

Exposure draft legislative package — February 2007

3.26 An exposure draft of an amending Bill and accompanying regulations was prepared so that stakeholders could comment on the detail of the proposals. The exposure draft legislative package was publicly released in February 2007. It included a revised version of the section 54 amendments. More than 20 submissions were received on the exposure draft Bill.

Identification of options

3.27 The options for reform, outlined below, are based on a number of the recommendations of the Review Panel, developed in the course of the review in meetings with the Review Panel and in response to issues raised by stakeholders in written submissions to the Review Panel. These options were subsequently modified in response to stakeholders' concerns raised in relation to the February 2007 exposure draft Bill.

3.28 The Insurance Contracts Amendment Bill 2009 (the Bill) is based on a number of the Review Panel's recommendations and contains some further modifications made to the February 2007 exposure draft Bill in the light of consultations with stakeholders subsequent to the release of the Bill, including, in some cases, removal of a measure.

3.29 The proposed regulatory changes in the 2009 Bill, which are not minor or machinery, relate to the following matters:

1. electronic communication;
2. objective component of insured's duty of disclosure;
3. disclosure obligations on renewal of an eligible contract of insurance;
4. notification of duty of disclosure;
5. non-disclosure rules and life insureds;
6. life insurance remedies; and
7. third party beneficiaries.

3.30 The groups that will primarily be impacted upon by the proposals include:

- insurers;
- insureds (especially those that have claims), including proposed insureds and beneficiaries under policies; and
- government and regulators, including self-regulatory organisations.

3.31 Most of the proposals affecting insurers or insureds would also affect insurance brokers, where a broker was involved in the negotiation and ongoing management of an insurance contract. However, for the sake

of simplicity, insurance brokers have not been identified as a separate impact group for the purposes of the regulation impact statement. It has been assumed that the costs and benefits accruing to insurance brokers as a result of the proposals would ultimately be passed onto insurers and insureds.

3.32 Options for responses to each of these matters are analysed below.

Identification of options, impact analysis, conclusions and recommendations

Impact assessment methodology

3.33 Impacts can be divided between three impact groups (consumers, business and government). Typical impacts of an option on consumers might be changes in access to a market, the level of information and disclosure provided, or prices of goods or services. Typical impacts of an option on business would be the changes in the costs of compliance with a regulatory requirement. Typical impacts on government might be the costs of administering a regulatory requirement. Some impacts, such as changes in overall confidence in a market, may impact on more than one impact group.

3.34 The assessment of impacts in this regulation statement is based on a seven-point scale (-3 to +3). The impacts of each option are compared with the equivalent impact of the 'do nothing' option. If an impact on the impact group would, relative to doing nothing, be beneficial, the impact is allocated a positive rating of +1 to +3, depending on the magnitude of the relative benefit. On the other hand, if the impact imposes an additional cost on the impact group relative to the status quo, the impact is allocated a negative rating of -1 to -3, depending on the magnitude of the relative cost. If the impact is the same as that imposed under the current situation, a zero score would be given, although usually the impact would not be listed in such a case.

3.35 The magnitude of the rating of a particular impact associated with an option has been assigned taking into account the overall potential impact on the impact group. The reference point is always the status quo (or 'do nothing' option). Whether the cost or benefit is one-off or recurring, and whether it would fall on a small or large proportion of the impact group (in the case of business and consumers), is factored into the rating. For example, a cost or benefit, even though large for the persons concerned, may not result in the maximum rating (+/-3) if it is a one-off event that only falls on a few individuals. Conversely, a small increase in

costs or benefits might be given a moderate or high rating if it would be likely to recur or if it falls on a large proportion of the impact group. The rating scale for individual impacts is explained in the table below.

Rating an individual impact

+3	+2	+1	0	-1	-2	-3
Large benefit/ advantage compared to 'do nothing'	Moderate benefit/ advantage compared to 'do nothing'	Small benefit/ advantage compared to 'do nothing'	No substantial change from 'do nothing'	Small cost/ disadvantage compared to 'do nothing'	Moderate cost/ disadvantage compared to 'do nothing'	Large cost/ disadvantage compared to 'do nothing'

3.36 The ratings for the individual impacts compared to the status quo are then tallied to produce an overall outcome for the option. If it is positive, it indicates that the option is likely to produce a more favourable cost/benefit ratio than the status quo. If it is zero there would be no overall benefit from adopting the option, and if negative the option would provide overall a less favourable cost/benefit ratio than the 'do nothing' option. Ordinarily, options that have the highest positive score would be the favoured courses of action.

3.37 What is classed as a 'large', 'moderate' or 'small' cost or benefit depends on the nature of the problem and options being considered. Of course, the costs and benefits associated with options to address a problem costing billions of dollars per year are likely to be of a much greater absolute magnitude than the costs and benefits of options for dealing with a rather modest issue that affects only a handful of persons. However, as all the ratings are made relative to the status quo/ do nothing option for a particular problem, the absolute value of 'large' or 'moderate' or 'small' is not really important. All that matters is that within a problem assessment, the impacts of each option are given appropriate ratings relative to the status quo and each other. If that occurs, it will be sufficient for the methodology to yield an overall rating that assists in assessing the relative merits of options, from a cost/benefit perspective, to address the particular problem.

3.38 An example of the rating calculation for an option, using the seven-point scale ratings of impacts, is in the table below. The example is based on a purely hypothetical scenario that a new type of long-wearing vehicle tyre is being sold and marketed, but it has become apparent that the new style of tyres have a higher risk of exploding while in motion than conventional tyres. The example is designed merely to illustrate how the rating scale might be used to compare a proposal's costs and benefits option to the 'do nothing' option — it is not intended to be a

comprehensive or realistic assessment of options to address such a problem.

Illustrative rating for the problem of a long-wearing tyre that may fail

Option A: Do nothing

	Benefits	Costs
Consumers	Access to a cheaper solution for vehicle tyres	Risk of tyre failure that can result in personal and property damage as a result of collision. Damage can be severe but cases are rare
Industry		Some compensation payments to persons as a result of collisions caused by the tyre
Government	Advantages for waste management perspective	

Option B: Ban on sale of the new tyre

	Benefits	Costs
Consumers	No persons will be affected by tyre failure and resultant damage (+3)	Lack of access by consumers to long-wearing vehicle tyres, increasing the cost of vehicle maintenance [-2]
Industry	No compensation payments for accident victims [+1]	Transitional costs involved with switching back all manufacturing/marketing operations to conventional tyres [-3]
Government		Conventional tyres produce more waste which is costly to deal with [-1]
Sub-rating	+4	-6
Overall rating	-2	

Option C: Industry-developed quality control standards

	Benefits	Costs
Consumers	Much lower risk of tyre failure and resultant damage than status quo [+2]	
Industry	Significantly less compensation payments for accident victims [+1]	Developing and monitoring industry-wide quality control standards [-2]
Government		
Sub-rating	+3	-2
Overall rating	+1	

3.39 In the above hypothetical example, Option C appears to have a better impact for consumers and a better overall cost/benefit rating than Option B.

Electronic communication

Problem

3.40 Communications under the IC Act are currently exempt from the operation of the *Electronic Transactions Act 1989* (ET Act). The ET Act provides that if a Commonwealth law requires a notice to be provided in writing, it may also be given by means of electronic communication if the relevant recipient consents.

3.41 There are no equivalent facilities in the IC Act. Accordingly, the exemption for the IC Act limits the ability of insurers to utilise electronic communication with insureds. Use of electronic communication for various requirements under the IC Act, including for the dissemination of notices, documents and other information, has the potential to lower costs and increase convenience for insurers and insureds.

Objective

3.42 The objective is to ensure that the IC Act permits a range of means of communication between insurers and insureds, including by electronic means, such as phone, facsimile, and the internet, provided that the risks for the recipients in the use of electronic means are not unreasonable.

Options

Option A: Do nothing

3.43 Under this option, the IC Act would remain exempt from the ET Act and a number of communications under the Act would still need to be made by traditional writing.

Option B: Make amendments so that electronic communication may be used for communications between insurers and insureds

3.44 This option would involve removing the exemption of the IC Act from the operation of the ET Act and amending the IC Act, so that communications currently required to be 'in writing' for the purposes of the IC Act may be made by electronic means. Under this option, insurers would not be compelled to utilise electronic communication methods to interface with insureds or potential insureds if they did not choose to do so.

Impact analysis

Impact group identification

Affected groups:

- insurers; and
- insureds.

Assessment of costs and benefits

Option A: Do nothing

	Benefits	Costs
Consumers	No risk of inadvertent loss of cover arising from electronic communication not being received or appropriately recognised	Additional costs of hard copy correspondence passed on through additional charges
Insurers		Using hard copy correspondence for all required communications may be more expensive than electronic means
Government/regulators		

Option B: Make amendments so that electronic communication may be used for communications between insurers and insureds

	Benefits	Costs
Consumers	Savings for insurers from use of electronic communications would be passed to consumers in the form of lower prices[+1]	Possible greater risk in some cases that cover will be inadvertently lost as a result of electronic statutory communications not being received or their importance not recognised by the insured [-1]
Insurers	Administrative savings by use of electronic means for statutory communications rather than hard copy correspondence [+3]	
Government/regulators		
Sub-rating	+4	-1
Overall rating	+3	

Consultation

3.45 Removal of the current IC Act exemption from the scope of the ET Act received wide support. There were no submissions in response to the Review Panel's reports opposed to allowing for electronic communications under the IC Act. However there were suggestions from representatives of consumers and the legal profession that allowing electronic communications should be subject to particular safeguards, including the safeguards proposed by the Review Panel in its final report.

3.46 Representatives of insurers submitted there should be no requirement to provide notices in hard copy if the relevant insured has consented to receive information electronically. This was supported by other submissions. However, an insurance dispute resolution body argued that no sanction should apply to an insured until they had been sent a hard copy of the relevant notice or acknowledged receipt of the notice through electronic means.

3.47 Following the release of the exposure draft bill for consultation, life insurance industry representatives suggested that the annual review notice could still be required to be provided in hard copy.

Conclusion and recommended option

3.48 Option A is not preferred because:

- general government policy, as reflected in the *Electronic Transactions Act 1999*, is to facilitate electronic transactions; and
- the potential cost savings in permitting electronic communication to be used for IC Act purposes are significant.

3.49 Option B would allow for electronic communications in accordance with the requirements of the ET Act. However, a number of submissions argued that insurance contracts warranted additional safeguards. The main issue of concern was that the failure of a consumer either to receive or react appropriately to a statutory communication under the IC Act might, in some cases, lead to inadvertent loss of cover and, if the cover had to be called upon due to a claim arising, they would face major financial difficulties. For example, it was argued strongly by consumer representatives and some lawyers that communications required under the IC Act, which are sent electronically, should be capable of being printed and retained. However, responses to the February 2007 exposure draft Bill argued that the requirements of the ET Act are sufficient to address these concerns.

3.50 A further counter-argument against additional safeguards is that electronic communications are more likely to be promptly read and recognised than hard copies.

Objective component of insured's duty of disclosure

Problem

3.51 A number of submissions to the Review Panel, particularly those from advocates for insureds, argued that the current tests for the duty of disclosure (particularly those under subsections 21(1) and 21A(4) of the IC Act) impose an unreasonable burden on insureds to know what an insurer regards as relevant to its decision whether to enter a contract of insurance.

3.52 Section 21, which applies to all contracts of insurance, requires an insured to disclose every matter that they know, or in the circumstances could reasonably be expected to know, would be relevant to the insurer's decision whether to accept the risk and enter the contract.

3.53 Section 21A, which applies in respect of eligible contracts of insurance,⁶ precludes an insurer from making open-ended requests for an insured to disclose 'any other matter'. However, the insurer may still seek disclosure of 'exceptional circumstances' that the insured, or a reasonable person in the circumstances, would be expected to know are relevant to the insurer's decision whether to accept the risk (subsection 21A(4)).

3.54 Disclosure is a significant issue in a number of insurance-related disputes. In a submission responding to the Review Panel's issues paper, the Consumers' Federation of Australia (CFA) estimated that around 13 per cent of determinations made by the then General Insurance Inquiries and Complaints Service Ltd (IEC) involved disputes regarding disclosure.⁷ More recently, the Financial Ombudsman Service has advised that in the year ending June 2009, 4 per cent of disputes determined by the General Insurance Division of the Service related to 'non-disclosure on proposal', and a further 2 per cent related to 'disclosure issues'. In the ended ending June 2009, about 4.5 per cent of disputes determined by the former Insurance Ombudsman Service related to 'non-disclosure on proposal'.

3.55 The CFA argued that no other consumer contract imposes a burden on the consumer to know what information the other party requires when deciding whether to enter the contract. The CFA noted that in the case of consumer credit, consumers must answer the credit provider's questions accurately but are not expected to know what other information the credit provider needs to assess the loan application.

6 'Eligible contracts of insurance' are defined in regulation 2B of the *Insurance Contracts Regulations 1985*.

7 The Consumer Federation of Australia (CFA) in its submissions to the Review Panel's March 2004 Issues Paper estimated that between January 1999 and April 2004, the external dispute resolution body, the IEC Claims Review Panel, had made 642 determinations on claims that at least, in part, considered disclosure. These determinations were broken down as follows: Small business (21); Consumer credit (39); Home contents (170); Home building (71); Marine (7); Motor vehicle (200); Motor vehicle TPPD (1); Personal accident/sickness (102); Travel (27); Other (4).

The IEC Panel determined 936 claims in 2002-2003. The CFA extrapolated that 642 claims over a five year timeframe is about 128 per year. 128/936 (the 2002-2003 figure) being 13.7 % - the figure the CFA noted represented the percentage of claims each year that involved (in part) disclosure issues.

In its 2006-2007 Annual Review (at page 10), the IEC (by then, the Insurance Ombudsman Service - the IOS) noted that 'once again, with 35 % of the total, motor vehicle disputes were the most highly represented at IOS, followed by home building disputes (21%), travel disputes (18%) and home contents disputes (12%). With respect to motor vehicle disputes, the main reason for the insurer denying liability was related to exclusion or condition (45%), with non-disclosure the next most frequently cited reason for denying liability (15%), followed by fraud (14%). (On 1 July 2008, the IOS was folded into the Financial Ombudsman Service.)

3.56 The CFA also argued that the IC Act provisions concerning disclosure fail to take account of technological advances such as data processing and the internet, which have placed insurers in an even better position to assess risk.

3.57 Requiring potential insureds to disclose all information relevant to an insurer's decision, when those persons are not necessarily in a position to assess what type of information may be relevant, can result in unfair outcomes for insureds, for example, where a claim is denied or reduced as a result of the failure to disclose.⁸

Objective

3.58 The objective is to ensure that the duty of disclosure requirements in the IC Act strike an appropriate balance between, on one hand, ensuring insurers have reliable information to assess and price risk and, on the other hand, the need to avoid placing unfair burdens on insureds in respect of the remedies available against them for non-disclosure.

Options

Option A: Do nothing

3.59 No changes would be made to the objective elements of the insured's duty of disclosure tests in sections 21 and 21A.

Option B: Replace the general duty to disclose in section 21 with a requirement to answer specific questions honestly and fully

3.60 Under this option, the general duty of disclosure in section 21 would be replaced with a duty on insureds to answer fully and honestly questions that are put to them by the insurer. If that were to happen, section 21A, which applies such a framework to eligible contracts of insurance, would no longer be necessary.

8 A majority of the High Court has taken the view that to require an insured to disclose to an insurer every matter known to (or reasonably knowable by) the insured that was relevant to the insurer's decision would impose an extraordinarily high burden on an insured, which few could ever fully discharge. *Permanent Trustee Aust Ltd & Anor v FAI General Insurance Co Ltd (in liq)* (2003) 12 ANZ Ins Cas 61-565 at page 76, 650.

Option C: Clarify the operation of the mixed objective/subjective duty of disclosure test in section 21

3.61 Under this option, the current mixed objective/subjective duty of disclosure that applies to insureds under section 21 would be retained. However, the application of the test would be elucidated by requiring reference to non-exclusive factors, including the nature of the particular cover being provided.

Option D: Remove that part of section 21A that permits insurers to ask ‘catch all’ questions in relation to eligible contracts of insurance

3.62 This option would discourage insurers that offer eligible contracts of insurance from asking general ‘catch all’ questions concerning ‘exceptional circumstances’. Insurers would no longer be able to rely on the duty of disclosure in relation to eligible contracts of insurance if they ask the insured to disclose ‘exceptional circumstances’ in circumstances such as described by the current paragraph 21A(4)(b).

Impact analysis

Impact group identification

Affected groups:

- insurers;
- insureds, including proposed insureds and beneficiaries under policies; and
- government and regulators, including self-regulatory organisations.

Assessment of costs and benefits

Option A: Do nothing

	Benefits	Costs
Consumers		Leaving the current duty of disclosure test unchanged may continue to unfairly disadvantage some insureds if they fail to disclose a matter they do not realise is relevant to an insurer's decision whether to enter the contract of insurance
Insurers	Insurers sometimes benefit from the objective elements of the existing duty of disclosure test to deny claims	Courts may continue to have different interpretations about the factors to consider in relation to the objective element of the duty of disclosure, which leads to a lack of uniformity in application of the IC Act
Government/regulators		

Option B: Replace the general duty to disclose with a requirement to answer specific questions honestly and fully

	Benefits	Costs
Insurers	Fewer disputes and legal actions by insureds concerning their obligation to disclose matters that were considered relevant by the insurer [1]	Applying this option to large commercial risks, and in respect of some life insurance products, practicable extremely costly for insurers, as it would require them to construct lengthy and complex specific questions to ensure all relevant information is obtained [-3]
Insureds	Fewer disputes about an alleged failure to disclose relevant matters [1]	Insurers may require consumers to respond to more lengthy and complex sets of questions [-2] Less availability of insurance and higher costs for insureds, especially in non-eligible lines [-2]
Government/regulators	Frequency of disputes regarding disclosure could reduce and ease of resolution could increase [1]	
Sub-rating	+3	-7
Overall rating	-4	

Option C: Clarify the operation of the mixed objective/subjective duty of disclosure test in section 21

	Benefits	Costs
Insurers	Reduction in frequency and complexity/cost of disputes [1]	This option may lead to some litigation about interpretation of the new objective factors [-1]
Insureds	Reduction in frequency and complexity/cost of disputes [1]	This option may lead to some litigation about interpretation of the new objective factors [-1]
Government/regulators	Ease of interpretation and reduction of inconsistencies between factors that are taken into account in determining an insured's duty of disclosure is likely to result in more efficient adjudication [2]	
Sub-rating	+4	-2
Overall rating	+2	

Option D: Remove the part of section 21A that permits insurers to ask 'catch all' questions in relation to eligible contracts of insurance

	Benefits	Costs
Insurers		For some insurers under eligible contracts, being no longer able to rely on 'catch all' questions may encourage them to formulate more, or more complex, specific questions [-1]
Insureds	Insureds under eligible contracts will not be disadvantaged by being required to answer questions that require a knowledge of what factors may be relevant to an insurer's decision [+2]	Possibility of having to answer a larger number, or more complex, questions [-1]
Government/regulators	Frequency and complexity of disputes that need to be adjudicated regarding the duty of disclosure will be reduced [+1]	
Sub-rating	+3	-2
Overall rating	+1	

Consultation

3.63 Option B was supported by stakeholders including representatives of insurance brokers, and a legal aid commission. It was argued that insurers should be required to ask insureds specific questions that reflect their underwriting guidelines. Insurers that offered insurance over large commercial risks disagreed. They provided examples suggesting that, in those cases, questions were formulated and asked in the course of negotiating the relevant contract of insurance. It was not possible to produce a 'pro-forma' list of questions at the outset capable of dealing with all relevant risk factors that may affect the policy proposal.

3.64 Option C was suggested to the Review Panel by a firm of commercial solicitors. They noted the existing test in section 21 had been applied inconsistently by various courts, which runs counter to the policy intention that the law concerning contracts of insurance should apply uniformly throughout Australia.

3.65 In respect of eligible contracts of insurance, one general insurer reported to the Review Panel that it asked potential insureds specific questions and did not have a 'catch all' question (Option D). That insurer argued the 'catch all' question was no longer relevant to eligible contracts. Insurers offering that type of contract had 'clear underwriting guidelines based on comprehensive historical data that effectively define what information a prospective customer needs to provide to enable a risk to be accepted'. This view was not shared by other general insurers and their representative body, which submitted to the Panel that it would not be possible for many insurers to develop a list of relevant specific questions.

3.66 In response to the exposure draft Bill, few stakeholders commented on this particular amendment and at least one major insurer supported the way the Bill gave the Review Panel recommendation effect. The general insurers' representative body offered no additional information on how the removal of the 'exceptional circumstances' question would impose costs on insurers.

Conclusion and recommended options

3.67 Option B (replacing the general duty of disclosure with a duty to answer specific questions) is unlikely to be practicable to apply more widely than in relation to eligible contracts. In particular, it would not appear to be practical to apply Option B in the context of large commercial insurance and some types of individual life insurance. Accordingly, Option B is rejected.

3.68 Option C, under which the duty of disclosure would be clarified by setting out some non-exclusive factors in the Act to which regard should be had in applying the duty test, does not result in greater expenses for insurers. This option is designed to assist courts in interpreting how the duty applies in difficult cases and should assist to remove current inconsistencies in the application of the test between courts and promote uniform application of the IC Act throughout Australia.⁹

3.69 Option D would address concerns about the duty of disclosure rules incorporating an objective test that requires insureds to know what an insurer regards as relevant, at least in respect of personal lines insurance (eligible contracts). Although some insurers have strongly opposed Option D on the grounds that it would increase expenses, others have noted that in the case of personal lines insurance, insurers generally have a very strong understanding of what factors are relevant to the risk in question, and ask specific questions accordingly. The likelihood of any unforeseen factors being relevant to risk is not high, and to the extent that it exists, there is a cogent argument that it is most appropriately borne by the insurer rather than the insured.

3.70 Option C is recommended because further guidance in interpreting provisions in the IC Act dealing with disclosure is likely to be of benefit to insurers, insureds and courts. Further, the costs of applying this option are not great. Option D (removing the ability to ask for disclosure of exceptional circumstances) is also recommended, because it largely addresses concerns from the insureds' perspective regarding the objective component of the duty of disclosure in respect of eligible contracts, notwithstanding there are some costs associated with its implementation.

9 Keall DCJ (Western Australian District Court) in *Delphin v Lumley General Insurance Ltd* (1989) 5 ANZ Ins Cas 60-941 concluded that the relevant tests required both extrinsic and intrinsic factors to be taken into account. On the other hand, Brooking J (Victorian Supreme Court) in *Twenty-first Maylux Pty Ltd v Mercantile Mutual Insurance (Aust) Ltd* (1990) VR 919 took the view that 'intrinsic' factors (such as imperfect understand of English or unfamiliarity with business or insurance practice) are not to be taken into account. Jones J (Queensland Supreme Court) applied the test applied by Brooking J in *Twenty-first Maylux Pty Ltd* and took into account extrinsic factors rather than individual idiosyncrasies: *Dew v. Suncorp Life and Superannuation Ltd* [2001] QSC 252.

Disclosure obligations on renewal of an eligible contract of insurance

Problem

3.71 The then General Insurance Enquiries and Complaints Service Ltd (IEC) (a predecessor of the Financial Ombudsman Service), in its first submission to the Review Panel, raised concerns at the current law surrounding notice of the duty of disclosure upon renewal of a contract of insurance. The IEC stated:

‘... the experience of (IEC) Review Panel members is that the great majority of people regard a renewal notice in the same way as they would a gas bill, that is an account to be paid at or about the due date, although unlike the gas bill, a reminder notice is usually not issued if the sum payable is not paid within the prescribed time. In other words, the general public do not understand the renewal process creates a new insurance contract, sometimes with new policy terms, with new disclosure obligations.’

3.72 In its submission, the IEC noted instances of insureds under motor vehicle policies being denied claims because they failed to update their driving history as required upon renewal. Apparently this was due to a lack of awareness of the disclosure requirement, rather than any deliberate concealment on their part.

3.73 To have circumstances such as these continuing to arise is undesirable because the detriment to the persons concerned is potentially great. If insureds do not realise that they are under a new set of disclosure obligations upon renewal of a contract of insurance, they risk failing to inform the insurer of matters that have occurred since the relevant contract was entered into that are relevant to the insurer’s decision whether to accept the risk of the renewed contract. As a consequence, the insured may be denied the right to recover under the contract, to potentially great detriment to the insured and any other person with an interest in the particular insurance contract.

3.74 An examination of statistics published by an external dispute resolution body is indicative of the extent to which non-disclosure on renewal leads to disputes between insurers and insureds. For the period July 2005 to June 2006 in relation to which the former Insurance Ombudsman Service — the IOS — reported on disputes determined by the scheme during that period with ‘Non-disclosure on proposal’ as a

reason members denied liability, in total, 53 out of 107 disputes relating to alleged non-disclosure involved renewals.¹⁰

Objective

3.75 The objective is to ensure that, as much as possible, insureds renewing an eligible contract of insurance understand their duty of disclosure obligations.

Options

Option A: Do nothing

3.76 The requirement on insurers under an eligible contract of insurance to ask specific questions of the insured — if they wish to rely on the insured's duty of disclosure — would not apply on renewal of the particular eligible insurance contract.

Option B: Make the obligation to provide details regarding the duty of disclosure the same at both inception and renewal of an eligible contract of insurance

3.77 Under this option, renewal of an eligible contract of insurance would trigger duty of disclosure obligations for both insurers and insureds similar to the obligations that applied when the contract was first entered into.

10 There were no disputes in the 2005-2006 reporting period relating to the IOS category 'Non-disclosure on proposal' for the general insurance lines of Caravan/Campervan; Consumer Credit, Marine-Pleasure Craft, Motor Vehicle – Third Party [TPPD], Small Business and Strata Title. The three disputes in the reporting period involving disclosure issues relating to Travel insurance did not involve renewals (undoubtedly due to the nature of the insurance). However, for the remaining lines of Motor Vehicle, Home Buildings, Home Contents, Personal Accident/Sickness and Medical Indemnity, more than half of the disputes involving disclosure issues were renewals. Three out of four Home Buildings disputes relating to alleged non-disclosure involved renewals; two out of three Home Contents disputes relating to alleged non-disclosure involved renewals; three out of four Personal Accident/Sickness disputes relating to alleged non-disclosure involved renewals and of four Medical Indemnity disputes, one related to renewal issues. Most disclosure/renewal issues arose in relation to Motor Vehicle insurance disputes. The IOS reported that in the financial year 2005-2006, motor vehicle disputes made up 35% of all referrals to IOS - 654 out of 1870 disputes in total (in all, 13% of the total of 11,235, 690 motor vehicle policies and renewals issued during 2005-2006 led to claims). Out of 93 Motor Vehicle disputes involving disclosure issues, 44 complaints resulted where claims had been rejected on renewal for alleged breaches of disclosure (including alleged misrepresentations).

3.78 For example, under this option, an insurer wishing to rely on an insured's duty of disclosure at renewal of an eligible contract would need to ask the insured specific questions or, alternatively, seek an update to the answers the insured had provided at the inception of the contract.

Impact analysis

Impact group identification

Affected groups:

- insurers;
- insureds; and
- government and regulators, including self-regulatory organisations.

Assessment of costs and benefits

Option A: Do nothing

	Benefits	Costs
Insurers	Minimal administrative burden to take advantage of duty of disclosure on renewal of eligible contracts	
Insureds		Disadvantage for some insureds who are denied claims because they did not realise their duty of disclosure obligations on renewal of eligible contacts
Government/ regulators		

Option B: Make the obligation to provide details regarding the duty of disclosure the same at both inception and renewal of an eligible contract of insurance

	Benefits	Costs
Insurers	Insurers would receive better information about the risks associated with renewal of a particular eligible contract [1]	Changes to administrative procedures for renewals of eligible contracts that could, for some insurers, involve significant costs [-2]
Insureds	Insureds would no longer face denial of a claim because they did not realise that the duty of disclosure applies on renewal of an insurance contract [3]	Possible increases in premiums passed on by some insurers due to increased costs [-1]
Government/regulators	Reduction in dispute resolution regarding the disclosure requirements on renewal of eligible contracts [1]	
Sub-rating	+5	-3
Overall rating	+2	

Consultation

3.79 In submissions to the Review Panel, a consumer representative body and a legal aid commission expressed support for the amendment proposed in Option B. The legal aid commission noted that, in its experience, many insureds were unaware of their duty of disclosure obligations on renewal and assumed that it was an automatic process, subject to payment of the premium. Insurance broker representatives submitted the IC Act should be amended so that insurers must make clear in any renewals the consequences of non-disclosure.

3.80 General insurer representatives submitted that requiring insurers to ask specific questions on renewal would result in significant increases in the costs incurred by insurers.¹¹ The additional costs would ultimately be passed on to insureds.

11 An insurance company submitted in relation to the 2007 exposure draft Bill that a renewal under the proposed changes would result in an average increased cost per policy of \$15, a cost that would ultimately be passed onto customers.

Conclusions and recommended options

3.81 Option B would result in the duty of disclosure obligations (such as the requirement to ask specific questions for eligible contracts) applying at renewal, as well as inception.

3.82 If Option B were adopted:

- insurers would be better advised of factors affecting the risk associated with a particular contract of insurance; and
- insureds would be less likely to be disadvantaged when making a claim because they failed to disclose adequately on renewal.
 - However, the change would result in costs for insurers because they would need to ask insureds to update answers provided at inception of the contract, or on last renewal, rather than relying on the general duty of disclosure in section 21 of the IC Act. Notwithstanding the prospect of increased administrative costs, Option B is recommended because:
- some general insurers either do not seek to rely on the duty of disclosure on renewal for lines of eligible contracts, or already adopt the practice of seeking an update to answers provided previously, so the potential for increased costs to insureds involved in changing processes would depend on the systems processes individual insurers have in place for handling renewals where practices such as these are not currently employed; and
- the measure would avoid the possibility of significant detriment for insureds as a result of a failure to comply with the general duty of disclosure obligations applying on renewal, due to ignorance about their existence.

Notification of duty of disclosure

Problem

3.83 Section 22 of the IC Act requires insurers to clearly inform prospective insureds of the general nature and effect of the duty of disclosure before the insured enters the relevant contract of insurance.

3.84 A legal aid commission noted in a submission to the Review Panel that, in its experience, many insureds assume they have complied with their duty of disclosure obligations when they disclose all facts known to the insured at the time of filling out a proposal form or answering an insurer's questions during a preliminary telephone application interview. However, matters that are relevant to the insurer's decision to accept the risk and enter the contract may arise after the date of application for the policy and the date it comes into effect, for example, significant changes in the state of an insured's or a life insured's health. It is quite common for insureds to fail to disclose such matters because they mistakenly believe they are under no obligation to do so. Ignorance about the duration and scope of the duty of disclosure was a common misconception.¹²

3.85 Thus, many insureds will inadvertently fail to disclose facts that may come to light after the insured completes the proposal process but before the contract of insurance comes into effect and, as a consequence, may be in breach of their duty of disclosure. The result of such ignorance on the part of some insureds, coupled with prolonged delays between application and the issuing of the insurance policy (the Review Panel was made aware that in some circumstances the time between providing the relevant disclosure and the commencement of the contract of insurance can be some months), may mean that claims and even entire policies may be jeopardized to the serious detriment of insureds or their dependants and beneficiaries. This is particularly important for beneficiaries of insurance linked to superannuation and dependants receiving or expecting to receive death benefits from life insurance policies applied for years prior to a claim being made on the policy.

3.86 Instances of disputes involving alleged breaches of disclosure (both innocent and fraudulent) where prolonged delays occurred have arisen before the life insurance and superannuation external dispute resolution schemes, in particular, the former Financial Industry Complaints Service (FICS) — now part of the Financial Ombudsman Service) and the Superannuation Complaints Tribunal. Cases have also arisen before the Australian courts involving ignorance of the extent of the

12 Many, if not most, insureds believe that their duty of disclosure ends when a proposal application has been completed and accepted by the insurer (that is, the proposal - not the contract). See the Annual Report of the General Insurance Enquiries and Complaints Scheme [IEC] Annual Report 1996, page 10-11; IEC Annual Report 1997, page 9; IEC Annual Report, 1998, page 10, cited in *Disclosure and concealment in consumer insurance contracts* by Dr Julie-Anne Tarr, Cavendish Publishing Limited, 2002. [The former General Insurance Enquiries and Complaints Scheme [IEC] is now part of the Financial Ombudsman Service].

insured's duty of disclosure where delays have been found to be a factor in disputes involving alleged breaches of the duty.¹³

3.87 Delays can be caused by both insurers and insureds. The problem tends to occur more frequently in certain lines of business, for example, in life insurance and in directors' and officers' (D&O) liability insurance, mainly because of the extended nature of the assessment process in those business lines. Delays may be caused by the insurer where time-consuming processes are involved, such as, example, collecting declarations from directors for D&O liability insurance or collecting medical disclosures in relation to life insurance policies. Delays may also be caused when negotiations are extended where the insurer makes a counter-offer.

3.88 Delays may be caused by the insured where, for example, a written application is posted many weeks after the blank application form had been provided to the insured, or where the insured has provided incomplete responses to questions or made mistakes in completing forms or failed to append their signature to a paper form.

3.89 Some of the determinations of the external dispute resolution schemes indicate that the policy/proposal wording used by many insurers is not clear about the scope of the disclosure obligation. The extent to which this may disadvantage consumers is accentuated when delays occur. While negative outcomes for consumers may be attenuated by the proposed reform that would require insurers to clearly inform the insured, before a contract is entered into, that their duty of disclosure applies until the proposed contract is entered into, this may not of itself alleviate those cases where there is a prolonged delay between the time an application is made and the concluding of the contract, particularly where this is coupled with lack of understanding or ignorance of the insured's duty of disclosure.

13 The FICS Panel, for example, dealt with approximately 200 cases over a ten year period involving alleged non-disclosure by insureds. Two out of some 14 disputes specifically involving Insurance Contracts Act section 22 over a period of six years involved extended delays (approximately four months between application and acceptance and issue of the contract of insurance) have been reported. At least two determinations of the Superannuation Complaints Tribunal (involving delays of two and three month delays respectively) were reported in a period of just over one year. In the 21 years since the Insurance Contracts Act became law, a number of cases have arisen before the courts involving disclosure issues in the context of extended delays: *Goodwin v State Government Insurance Office (QLD)* (1991) 6 ANZ Ins Cas 61-064 [Full Court of the Supreme Court of Queensland]; *Summerton v SGIC Life Ltd* (1999) 19 ANZ Ins Cas 90-102; *McCabe v Royal & Sun Alliance* (2003) WASCA 162.

3.90 If no action is taken, failure to provide requisite disclosures for events that took place between the date of the initial application and the time the contract was entered into will continue to be one of the reasons that the claims of some insureds are jeopardised. The Review Panel noted that although some insurers ask the insured immediately prior to the policy coming into effect whether they have anything additional to disclose since filling out the original proposal form, this is not a universal practice.

Objective

3.91 The objective is to ensure, so far as is reasonably possible, that insureds are not disadvantaged when a claim arises because they did not understand their duty of disclosure obligations where there was a delay between the date they initially applied for the insurance and the date the contract was entered into.

Options

Option A: Do nothing

3.92 This option would retain the current rule that insurers must advise prospective insureds of their duty of disclosure at the time the insured submits an application for insurance. There is no further requirement for a reminder at the time the policy is issued.

Option B: Require insurers to issue reminders concerning the duty of disclosure at the time the relevant contract is issued

3.93 Under this option, insurers would be required to provide to the insured, at the time the contract of insurance is issued, a reminder that the duty of disclosure continues until the time that the policy is entered into, unless the contract is entered a short time after the person initially applied for insurance.

Option C: Require insurers to use clearer language as to when the duty applies in the initial notification

3.94 Under this option, there would be no need for an additional reminder when the policy is issued as proposed by Option B. However, insurers would need to clearly state when explaining the insured's duty of disclosure that it extends until the time the contract of insurance is entered into.

Impact analysis

Impact group identification

Affected groups:

- insurers;
- insureds (especially those that have claims), including proposed insureds and beneficiaries under policies; and
- government and regulators, including self-regulatory organisations.

Assessment of costs and benefits

Option A: Do nothing

	Benefits	Costs
Insurers		
Consumers		Claims by some insureds will continue to be jeopardised due to non-disclosure
Government/regulators		Ongoing need to resolve disputes about non-disclosure of events between application and contract

Option B: Require an additional reminder at the time the policy is issued

	Benefits	Costs
Insurers	An reminder notification increases the likelihood that insurers will be properly advised of relevant factors necessary to assess risks [1]	Possible additional administrative costs. Note that some insurers already issue a reminder where delays have occurred after the initial application [-2]
Insureds	Significant reduction in claim denials due to a failure to understand that the duty of disclosure extends until the policy is entered into [3]	
Government/regulators	Likely reduced need to resolve disputes involving a failure to disclose events between application and contract [1]	
Sub-rating	+4	-2
Overall rating	+2	

Option C: Require insurers to use clearer language as to when the duty applies in the initial notification

	Benefits	Costs
Insurers		Insurers would incur one-off administrative expenses required to change reminder wordings [-2]
Insureds	Likely reduction in claim denials due to a failure to understand that the duty of disclosure extends until the policy is entered into [2]	
Government/regulator	Likely reduced need to resolve disputes involving a failure to disclose events between application and contract [1]	
Sub-rating	+3	-2
Overall rating	+1	

Consultation

3.95 General insurance industry representatives argued the benefits of a change such as proposed by Option B were not significant enough to justify the costs. Option B would require a change in the compliance requirements of insurers that was disproportionate to the benefits that may flow from such an amendment. A submission made in relation to the February 2007 exposure draft Bill argued that sending a reminder notice was unnecessary, problematic and administratively costly.¹⁴

3.96 However, other submissions, including from legal profession representatives and a dispute resolution body, supported reform of the type proposed in Option B. One submission noted that an amendment such as Option B could be expected to lead to a reduction in the number of disputes.

3.97 Life insurance industry representatives indicated to the Review Panel that the majority of life insurers already included advice to

14 The insurer argued that the proposed reminder notice requirement was unnecessary because the duty of disclosure notice has already clearly informed the insured that the duty continues to apply until the contract is entered into. It would also require an upgrade to the insurer's computer systems and increase the administrative burden on the insurer, again at increased cost. Further the proposed amendment may have an adverse impact on insureds, because insurers may deal with this issue by refusing to issue policies more than 2 months in advance. The insured may instead be asked to call back and obtain a quote closer to the time of inception of the policy and if they forget to do so, it may result in non-insurance.

prospective applicants that their duty of disclosure continues until the date the contract is entered into, such as that proposed in Option C.

Conclusions and recommended options

3.98 Many insureds do not realise that their duty of disclosure extends until the contract is entered into, so that if the policy is issued some time after a proposal form is submitted, the insured may be exposed to the denial of a claim if they failed to disclose a relevant fact that arose (or which they became aware of) during the interim period. A failure to disclose could lead to loss of the insurance cover altogether through avoidance of the policy by the insurer.

3.99 Option B minimises this risk by requiring insurers to give insureds a reminder of the duty at the time the contract is issued (unless the contract is issued within a short time of receiving the proposal). This option would generate additional administrative expenses for insurers.

3.100 Option C goes some way toward addressing the problem by having the initial notice of the duty state more clearly that the duty extends until the time the contract is issued. The additional administrative expenses associated with Option C would be less than those associated with Option B, but Option C is likely to be less effective than a reminder at the time the policy is issued, especially when the contract is entered into some time after the proposal form is submitted.

3.101 Typically, the insurer would communicate with the insured at the time the proposal is accepted by the insurer to notify the insured of the acceptance and to request payment. At this time, the insurer could add an additional 'standard' element to that communication regarding the fact that the duty of disclosure extended until the relevant contract was entered into. Therefore, the additional costs of complying with Option B (after a transitional phase) are not expected to be great.

3.102 On balance, Option B is favoured.

Non-disclosure rules and life insureds

Problem

3.103 Misrepresentations by a 'life insured' (that is, a person other than the insured whose life is insured under the contract of life insurance) are treated as if they were made by the insured themselves pursuant to section 25 of the IC Act. As a consequence, if a life insured is found to

have made a misrepresentation to an insurer, the insurer has the same remedies against the insured as if the misrepresentation had been made by the insured. However, under the current law, there is no remedy against the insured where the *life insured* fails to disclose some matter that is relevant to an insurer's decision whether to enter the contract of life insurance.

3.104 Non-disclosure by a life insured may adversely affect the reliability of information available to insurers. In that regard, non-disclosure has a similar result to misrepresentation. Preventing non-disclosure by life insureds would help ensure that insurers are fully informed about the relevant risks so they can price them accordingly.

3.105 An expansion of section 25 to include non-disclosure by a life insured would provide a fairer balance between the interests of the parties. The reason is that insurers must still satisfy a claim under a contract of life insurance, notwithstanding that there has been a non-disclosure by the life insured that, if made by the insured, would have allowed the insurer the right to avoid the contract or reduce their liability.

3.106 There appears to be no reason why non-disclosure and misrepresentation on the part of the life insured should be treated differently and for the current disparity with respect to misrepresentation and non-disclosure by life insureds to continue.

3.107 If no change is made, then the degree of information asymmetry as between the parties would not be reduced and the current disparity of remedies for insurers with respect to misrepresentations and non-disclosures by life insureds would continue, resulting in unfair and anomalous outcomes.

Objective

3.108 The objective is to ensure that insurers receive reliable and adequate information to assess and price risk, without placing an unfair burden on insureds in respect of the remedies available against them for non-disclosure.

Options

Option A: Do nothing

3.109 This option would leave section 25 of the IC Act unchanged so that it continued to apply only in respect of misrepresentation by a life insured, but not in respect of non-disclosure by a life insured. Also, there

would be no obligation on insurers to give the life insured notice of the duty of disclosure.

Option B: Expand the duty of disclosure under section 25 to cover non-disclosure by a life insured

3.110 Under this option, the rule in section 25 of the IC Act that imputes a misrepresentation by a life insured to an insured would also apply to a non-disclosure by the life insured. Further, the insurer would be required to give the life insured notice of the duty of disclosure before the relevant insured entered into the contract of insurance.

3.111 Section 22 of the IC Act would be amended to require the insurer to clearly inform the life insured of their proposed new duty of disclosure.

Impact analysis

Impact group identification

Affected groups:

- insurers;
- insureds (including life insureds and prospective life insureds); and
- government/regulators.

Assessment of costs and benefits

Option A: No specific action

	Benefits	Costs
Insurers		Insurers would continue to be disadvantaged in some cases by non-disclosures by life insureds that cannot be imputed to the insured
Insureds		
Government/regulators		

Option B: Expand the duty of disclosure under section 25 to cover non-disclosure by a life insured

	Benefits	Costs
Insurers	Insurers would benefit by being able to rely on non-disclosures by life insureds as a defence to claims, as well as their current right to rely on misrepresentations [3].	The proposed additional requirement that insureds notify life insureds of the duty of disclosure would result in additional compliance costs for insurers [-2]
Insureds	The savings to insurers by denying claims for non-disclosure by life-insureds could lead to risk premiums for consumers [1]	Additional compliance costs for insurers may lead to increased premiums for consumers [-1]
Sub-rating	+4	-3
Overall rating	+1	

Consultation

3.112 In submissions to the Review Panel, life insurance industry representatives strongly supported amending the IC Act in the manner proposed by Option B.

3.113 Representatives of the legal profession submitted that further evidence and consideration were necessary before Option B were considered. A consumer representative body argued there was no empirical evidence to suggest the current formulation of section 25 had caused problems for insurers, and a legal aid commission also opposed any reform of the type proposed in Option B.

Conclusions and recommended options

3.114 Non-disclosure by a life insured may have a similar result to that of a misrepresentation by the life insured, in that a non-disclosure may also adversely affect the reliability of information available to insurers to price their risk. Reducing information asymmetry between parties to a contract will achieve a fairer result for the parties and also third party beneficiaries.

3.115 Option B ensures that non-disclosure by a life insured would have similar ramifications to a misrepresentation. This will help to ensure insurers are fully informed about the relevant risks so that they can price them accordingly. Failure to disclose by a life insured would have the same impact for insureds as a misrepresentation by a life insured. Although life insureds would be subject to a duty of disclosure to which they are not currently subject, the non-disclosure would be imputed to the insured.

3.116 If a life insured's non-disclosure or misrepresentation is to be imputed to an insured, then it follows that the life insured should receive some notice that this may occur. A key principle underlying the ALRC recommendations that gave rise to the IC Act was that consumers should receive all the information relevant to their contract of insurance and therefore the notice requirement in Option B appears appropriate. Insurers would usually communicate with life insureds about their disclosure obligations, so it is reasonable that the insurer provide information about the duty directly as part of that process, rather than relying on indirect channels through the insured.

3.117 Although Option B does impose some additional costs for life insurers (in relation to the notification obligation) and life insureds (in respect of the broader duty), it is preferred over Option A in order to ensure that non-disclosure by a life insured is dealt with appropriately, and insurers may deny or reduce claims in appropriate circumstances if non-disclosure by a life insured occurs.

Life insurance remedies

Problem

3.118 The current provisions in the IC Act that deal with the remedies available to a life insurer are of long standing. The life insurance industry argues that the remedies are now inadequate and inappropriate for many life insurance products now on the market.

3.119 Sections 29 and 30 of the IC Act provide remedies for life insurers in relation to misstatements, misrepresentations and non-disclosures. If there is a misstatement about the date of birth of a life insured, section 30 provides for a remedy for the insurer, based on the principle of proportionality, to vary the sum insured or adjust/refund premiums. The remedies in section 29 deal with pre-contractual misrepresentations and non-disclosure about relevant matters other than age/date of birth. In summary:

- the only remedy for fraudulent non-disclosure or misrepresentation is avoidance of the contract;
- the only remedies for innocent non-disclosure or misrepresentation discovered within three years are either:
 - a variation of the sum insured to an amount not less than by a factor calculated by reference to the premiums actually charged as

a proportion of the premiums that would have been charged if the non-disclosure or misrepresentation had not occurred; or

- if the insurer would not have been prepared to enter into a contract of life insurance *on any terms* it may avoid the contract;
- there is no remedy for innocent non-disclosure or misrepresentation discovered after three years.

3.120 The remedies in sections 29 and 30 derive from remedies formerly available under the *Life Insurance Act 1945*. They were designed for the ‘traditional’ life insurance products that were common at the time the remedies were developed (for example, whole of life and endowment policies). Traditional products such as these were long term, provided for cover on death and had a surrender value. A surrender value is, in effect, an investment (rather than a risk) component that provides for an amount payable to an insured should their contract be terminated before the end of its term.

3.121 Arguing that the remedies for non-disclosure are now inadequate and inappropriate for many life insurance products now on the market, life insurance industry representatives, in a submission to the Review Panel, identified the following developments in the life insurance market that had taken place since the IC Act commenced operation:

- the increasing popularity of risk-only products such as income protection (IP) and total and permanent disablement (TPD) insurance, as well as trauma/critical illness and term life insurance;
- the practice by some life insurers of selling multiple types of cover within one contract (for example, ‘bundled’ contracts);
- the incidence of life insurance products allowing for more than one life insured;
- the increasing proportion of policies taken out on a short term basis; and
- developments in underwriting practices to take account of the changing nature of life insurance products available.

3.122 The submission argued that the prescriptive and inflexible nature of the remedies in section 29 no longer provides a fair balance between

the interests of insurers and insureds.¹⁵ For example, if different types of life cover are bundled in the same contract, which often occurs¹⁶, the section 29 remedies are not sufficiently flexible to allow avoidance of the contract by the insurer or correction of one cover that is affected by a non-disclosure or a misrepresentation without affecting the other cover(s) bundled in the same contract.¹⁷

3.123 Life insurance industry representatives also argued that the relative inflexibility of remedies in section 29 frequently leads to inequitable results for the insured. For example, if an insured innocently failed to disclose that they were a smoker and this was discovered by the insurer within three years, an appropriate remedy could be to continue the insurance as initially agreed but to set a higher premium rather than relying on the available section 29 remedy of reducing the sum insured: a harsher penalty for the insured than may have been needed or appropriate in the circumstances.

Objective

3.124 The objective is to ensure that remedies in respect of pre-contractual misrepresentation and non-disclosure by insureds provide adequate redress for life insurers but do not result in penalties for insureds that are disproportionate to the loss suffered by the insurer.

15 The courts (*Hoare v Mercantile Mutual Life Insurance Co* unreported, Rolfe J, Supreme Court of New South Wales, 7 November 2000; *Herbohn v NZI Life Limited* (1998) 10 ANZ Ins Cas 61-410) and the external resolution bodies (FICS and the Banking and Financial Services Ombudsman Limited – now merged into the FOS) have acknowledged there are limitations placed on insurers by the inflexibility of section 29.

16 Life insurers often offer ‘package’ policies that have a number of different component covers - such as death, TPD, trauma and IP cover. The client does not have to buy the whole package; rather, they can select the different options they want. The combination they choose may or may not include death cover.

17 The discovery of non-disclosure or misrepresentation may impact the sum insured or premium levied on certain products, but not others. Similarly, with knowledge of the additional facts, an insurer may want to avoid certain aspects of the policy, but not others (for example, avoid an IP policy but keep the term cover on foot). If bundled contracts cannot be severed, an insurer may be forced to cancel all cover from inception, to the detriment of both the insured and the insurer.

Options

Option A: Do nothing

3.125 Under this option, the specialised life insurance remedies in section 29 would continue to apply to all types of life insurance.

Option B: Make remedies for breach of the duty of disclosure for life insurance mirror the counterpart remedies for general insurance

3.126 Under this option, the remedies for non-disclosure or misrepresentation under a contract of life insurance would be similar to remedies for non-disclosure and misrepresentation under a contract of general insurance, providing an avenue whereby a policy could be continued, albeit on terms that reflected the position had non-disclosure or misrepresentation not occurred. In the case of fraud, the insurer could avoid the contract.

3.127 In the absence of fraud, the insurer could, for example, impose an exclusion so as to put the life insurer and the insured in the same position they would have been in if the non-disclosure or misrepresentation had not occurred, or could reduce its liability to an amount that would restore the insurer to its original position had no breach of the duty of disclosure occurred.¹⁸ This is a much more flexible remedy than the proportionate reduction of the sum insured currently provided for in section 29.

3.128 If the remedy currently available to general insurers under subsection 28(3) were applied, this would put the life insurer and the insured in the same position they would have been in if the non-disclosure/misrepresentation not occurred in the first place, providing protection for other policyholders in respect of the cross subsidisation of spiralling claims costs by paying increased premiums.

¹⁸ In many cases, this allows the insurer to reduce the claim to nil.

3.129 The three-year time limit for insurers to seek a remedy on the basis of innocent non-disclosure or misrepresentation would be removed.¹⁹

3.130 There would continue to be a distinct remedy in respect of fraud or non-disclosure concerning age as currently applies under section 30.

Option C: As per Option B, but retain specialised life insurance remedies for policies that have a surrender value or provide death cover

3.131 This option is like Option B, but the current remedies for life insurance in section 29 would be retained for policies that have a surrender value or provide death cover.²⁰

3.132 If the policy has an aspect of cover with a surrender value and/or death cover, and some other type of insurance cover as well, the policy would be ‘unbundled’ for the purposes of considering the application of remedies for breach of the duty of disclosure.

3.133 In addition, contracts could be ‘unbundled’ so that a misrepresentation or a non-disclosure that was relevant to the risk for one type of cover, for example, a misrepresentation about assets relevant to

19 Life insurance representatives indicated in a submission to the Review Panel pointed out that in so far as a distinction exists between the remedies available for the life insurer in section 29 and the general insurer under section 28, historically, traditional life insurance policies (whole of life and endowment policies) offered a bundled mix of ‘risk’ insurance and participating or non-participating investment/savings. However, public policy may be seen to be served by limiting the insurer’s right to void a long term life insurance bundled policy for innocent misrepresentation to 3 years. It may have been determined that it would be inequitable for an insurer to have the right to void a long term bundled investment/risk policy for innocent misrepresentation. On the other hand, the submission suggested that the 3 year period is consistent with the period referred to in the ‘non-forfeiture’ provisions of both the *Life Insurance Act 1945* (sections 95 to 102) and the *Life Insurance Act 1995* (section 210), restricting the right of the life insure to avoid a policy for non-payment of contract premiums after 3 years premiums had been paid. According to the submission, these non-forfeiture provisions did not apply to term life insurance where the policy did not provide for a ‘surrender value’, but represented pure risk.

20 In a submission to the Review Panel, life insurance representatives indicated that whereas in 1972 whole of life and endowment insurance represented 95.3% of sales that year, by 1996, whole of life and endowment products represented 6.1% of sales, while investment account and investment-linked products represented 12.6% of sales – these types of policies typically have surrender values. On the other hand, term life insurance provided for an insurance benefit payable only on death without the investment/savings component. In 1977, the proportion of new business constituted by Term Insurance was less than 15%. By 2004, the proportion of new long term life insurance represented by Term Insurance (including Rider Benefits and Disability Insurance, Crisis, etc) is 94%.

income protection insurance, would not necessarily apply to a different type of cover, provided as part of the bundled policy, in relation to which the misrepresentation was of no consequence or relevance.

3.134 Like Option B, section 30 would still apply to misstatements regarding age. The three year limitation on remedies would apply only to policies, or types of cover under a bundled contract, which included a surrender value or death cover.

Impact analysis

Impact group identification

Affected groups:

- life insurers;
- insureds, including life insureds; and
- government and regulators, including self-regulatory organisations.

Assessment of costs and benefits

Option A: Do nothing

	Benefits	Costs
Insurers		No scope for use of less costly remedies for life insurers Lack of flexibility of remedy can force insurers to allege fraud, with resultant costly litigation placing pressure on premium rates
Insureds	The claims of insureds under traditional policies and risk only term life insurance policies will continue to enjoy the protections offered under the present remedies framework	The lack of flexibility in remedies for life insurance can result in detriment to insureds who are subjected to a sanction more onerous than necessary The price and availability of life insurance may continue to be adversely affected through lack of access to more appropriate remedies
Government/regulators		

Option B: Make remedies for breach of the duty of disclosure for life insurance mirror the counterpart remedies for general insurance

	Benefits	Costs
Insurers	This option would allow more flexibility in determining remedies for breach of duty of disclosure allowing the use of less costly remedies [+3]	There will be transitional administrative costs for insurers associated with adopting a new remedies framework [-1]
Insureds	Increased flexibility of remedy may benefit insureds overall through use of less costly and less onerous remedies, and possible decrease in premiums [+1]	Removal of the specialised remedies and the protection offered by the 'three year rule' in section 29 could produce inappropriate outcomes in some cases (particularly 'traditional' life insurance policies, including those with death cover/surrender value) to the significant detriment of some insureds and their beneficiaries [-3]
Government/regulators	Increased flexibility of remedy may lead to less complex dispute resolution processes [+1]	
Sub-rating	+5	-4
Overall rating	+1	

Option C: As per Option B, but retain specialised life insurance remedies for policies that have a surrender value or provide death cover

	Benefits	Costs
Insurers	This option would allow more flexibility in determining remedies for breach of duty of disclosure allowing less costly remedies [+3]	Dividing different types of life insurance cover into categories, including for the purposes of 'unbundling', increases complexity and administration of the legislation [-1]
Insureds	Increased flexibility of remedy may benefit insureds overall through use of less costly and less onerous remedies, and possible decrease in premiums [+1]	The claims of some insureds, including those with beneficiaries, may be detrimentally affected by loss of protections offered under the present remedies framework, though if surrender value/death policies retain the prior remedies, this would occur rarely [-1]
Government/regulators	Increased flexibility of remedy may lead to less complex dispute resolution processes [+1]	
Sub-rating	+5	-2
Overall rating	+3	

Consultation

3.135 There has been no clear consensus regarding the need to reform the current remedies available to life insurers in respect of non-disclosure and misrepresentation. The life insurance industry strongly argues that there are significant deficiencies in the current remedy arrangements given the range and type of life insurance products currently on the market. In a submission to the Review Panel, one life insurer noted that difficulties with the current life insurance remedies may be affecting the cost and availability of insurance (with consequent negative effects for insureds).²¹ Life insurance representatives argued that if the remedy currently available to general insurers under subsection 28(3) of the IC Act were applied, this would put the life insurer and the insured in the same position they would have been if the non-disclosure/misrepresentation not occurred in the first place, providing protection for other policyholders in respect of the cross subsidisation of spiralling claims costs by paying increased premiums.

3.136 However, consumer representatives opposed any change of the type proposed by Options B or C. A consumer representative body submitted that the distinction between remedies in respect of life insurance and general insurance had historical foundations in that it was an acknowledgement that the *Life Insurance Act 1945* already regulated life insurer conduct. Consumer representatives questioned whether the current remedies are as restrictive as claimed by members of the life insurance industry and expressed concern about the impact of changes to the protections currently available to insureds.

3.137 It was argued that life insurance, even the types of life insurance that are akin to 'pure risk', involve more complex disclosures than an

21 One industry submission to the Review Panel provided an example of the overall impact on the cost of insurance arising from the inflexibility of the remedies available to life insurers under section 29. With income protection insurance, a frequently occurring event is the overstatement of income, resulting in an insured benefit exceeding the level of appropriate cover. In the event that no remedy can be applied (that is, reduction in insured benefit) when a claim is made, an insured will often receive more income by remaining on claim than if they returned to work. The overall effect is extended claim periods and increased claim costs, which are ultimately passed on to other policyholders in the form of premium increases. As to the availability of insurance, another industry submission pointed out that in some cases, section 29 works to penalise insureds by forcing insurers to allege fraud in order to avoid a contract where they may in fact have been prepared to offer alternative terms, if such a remedy were available. The stigma of a fraud allegation made against an insured by an insurer will result in the insured having difficulties in obtaining cover in the future. For insurers, establishing fraud is costly and complex, leading to protracted litigation with legal costs for individual cases often exceeding \$100,000. Ultimately, these legal costs place pressure on premium rates.

ordinary general insurance product. Therefore, life insureds require greater protections than general insureds in relation to remedies for breaches of the duty of disclosure and, in particular, the protection offered by the 'three year rule' should be retained for all life insurance.

Conclusions and recommended options

3.138 The problem is that the remedies available to life insurers under the IC Act for non-disclosure or misrepresentation do not adequately take into account the changed nature of life insurance products and, as a result, unnecessarily limit the availability of life insurance or increase its cost.

3.139 Option A would involve no change to the current remedies and, as a consequence, the concerns regarding the inflexible nature of life insurance remedies would remain. Option B would involve removing the current distinction between remedies for a breach of the duty of disclosure in life insurance and general insurance so that the remedies are the same. Option C is similar to Option B, although Option C would leave the existing life insurance remedies available for particular types of cover (namely, life policies with a surrender value and those with a death cover component).

3.140 It is accepted that the current remedies for breaches of the duty of disclosure in life insurance (not related to age) unnecessarily restrict the remedies available to insurers in the context of some types of cover. However, the restricted and specialised remedies offered in relation to life insurance policies with a surrender value and/or death cover remain appropriate and provide useful protections to insureds. The benefits of freeing up the remedies in other cases outweigh the costs of moving to a bifurcated system, with the added complexity of 'unbundling' the components of policies. The risks of unfairly disadvantaging insureds by removing the protections currently provided is not considered great in respect of policies that do not have a surrender value.

Third party beneficiaries

Problem

3.141 Third party beneficiaries are not parties to a contract of insurance. Rather, they are specified in the contract as being persons to whom insurance cover provided by the contract extends. They may be, for example, employees who are covered by a personal accident policy taken out by their employer or members of a superannuation fund who

receive life insurance cover under a policy taken out by the trustee of the fund.

3.142 Although the IC Act deals with the entitlement of such persons to make a claim, notwithstanding that they are not parties to the contract (see section 48 as one example), there are few other references to third party beneficiaries in the IC Act. It has been suggested that their status as the primary object of insurance cover in many instances may mean that third party beneficiaries should have essentially the same rights and obligations as insureds.

3.143 For example, it is arguable that an insurer should have a duty to act in good faith towards a specified third party beneficiary, and vice-versa, at least after the contract has been entered into.

3.144 As a result of the IC Act dealing with specified third party beneficiaries to a limited extent, there is uncertainty about aspects of the legal rights and obligations among the insurer, the insured and the third party. Uncertainty leads to expensive litigation and, although the precedents set by earlier litigation provides guidance for later cases, there is often still room to argue how a particular case should be resolved. Uncertainty of outcomes ultimately leads to higher risk premiums being charged in relation to the affected policies and also results in outcomes that may be anomalous or inconsistent.

3.145 Inclusion of suitable contractual provisions to deal with third party beneficiaries may provide a partial solution to the limited application of the IC Act. However, as third party beneficiaries are not parties to the contract, there are limitations to the scope of contractual solutions.

Objective

3.146 The objective is to ensure that, to the extent reasonably practical, third party beneficiaries under an insurance contract have rights and obligations that are predictable and in keeping with the context and intention of their relationships with both the insurer and the insured.

Options

Option A: Do nothing

3.147 This option would retain the current position under which specified third party beneficiaries are generally not covered by the IC Act.

Option B: Extend all rights and obligations of insureds under the IC Act to specified third party beneficiaries

3.148 Under this option, specified third party beneficiaries would have the same rights and obligations under the IC Act as if they were the insured. The insurer would need to notify all third party beneficiaries of their duty of disclosure before the relevant contract is entered into. Further, in relation to eligible contracts of insurance, all third party beneficiaries would need to be notified of unusual terms in the contract.

Option C: Extend only certain rights and obligations under the IC Act to specified third party beneficiaries

3.149 This option would treat specified third party beneficiaries as insureds under the IC Act only for the purposes of:

- subrogation, in that the insurer would be able to substitute for the third party beneficiary in an action against a third party who is liable for a loss that has been paid by the insurer;
- the duty of utmost good faith (but not pre-contractually); and
- circumstances where the IC Act allows an insured to request the insurer provide them with particular information by way of written notice.

Impact analysis

Impact group identification

Affected groups:

- insurers;
- insureds (including specified third party beneficiaries and insureds); and
- government and regulators, including self-regulatory organisations.

Assessment of costs and benefits

Option A: No specific action

	Benefits	Costs
Insurers		Risk of unanticipated outcomes, which may require litigation to resolve
Insureds		Risk of unanticipated outcomes, which may require litigation to resolve Some increased risk premium passed on to insureds as a result of uncertainty
Government/regulators		

Option B: Extend all rights and obligations of insureds under the IC Act to specified third party beneficiaries

	Benefits	Costs
Insurers	Decreased risk of unanticipated outcomes regarding claims by third party beneficiaries [2]	Greater administrative expenses in treating third parties as beneficiaries, for example, due to the requirements to give notices pre- and post- contractually, which may be impractical to apply [-3]
Consumers	Reduced uncertainty act can reduce litigation costs and expenses and risk premiums [1]	Higher administrative costs are likely to be passed on to customers [-2] Insurers may cease to offer some products involving multiple third party beneficiaries, reducing the opportunity for insureds to manage risk [-2]
Government/regulators	Increased certainty may lead to less complex dispute resolution processes [+1]	
Sub-rating	+4	-7
Overall rating	-3	

Option C: Extend only certain rights and obligations under the IC Act to specified third party beneficiaries

	Benefits	Costs
Insurers	Decreased risk of unanticipated outcomes regarding claims by third party beneficiaries [+2]	There would be some administrative costs arising from the requirement to provide third party beneficiaries with notices in limited circumstances [-1]
Insureds	Reduced uncertainty about the status of third party beneficiaries may reduce litigation costs and premiums [+2]	Some additional administrative costs could be passed on to insureds [-1]
Government/regulators	Increased certainty may lead to less complex dispute resolution processes [+1]	
Sub-rating	+5	-2
Overall rating	+3	

Consultation

3.150 There was support from consumer and insurance industry representatives for extending the duty of utmost good faith to third party beneficiaries. However, concerns were expressed about the practicalities of extending all rights and obligations of an insured to third party beneficiaries. NIBA noted it would be impractical to extend the duty of utmost good faith to pre-contractual matters such as the duty of disclosure.

Conclusions and recommended options

3.151 The problem is that the current limited application of the IC Act to third party beneficiaries has resulted in anomalies and inconsistencies, and legal uncertainty.

3.152 The proposal in Option B would extend all rights and responsibilities conferred on insureds under the IC Act to third party beneficiaries. Although this would resolve the uncertainty, it would have significant practical difficulties because the identity of many third party beneficiaries will not be known until after the contract is entered into. Option C avoids those difficulties by only conferring on third party beneficiaries a limited range of rights and obligations which do not involve significant expense. Option A involves no change to the current situation.

3.153 The preferred option is Option C. Concerns raised during the initial consultation period regarding the expense and practical difficulties

of bestowing third party beneficiaries with all of the rights and obligations held by insureds are justified. Option C clarifies rights and obligations in a range of areas but could be implemented without any significant cost burden for insurers or consumers.

Summary of impacts

3.154 Elements of the proposals set out in the Bill will benefit both insurers and insureds, without imposing significant ongoing compliance costs on industry with flow-on impacts on premium settings.

3.155 The key measures in the bill relate to

1. electronic communication;
2. objective component of insured's duty of disclosure;
3. disclosure obligations on renewal of an eligible contract of insurance;
4. notification of duty of disclosure;
5. non-disclosure rules and life insureds;
6. life insurance remedies; and
7. third party beneficiaries.

3.156 Both insurers and insureds will benefit from the ability to use electronic communication for various notice requirements under the IC Act. Use of electronic communications has the potential to lower costs related to use of hard copy communications and to increase convenience for both insurers and insureds.

3.157 The Bill will clarify the insured's duty of disclosure, remove the insurer's option to ask 'catch-all' questions and effectively require specific questions to be asked on renewal. Insurers will be required to remind insureds of their duty of disclosure where there is a significant elapse of time between application and contract.

3.158 Initially, some additional administrative costs will be placed on insurers in terms of altering established processes for renewing policies, which could flow through to increased premiums charged. However, these measures are intended to strike an appropriate balance between ensuring insurers have reliable information to assess and price risk, while at the same time, avoiding an unfair burden being placed on insureds in

meeting their duty of disclosure, with potential detrimental outcomes with respect to claims.

3.159 Insurers, insureds and regulators would benefit from fewer and less complex disputes relating to disclosure and ease of resolution would increase. This could ultimately be reflected in lowered costs to insurers, with this factored into premium rates.

3.160 Insurers will benefit from clarification of the remedies available to them for non-disclosure by life insureds, who are not the insured under life policies. More generally, insurers will benefit from simplification of remedies for non-disclosure, with unbundling of remedies allowing for greater flexibility and alignment of life remedies with those available to general insurers more realistically reflecting market realities, namely, bundling of mortality and morbidity life insurance policies, and the almost total contraction of the market for traditional life policies with surrender values being replaced by short term, pure risk policies.

3.161 Holders of life insurance policies will benefit from less harsh and inflexible remedies being available to insurers with respect to non-fraudulent (innocent) non-disclosure, with insureds generally benefiting from fewer cost pressures placed on premiums rates (these are ultimately impacted by pursuit of expensive litigation for alleged fraudulent non-disclosure necessitated by the current rigid remedy regime).

3.162 It is expected that options to benefit third party beneficiaries by clarifying rights and obligations in a range of areas could be implemented without any significant cost burden for insurers or consumers.

3.163 While some proposals in the Bill may result in an increase in compliance costs, these are expected to be low when taken into account in the broader context where the overall impact of the changes is likely to lead to greater balance between insurers and insureds and produce fairer outcomes for all parties to the insurance contract and those affected by it.

Implementation and review

3.164 The recommended actions all require legislative amendments to the IC Act.

3.165 No formal review has been scheduled. The operation of the IC Act will be under continuous monitoring and adjustments or refinements to the proposed amendments will be made as required.