2019

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

---

# FINANCIAL SECTOR REFORM (HAYNE ROYAL COMMISSION RESPONSE – PROTECTING CONSUMERS (2020 MEASURES)) BILL 2020: AVOIDANCE OF LIFE INSURANCE CONTRACTS (FSRC REC 4.6)

---

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer)

# Table of contents

# Glossary

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

| ***Abbreviation*** | ***Definition*** |
|---|---|
| Financial Services Royal Commission | Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry |

# Chapter 1
# Increasing the standard for insurer avoidance of life insurance contracts

## Outline of chapter

1.1 Schedule 1 to the Bill implements recommendation 4.6 of the Financial Services Royal Commission by amending the *Insurance Contracts Act 1984* to limit the circumstances in which an insurer can avoid a life insurance contract on the basis of non-fraudulent misrepresentation or non-disclosure by an insured.

## Context of amendments

1.2 The Financial Services Royal Commission considered life insurance in Australia and concluded that the current regime for allowing insurers to avoid contracts of life insurance is unfairly weighted in favour of insurers. The Financial Services Royal Commission recommended (Recommendation 4.6) that the *Insurance Contracts Act 1984* be amended to limit the circumstances in which an insurer can avoid a life insurance contract on the basis of non-fraudulent misrepresentation or non-disclosure by an insured.

1.3 The Government committed to implementing this reform on 4 February 2019 as part of its response to the Financial Services Royal Commission.

1.4 Division 1 of Part IV of the *Insurance Contracts Act 1984* currently imposes a duty of disclosure on the insured in relation to certain matters that are relevant to the insurer's decision whether to accept the risk and, if so, on what terms. Division 2 of Part IV of the *Insurance Contracts Act 1984* imposes an obligation on the insured not to make a misrepresentation to an insurer.

1.5 The Government has committed to implementing Recommendation 4.5 of the Financial Services Royal Commission which, for consumer contracts, would replace the current insured's duty of disclosure under section 21 of the *Insurance Contracts Act 1984* with a duty to take reasonable care not to make a misrepresentation to an insurer. The Government has released exposure draft legislation, including appropriate consequential amendments, to give effect to this recommendation.

1.6 Subsection 29(3) of the *Insurance Contracts Act 1984* allows a life insurer to avoid a contract of life insurance within 3 years of entering into the contract, if the insured failed to comply with their duty of disclosure at the time of entering into the contract, or made a misrepresentation to the insurer before entering into the contract. Subsection 29(3) applies where the insured's failure to comply with the duty of disclosure or misrepresentation was not fraudulent.

1.7 Before it was amended to its current form by the *Insurance Contracts Amendment Act 2013* (the 2013 amendments), subsection 29(3) of the *Insurance Contracts Act 1984* did not give life insurers as broad a power to avoid contracts of life insurance on the basis of non-fraudulent failure to comply with the duty of disclosure or non-fraudulent misrepresentation. Before the 2013 amendments, the insurer could not avoid the contract unless it could demonstrate that it would not have entered into a contract of life insurance *on any terms* with the insured, had it known the information that was non-fraudulently omitted or misrepresented.

1.8 The amendments in Schedule 1 to the Bill restore the pre-2013 wording to subsection 29(3) of the *Insurance Contracts Act 1984*, as recommended by the Financial Services Royal Commission.

## Summary of new law

1.9 Schedule 1 to the Bill amends the *Insurance Contracts Act 1984* to limit the circumstances in which an insurer can avoid a contract of life insurance because of a non-fraudulent misrepresentation or non-fraudulent failure to comply with the duty of disclosure by the insured to the insurer.

1.10 The key feature of the new law is that an insurer may only avoid a contract of life insurance on the basis of a non-fraudulent failure to comply with the duty of disclosure or a non-fraudulent misrepresentation, within 3 years of entering into the contract, if the insurer would not have been prepared to enter into a contract of life insurance with the insured on any terms, had the duty of disclosure been complied with or the misrepresentation not been made.

## Comparison of key features of new law and current law

| ***New law*** | ***Current law*** |
|---|---|
| Where the insured:<br>- failed to comply with the duty of disclosure, or<br>- made a misrepresentation to the | Where the insured:<br>- failed to comply with the duty of disclosure, or<br>- made a misrepresentation to the |

| | |
|---|---|
| insurer before the contract was entered into, and<br>- the failure or misrepresentation was not fraudulent; and<br>- the insurer can demonstrate it would not have entered into a contract of life insurance with the insured *on any terms*, had the duty of disclosure been complied with or the misrepresentation not been made,<br>the insurer may avoid the contract within 3 years of entering into it. | insurer before the contract was entered into, and<br>- the failure or misrepresentation was not fraudulent,<br>the insurer may avoid the contract within 3 years of entering into it. |

## Detailed explanation of new law

1.11 The existing broad discretion for an insurer to avoid a contract of life insurance under subsection 29(3) of the *Insurance Contracts Act 1984* is repealed. ***[Schedule 1, item 1, subsection 29(3) of the Insurance Contracts Act 1984]***

1.12 It is replaced with new subsection 29(3) which provides that an insurer may avoid a contract of life insurance on the basis of a misrepresentation or failure by the insured to comply with their duty of disclosure within 3 years of entering into the contract of life insurance if the failure to comply with the duty of disclosure was not fraudulent or the misrepresentation was not made fraudulently. However, the insurer's discretion to avoid the contract of life insurance is subject to it demonstrating that, if the duty of disclosure had been complied with or the misrepresentation not been made, it would not have been prepared to enter into a contract of life insurance with the insured on any terms. ***[Schedule 1, item 1, subsection 29(3) of the Insurance Contracts Act 1984]***

### Example 1.1

Jason purchased life insurance two years ago. When applying for the policy Jason made a non-fraudulent misrepresentation to the insurer with regard to symptoms of ventricular tachycardia (an irregular heartbeat) he had previously experienced. The insurer's internal underwriting policy, which was consistently followed in practice, stated that where symptoms of ventricular tachycardia are disclosed, the application should be accepted with a premium loading. This means that the insured pays a higher premium to account for the additional risk. As such, the insurer **cannot avoid** the insurance contract.

### Example 1.2

Jason purchased life insurance two years ago. When applying for the policy Jason made a non-fraudulent misrepresentation to the insurer with regard to symptoms of ventricular tachycardia (an irregular heartbeat) he had previously experienced. The insurer’s internal underwriting policy, which was consistently followed in practice, stated that all applications for cover that disclosed symptoms of ventricular tachycardia should be declined. As such, the insurer **can avoid** the insurance contract.

## Application and transitional provisions

1.13 The amendments made by Schedule 1 to the Bill apply to contracts of life insurance that are originally entered into after the commencement of the Bill, which commences on the day after it receives Royal Assent. ***[Schedule 1, subitem 2(1)]***

1.14 Additionally, if a contract entered into prior to the commencement of Schedule 1 is varied after that commencement date to increase the sum insured or to provide one or more additional kinds of insurance cover, then, to the extent of that variation, the contract is treated as though it were entered into after the commencement date. The variation must not be an automatic variation, but must be a variation that was required to be expressly agreed between the insured and insurer before the contract was varied. ***[Schedule 1, subitem 2(2)]***