asset insure

The Secretary
Insurance Contracts Act Review Secretariat
Department of the Treasury
Langton Crescent
CANBERRA ACT 2600

16 April 2004

Dear Madam

Re: Review of the Insurance Contracts Act – Section 54
Insurance Contracts Amendment Bill 2004

We refer to the *Report into the Operation of Section 54* (the *Report*) released in October 2003 and the Exposure Draft of the *Insurance Contracts Amendment Bill 2004* (the *Bill*) recently released for comment.

Background on Assetinsure

Assetinsure Pty Ltd was granted a general insurance license by APRA on 18 February 2004 and as such we are the newest general insurer in Australia. Our aim is to be a specialist corporate insurer in a limited number of classes including Professional Indemnity (PI) and Directors' & Officers' Liability (D&O). It is our intention that these types of insurance will produce a very significant proportion of our income, and accordingly the issues surrounding the operation of Section 54 of the *Insurance Contracts Act 1984* in respect of claims made policies are of great interest to Assetinsure.

Assetinsure is a member of the Insurance Council of Australia (ICA) and is represented on the ICA Professional Indemnity Committee. We fully support the ICA submissions in response to the *Issues Paper on Section 54* and the Exposure Draft of the *Insurance Contracts Amendment Bill 2004*. However, we feel we must emphasise certain points covered in those submissions.

Claims Made Policies

The principal reason for adopting the claims made form for PI and D&O policies is the increased level of certainty it provides to the insurer and the insured. This fact is accepted in the *Report* (p.4). In particular, the claims made format provides increased certainty to insurers in respect of claims reserving, and accordingly the measurement of the performance of their PI/ D&O portfolios.

The judicial interpretation of Section 54 has largely removed this inherent certainty and therefore undermined the *raison d'etre* of claims made policies.

The use of claims made policies for these classes is standard practice internationally. In the vast majority of jurisdictions such policies operate unencumbered by legislative provisions such as Section 54 (as acknowledged in the *Report* p.19).

Assetinsure Pty Ltd
ABN 65 066 463 803
44 Pitt Street Sydney NSW 2000

PO Box R299
Sydney NSW 1225
Australia

T (02) 9251 8055
F (02) 9251 6387
www.assetinsure.com.au

The Effect of Uncertainty

The *Report* accepts that the uncertainty caused by Section 54 "*...is a major contributing factor in discouraging insurers from offering 'claims made' insurance in Australia, and is increasing the costs of, and reducing the breadth of coverage of, 'claims made' insurance.*" (p.1).

It follows that this uncertainty must be eliminated (or at least reduced) if these problems are to be mitigated.

The Effect of the *Bill*

The provisions of the *Bill* would appear to have the effect that Section 54 will not apply where facts that may give rise to a claim are not reported with the policy period or a specified "period of grace". At first glance this would appear to restore some certainty for insurers as to the response of claims made policies in respect of facts or circumstances that may give rise to a claim.

However, we would submit that the *Bill* only moves the uncertainty to a new front because it results in a different treatment by Section 54 of claims and facts that might give rise to a claim. We believe this will simply result in considerable dispute (and therefore litigation) as to what constitutes "a claim" versus "a fact that might give rise to a claim".

Thus the uncertainty relating to the effect of Section 54 on facts that might give rise to a claim is replaced by uncertainty as to the definition of "claim" and "fact that might give rise to a claim". We submit that this situation does not represent a nett improvement in certainty for insurers offering claims made policies and therefore is unlikely to mitigate the problems identified in the *Report*.

Indeed, it could be argued the *Bill* is a backward step for insurers. There is a general expectation among most insurers offering PI and D&O in Australia that some certainty regarding the application of Section 54 to facts that might give rise to a claim can be achieved by careful policy drafting. This approach is yet to be conclusively tested in the High Court but there have been some cases in lower courts that provide insurers with some confidence this approach will work. The *Bill* restores some certainty regarding Section 54 and facts that might give rise to a claim but also requires insurers to provide a "period of grace" for notification and adopt a new notice procedure. Does the *Bill* in fact only confirm rights that insurers have now but also impose new obligations on them? If so, how does this encourage more insurers to offer claims made policies in Australia?

In any event, given the stated intention of the Review and the *Bill* we can only assume this outcome is unintended.

The Procedural Requirements in the *Bill*

The proposed Sections 40(2A) and (2B) are problematic in that they do not recognise the realities of the insurance market, nor do they seem to directly accord with the recommendations of the *Report*. This issue is covered in the ICA submission responding to the *Bill* and we do not propose to repeat those comments here other than to say that any notice requirements regarding the effect of Section 40(3) should -

- align with other notice requirements i.e. Section 58 (expiry notices) and/ or Section 22 (duty of disclosure); and
- be subject to Section 71; and
- not be subject to any criminal penalty.

Assetinsure's Approach to Claims Made Policies

Given the difficulties with Section 54 and claims made policies identified in the *Report* and the various ICA submissions it would be reasonable to question why a new insurer such as Assetinsure has chosen to write PI and D&O business (on a claims made basis) in Australia.

We would emphasise that when issuing a claims made policy it is not Assetinsure's intention (except where we are legally obliged) to cover any claim or fact that might give rise to a claim that is notified outside the policy period. To enforce our intent we have adopted a multi-faceted strategy covering policy drafting, disclosure requirements, risk selection and punitive action against insureds who notify claims or facts that may give to a claim outside the policy period. In summary this strategy involves –

- adopting a very narrow definition of "claim" within the policy wording; and
- removing the "deeming" clause traditionally found in claims made policies (see p.17 of the *Report*); and
- removing any reference to facts or circumstances that might give rise to a claim from the policy wording (with the exception of exclusions); and
- specifically asking proposed insureds whether they have ever notified a claim or fact that might give rise to a claim under any previous claims made policy after such policy has expired (proposed insureds who answer in the affirmative are declined insurance); and
- only writing medium to large risks with sound internal systems thereby reducing the risk of late notification (i.e. after the applicable policy period has expired); and
- in the event an existing insured notifies a claim or facts that might give rise to a claim outside the applicable policy period, strictly exercising our rights to cancel the existing policy (under Section 60) for non-disclosure.

Assetinsure believes that a disciplined application of this strategy –

- maximises our rights in respect of notifications outside the applicable policy period; and
- "culls" risks with a history of late notification; and
- results in us writing those risks which are least likely to notify claims, or facts that might give rise to a claim, after the expiry of the applicable policy.

On balance we feel this strategy enables us to successfully write claims made policies in Australia. However, we would emphasise that Assetinsure would have to reassess its stance if the High Court overturned the current treatment of Section 54 and facts that might give rise to a claim by lower courts.

It should also be noted that there is nothing in the *Bill* which would lead us to alter any aspect of the above strategy should it be passed by Parliament.

Conclusion

We submit that, at best, the provisions of the *Bill* provide no nett benefit to insurers offering claims made insurance in Australia. Indeed, some may see the *Bill* as a backward step for insurers. Either way, passage of the *Bill* will not meet the Governments goal of making the Australian PI and D&O market more attractive to local and overseas insurers.

Assetinsure urges the Review to reconsider the implementation of "Option 3" as proposed in the Issues Paper on Section 54 whereby Section 54 would not apply to both claims and facts that may

give rise to a claim notified outside the policy period. We believe this is the only approach that will produce a material change to insurers' attitude to claims made policies in Australia.

The implementation of "Option 3" will restore the original intent of the claims made policy and align the Australian market with prevailing international practice.

We trust our comments are of some value to the Review.

Please do not hesitate to call Ewen McKay on (02) 8274 2813 should you wish to discuss any aspect of the above.

Yours sincerely

Gregor Pfitzer
Chief Operating Officer

Gregor.Pfitzer@assetinsure.com.au

Ewen McKay
National Manager - Professional Risks

Ewen.McKay@assetinsure.com.au

O:\ICA\Section 54\ICA Review 160404.doc