INSURANCE COUNCIL OF AUSTRALIA LIMITED

Comments on the Exposure Draft
Insurance Contracts Amendment Bill 2004
16 April 2004

The draft Insurance Contracts Amendment Bill 2004 (the Bill) gives effect to the recommendations of the *Review of the Insurance Contracts Act 1984 Report Into the Operation of Section 54*, dated October 2003. In January 2004 the Insurance Council of Australia (ICA) provided a response to the recommendations contained in the Report. ICA now appreciates the opportunity to provide comments on the exposure draft Bill. These comments have been prepared after detailed discussions with senior executives of ICA member companies who have extensive involvement in the conduct of professional indemnity insurance business in Australia for many years.

Preliminary

ICA strongly believes that the preparation of draft legislation to give effect to the recommendations must take into account a number of important features of the professional indemnity insurance market in Australia. These include –

1. The market operates almost entirely through the involvement of intermediaries, primarily insurance brokers. Underwriting agents are also a common feature of the market, particularly in the case of insurance placed overseas and at Lloyds. Therefore, the great majority of business is placed in a manner whereby the insurer would not have a direct business relationship with the policyholder.
2. Co-insurance is a common feature of professional indemnity insurance, because of the nature of the risks and the level of cover that is often provided to policyholders. It must not be assumed that the majority of policies include indemnity provided by a single insurer only.
3. It is important to distinguish between the policyholder (the party the insurer contracts with) and people and entities insured under a policy. For example, where a professional firm operates in the form of a company, inevitably the company is the policyholder, but the insurance policy may well included as “insureds” the principals and senior employees of the company.
4. Much professional indemnity insurance is arranged on a collective or “scheme” basis. In many cases, an insurance broker will establish a scheme with a professional trade association. The policyholder may well be the trade association, and the insured would include those members of the association wishing to be covered by the master insurance policy as part of the scheme. The members of the association may or may not be specifically named in the policy – in fact, it is not unusual for professional indemnity policies to name a defined class or group as the insured without specifically naming the insured parties.

5. The *Insurance Contracts Act 1984* already recognises these features of professional indemnity insurance, for example by requiring the giving of notices relating to claims made and notified policies (section 40(2)) and of notices relating to the expiry and renewal of policies (section 58), and by recognising the role of intermediaries (section 71).

General Comments on the draft Bill

The submissions by ICA and insurers have constantly raised concerns regarding the judicial interpretation of the effect of section 54 in relation to –

- Late notification of claims; and
- Late notification of facts and circumstances that might give rise to a claim.

The Bill provides a legislative remedy in relation to the latter, but not the former. To that extent, the Bill only partly addresses the concerns regularly expressed by ICA and insurers over a number of years.

The insurance market has largely dealt with late notification of facts and circumstances that might give rise to a claim, by the removal of "deeming" clauses from professional indemnity insurance policies. With this issue already having been dealt with, from an insurance market perspective, the Bill offers little to promote the availability and affordability of professional indemnity insurance. On the contrary, it imposes a number of obligations on insurers, and creates new uncertainties for the market.

If passed, the Bill will confirm that once the period of grace has expired, late notification of facts and circumstances that might give rise to a claim will not be excused by section 54.

More importantly, the Bill will provide a strong incentive for policyholders and insureds to make use of section 54 to excuse late notification of claims. There can be a range of views as to what facts and circumstances might constitute a "claim", and whether those facts and circumstances might constitute "facts that might give rise to a claim against the insured". Clearly, policyholders and insureds wishing to continue to utilise section 54 will now seek to argue that those facts and circumstances are not "facts that might give rise to a claim" for the purposes of the new section 54A.

Insurers strongly fear that there will be a new round of litigation to determine what facts and circumstances do, and do not, fall within the coverage of proposed section 54A. This ongoing level of uncertainty is a major cause of concern to insurers in relation to the future operation of section 54 on claims made and notified insurance policies.

As ICA has stressed in previous submissions, the fundamental reason for claims made policies is to provide the best possible certainty about claims facts that might give rise to claims. This certainty has been undermined by section 54, and any amendments that do not deliver a clear increase in certainty in this area are unlikely to result in a stronger professional indemnity insurance market in Australia.

The Bill, therefore, is unlikely to achieve the degree of confidence and certainty insurers have been seeking for many years. The preferred solution is for the proposed changes to apply to both late notification of claims, and late notification of facts and circumstances that might give rise to a claim.

Specific Comments on the draft Bill

Proposed subsections 40 (2A) and (2B) impose notice obligations on "the insurer". These obligations are in addition to any other notice obligations in the Act, such as those in section 40(2) and section 58.

The obligations in the current draft are completely impractical, primarily because the policyholder's key relationship is with the insurance broker, not the insurer. In addition, for reasons noted above, the insurer is unlikely to be fully aware of the name and address of each insured covered by the policy. In any event, the policy renewal process usually commences approximately 6 weeks prior to expiry, not 30 days prior to expiry.

Proposed subsection (2B) effectively requires insurers to introduce processes and procedures to ensure that they "become aware" that the insurance broker has given the necessary notices. This would be extremely difficult to implement, and this provision would effectively require insurers to implement their own procedures to give notices to those policyholders and insureds whose details were available to the insurer. This requirement is not currently a feature of section 71, and ICA submits the requirement should not be an obligation under section 40.

ICA firmly believes that failure to comply with proposed subsection (2A) should not constitute a criminal offence.

ICA submits that it should be sufficient that notice is given at the time the policy is entered into, utilising current industry practices and procedures. If notice is to be given at the time of renewal of a policy, the amendment should simply require that for policies to which section 40 applies, the notice of expiry and the offer to renew under section 58 should include a notice that informs the insured of the effect of section 40 (3). The provisions of section 71 should be available to the insurer in these circumstances, if necessary with any consequential amendments.

Special provision may need to be made in circumstances where the insurance policy is cancelled prior to the normal expiry date. Where a policy is cancelled at the request of the policyholder, the insurer may not be aware of the likely date of cancellation, and would not be able to provide notices prior to the cancellation date. ICA submits that the notice to the insured at the time the policy was issued should be sufficient notice of the effect of section 40 (3) in cases where the policy is cancelled prior to the normal expiry date.

Proposed subsection 40 (3) introduces a period of grace of 45 days for late notification of facts that might give rise to a claim. The insured must become aware of the facts that might give rise to a claim, before the policy expires.

For the provision to operate, the insured must have knowledge of circumstances which might give rise to a claim. If those facts are reported to the insurer after the policy expires, and the policy is renewed by the existing insurer, there may well be issues of non-disclosure by the insured to the insurer.

Similarly, if there is a change of insurer, there may be issues of non-disclosure to the new insurer, or at least confusion as to whether a claim made after expiry has access to the period of grace, and is covered by the expired policy, or is covered by the new policy, or both.

ICA previously accepted the argument for a period of grace, but did so on the basis that there would be a general rule preventing late notification of both claims and facts and circumstances that might give rise to a claim. Having said that, ICA submits the period of grace should, in any event, be no longer than 21 days.

The Bill, if enacted, will only apply to contracts of liability insurance entered into on or after the end of 28 days after the date of Royal Assent. The amendments are unlikely to be available for the June 2004 renewal season.

Conclusion

As stated previously, the overall intent of the Bill, if enacted, is to provide a remedy in respect of late notification of facts and circumstances that might give rise to a claim, and to offer a period of grace. For the reasons outlined above, the insurance market has already adjusted to overcome the primary concerns raised by *FAI v Australian Hospital Care*, and the amendments are unlikely to have any positive benefit to the professional indemnity insurance market.

The procedural obligations set out in the Bill are both onerous and administratively impractical. If not substantially amended, they may well result in a position where insurers have less incentive to participate in this market.

On the whole, ICA has serious concerns that the Bill will not facilitate the availability and affordability of professional indemnity insurance, and may in fact be counter productive. If the Government is minded to alter the drafting of the Bill in the light of the recent period of consultation, ICA and insurers would greatly appreciate the opportunity to view a further draft before it is introduced into Parliament.