REVIEW OF THE INSURANCE CONTRACTS ACT 1984 (CTH)

FINAL REPORT ON SECOND STAGE: PROVISIONS OTHER THAN SECTION 54

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PREFACE

On 10 September 2003, the Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan and the then Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell announced that we would conduct a review of the *Insurance Contracts Act 1984* (IC Act).

The terms of reference of the review are contained in the Ministers' press release of 10 September 2003, these being:

> 'The Review of the operation of the Insurance Contracts Act 1984 (the Act) is to be conducted having regard to the following:
>
> 1. whether the rights and obligations of insurers and insureds (including persons seeking insurance) under the Act continue to be appropriate, including in light of:
>
>   - product, regulatory and other developments in the financial services industry (particularly the insurance sector) since the Act was enacted; and
>
>   - judicial interpretation of the Act;
>
> 2. whether any amendments to the Act are required to take into account of the matters set out in item 1, and whether there are any deficiencies in the Act, such as aspects of the relationship between insurers and insureds that are not adequately covered;
>
> 3. whether any amendments are warranted in order to remove ambiguity and more clearly express the intent of the Act; and
>
> 4. any other matters relating to the Act which the reviewers consider it appropriate to examine.'

As the Ministers requested, we first examined section 54 of the IC Act, due to concerns about its impact on the availability and affordability of professional indemnity insurance. The findings of the first phase of the review were reported to Government on 31 October 2003. The Government agreed to our recommendations for amendments to section 54 and related provisions. Draft provisions were released for stakeholder consultation on 8 March 2004. Following receipt of comments on the draft provisions, we made some further recommendations to Government which supplement our report of 31 October 2003.

In relation to reviewing the remainder of the IC Act, the Government asked us to report by 31 May 2004. However, given the number of issues raised by stakeholders, we found it necessary to seek an extension to the end of June 2004.

In undertaking the review, we pursued an open and inclusive consultation process. In relation to the review of the IC Act (provisions other than section 54), we commenced by seeking from stakeholders, by 31 December 2003, 'submissions at large' to identify issues relating to the operation of the IC Act. A surprisingly large number of issues were raised. And while many of these issues have been dealt with, there were a few that were not; these being outside the terms of reference, ambiguities that have been clarified by judicial interpretation, or requests to modernise the language of the law.

Following receipt of the submissions and various meetings with stakeholders, we released on 24 March 2004 an issues paper on the provisions of the IC Act other than section 54. Comments were sought on issues raised in this paper. From the comments received, both in written form as well as orally, we prepared a proposals paper, which was released for comment on 25 May 2004. The comments received following the release of the proposals paper have enabled us to finalise our recommendations that are contained in this report.

When preparing our recommendations, our primary consideration was to preserve the appropriate balance between the rights and obligations of insurers and insureds. The Ministers in their 10 September 2003 press release had said:

> 'The review is aimed at ensuring the Act continues to meet its original consumer protection objectives and does not discourage insurers from writing policies in Australia.'

We agree with most stakeholders that the IC Act has been generally operating satisfactorily to the benefit of insurers and insureds. For example, in its submission on the issues paper the National Insurance Brokers Association made the following remark:

> 'By all accounts the Act has worked well since its commencement in 1984 and while it is appropriate that all legislation be reviewed from time to time, having regard to judicial interpretation as well as developments in products and regulation, only minor modifications would appear necessary in the case of the IC Act.'

We believe there is a need for a number of amendments to the IC Act, given the effluxion of time since its enactment, developments in the insurance market and judicial interpretation of the Act. We have made detailed proposals

for changes designed to address most issues. In a small number of cases an issue is noted and further consideration is suggested. This approach has been taken, for example, in relation to how to protect the interests of innocent co-insureds.

Some stakeholders commented that the time frame in which the review was conducted was short. The Insurance Council of Australia Limited (ICA) stated that the consultation period on the proposals paper has not allowed insurers to properly consider the proposals. However, the majority of stakeholders were able to meet the timeframes on consultation. The Law Council of Australia noted that it 'values the transparent way the Review has been conducted, with several opportunities for comment and discussion'. We believe that the stakeholder input we obtained during consultations enabled us to make recommendations that will improve the operation of the IC Act, while having regard to the interests of insureds and insurers.

If our recommendations are implemented, we suggest that there is further consultation on the details of the legislative amendments.

We are grateful to all stakeholders who made submissions throughout the review in the form of written comments and in discussions with us.[1]

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1 Lists of persons who made submissions and meetings held with stakeholders are at the end of this Report. Copies of written submissions are available at the Review website, http://icareview.treasury.gov.au.

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RECOMMENDATIONS

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1.2 A breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act, although the breach of the IC Act would not be an offence and would attract no penalty.

1.3 The IC Act should be amended so that insurance contracts that are entered into for the purposes of workers' compensation are excluded from the operation of the IC Act in their entirety, even if the contracts also contain cover for employers' common law liability to pay damages to workers for employment related personal injury.

1.4 In other cases of bundled insurance contracts, the exceptions in subsection 9(1) of the IC Act should apply to each aspect of the bundled cover as if they were included in separate insurance contracts.

1.5 The IC Act and/or *Marine Insurance Act 1909* should be amended so that the IC Act covers insurance of the water transportation of domestic or household goods, as recommended by the Australian Law Reform Commission.

1.6 The IC Act should be amended to clarify its intended territorial application to all contracts issued by direct offshore foreign insurers to Australian insureds or in respect of Australian risks.

2.1 Amendments to the IC Act and other Acts and regulations should be made so that communications under the IC Act may be made electronically. They should be subject to the *Electronic Transactions Act 1999*, and subject to appropriate safeguards including:

- clarity;
- consent by the recipient to electronic communication and nomination by the recipient of an information system for that purpose;
- ability to print and retain the communications; and
- certainty of time and place of origin and receipt.

2.2 There should be a facility to provide in regulations circumstances in which specific types of notices or documents required under the IC Act

must be communicated by traditional means in addition to, or instead of, by electronic means.

2.3 The provisions in the IC Act that permit alternatives to direct written communication between insurers and insureds should be harmonized, to the extent reasonably practicable, with equivalent provisions under the *Corporations Act 2001*.

3.1 The Australian Securities and Investments Commission should be given a statutory right to intervene in any proceeding relating to matters arising under the IC Act.

4.1 Section 21 of the IC Act should be amended to include non-exclusive factors that can be taken into account when determining the application of the duty of disclosure test.

4.2 Section 21A of the IC Act should be amended so that:

- it applies on renewal; and
- paragraph 21A(4)(b) is repealed.

4.3 The IC Act should be amended so that the insurer must provide to the insured, at the time when the insurance policy is issued, a reminder that the duty of disclosure obligations continue until the time the policy is entered into.

4.4 Section 25 of the IC Act should be expanded to include a non-disclosure by a person whose life is insured under the contract.

4.5 Section 22 of the IC Act should be expanded so that the insurer must give the life insured notice of the duty of disclosure.

4.6 The prescribed form of words for notifying an insured of the general nature and effect of the duty of disclosure for oral disclosures should apply to all contracts of insurance and not just 'eligible contracts of insurance'.

5.1 The clarity test of 'clearly inform' in sections 35 and 37 of the IC Act should be replaced by a requirement that the information be presented in a 'clear, concise and effective manner'.

5.2 The standard cover regulations should be updated and modernised following a suitable process of consultation with stakeholders including the insurance industry and consumer representatives.

5.3 Sections 35 and 37 should be amended so that the product disclosure statement (PDS) is specified as one of the documents through which disclosure of non-standard and unusual policy terms can occur.

- Such disclosure would need to satisfy both the requirements of the standard cover provisions under the IC Act and the requirements of the PDS regime.

5.4 Consideration should be given to the need for regulations under the *Corporations Act 2001* that would clarify:

- that a PDS may include information that satisfies the disclosure requirements of the standard cover provisions of the IC Act; and

- that where an insurer fails to fulfil its standard cover disclosure obligations through the provision of a PDS, then the insured may rely upon the remedies of the IC Act as well as the remedies of the *Corporations Act 2001.*

6.1 Section 14 of the IC Act should be amended so that it applies to provisions that are implied or imposed by the IC Act.

6.2 The rate of interest prescribed under section 57 of the IC Act should be increased to 5 per cent above the 10 year Treasury bond yield.

7.1 For the purposes of Part IV of the IC Act life insurance contracts should be 'unbundled'.

7.2 Subsection 29(3) should be amended so that the words 'a contract' are replaced by the words 'the contract'.

7.3 All 'contracts' of life insurance (including parts of a contract of life insurance) excepting those that cover mortality or contain a surrender value, should be subject to section 28 of the IC Act, subject to any necessary modifications.

7.4 The interest rate prescribed for the purposes of section 30 should be the Treasury 10 year bond rate.

7.5 Section 30 of the IC Act should be amended to allow insurers to change the expiration date of contracts where that date has been calculated with reference to the insured's (incorrectly stated) date of birth.

8.1 Sections 31 and 56 of the IC Act should be re-drafted so that they can be applied by alternative dispute resolution bodies.

8.2 Section 31 of the IC Act (including the limitation in subsection 31(2)) should be amended so it applies where it is alleged there has been innocent non-disclosure or misrepresentation.

8.3 The IC Act should be amended so that if an insured makes a claim on an insurance policy extended by operation of section 58, it must pay a premium equal to the amount that was payable under the original contract of insurance, irrespective of the size of the claim.

10.1 Third party beneficiaries should have access to the following provisions of the IC Act:

- the same rights and obligations as an insured for the purposes of subrogation;
- the duty of utmost good faith (but not pre-contractually); and
- where the IC Act allows the insured to give notice, for example, pursuant to subsection 40(3) or section 74.

10.2 Subsection 48(3) of the IC Act should be clarified so that it is clear that a third party beneficiary is in no better position than the actual insured, that is, insurers should be able to raise the conduct of the insured (whether pre or post contract) in defence to a claim brought by a third party beneficiary.

10.3 Section 48A of the IC Act should be amended so that:

- it is clear that a third party can bring an action against an insurer without the intervention of the policy owner;
- the life insured can be nominated as a third party beneficiary; and
- a third party beneficiary can provide a valid discharge to the insurer.

10.4 Section 51 of the IC Act should be revised to ensure its interaction with related provisions in other legislation results in consistent operation. The following situations should be addressed:

- the insured is alive and can be found but the third party cannot recover under execution of a judgment obtained against the insured, that is, when execution is returned with a nulla bona endorsement; and
- a section 48 party is liable and cannot after reasonable inquiry be found.

10.5 Section 32 of the IC Act should be amended so that it is clear that remedies for non-disclosure and misrepresentation remain available in relation to a misrepresentation or non-disclosure that occurs between the time an insured becomes a member of the scheme and applies for cover.

10.6 Section 32 of the IC Act should apply to non-superannuation group life schemes.

11.1 Section 67 of the IC Act should be brought into harmony, in due course, with the outcome of the review of the *Marine Insurance Act 1909* on the same subject.

11.2 The IC Act should be amended to clarify that the provisions regarding subrogation in Part VIII apply to claims made by third party beneficiaries who are not 'insured' for the purposes of those provisions.

CHAPTER 1: SCOPE AND APPLICATION

1.1 In the course of the review, a range of issues relating to the scope and application of the *Insurance Contracts Act 1984* (IC Act) were raised:

- the extent to which the IC Act deals with insurers' conduct (beyond regulating the contractual relationship);
- the interface of the IC Act and the *Corporations Act 2001*, particularly, the disclosure requirements included in the *Financial Services Reform Act 2001;*
- the application of the IC Act to composite policies including compulsory statutory insurance (such as workers' compensation);
- the interface of the IC Act and the *Marine Insurance Act 1909;* and
- the extent to which the IC Act deals with contracts issued by foreign insurers, and insurance-like products issued by, for example, discretionary mutual funds.

GENERAL CONDUCT OF INSURERS

1.2 As stated in its long title, the IC Act regulates the terms included in insurance contracts and insurer conduct in relation to such contracts. The focus is the contractual relationship between insurers and the insured.

1.3 The duty of utmost good faith imposed in Part II of the IC Act operates as an implied term of insurance contracts. Under Part IA, the Australian Securities and Investments Commission (ASIC) can gather information from insurers about the way they conduct their business. ASIC can bring a representative action against an insurer under section 55A of the IC Act, but only in respect of insurance contracts entered into. Despite those provisions, neither the IC Act nor the regulations made under it include provisions that directly regulate insurer conduct beyond the extent to which the conduct relates to individual insurance contracts.

1.4 Conduct matters, such as claims handling and dispute resolution processes, are dealt with in the General Insurance Code of Practice developed by the Insurance Council of Australia Limited and oversighted by ASIC.[2]

1.5 ASIC's preliminary submission urged the review to consider whether the current regulatory system as a whole ensures that insurers have proper claims handling procedures in place, including the appropriate training of employees and outsourced service providers, to ensure that claims handling is dealt with in a fair, transparent and timely manner.

1.6 Given the scope of the IC Act and the terms of reference of the review, it was foreshadowed in the Issues Paper that the Review Panel did not propose to make detailed recommendations going beyond the relationship between parties. However, there are two matters connected with claims handling about which the Review Panel considers it appropriate to make recommendations.

1.7 First, the Review Panel considers that the issue of claims handling practices should, at least in the first instance, be dealt with through industry codes. Industry bodies should have an opportunity to develop codes in consultation with stakeholders that offer appropriate protection for consumers in relation to claims handling.[3]

1.8 Second, as mentioned elsewhere in this report, the Review Panel believes that the duty of utmost good faith in section 13 of the IC Act has potential to provide remedies for some of the issues relating to claims handling by insurers.[4] For example, an insurer who has caused unreasonable delay in admitting liability and paying a claim has been found to have breached the duty of utmost good faith.[5] The Review Panel agrees with the commentators who have noted that there is a significantly wider scope to use section 13 in comparable circumstances.[6] It has been suggested to the Review Panel that a breach of the duty of utmost good faith should not only be a breach of an implied term of the insurance contract — it should be a breach of the IC Act. If this was made clear, there would be no doubt that ASIC would have power to commence representative proceedings in relation to the breach. The Review

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2 The Insurance Council of Australia Limited released a draft revision of its General Insurance Code of Practice on 8 June 2004 for public comment, available at: www.ica.com.au/codepractice.

3 Codes of conduct may be approved by ASIC under section 1101A of the *Corporations Act 2001*.

4 See Chapter 6, 'Remedies of insured' below.

5 *Moss v Sun Alliance Australia Ltd* (1990) 55 SASR 145; (1990) 93 ALR 592; (1990) 99 FLR 77; (1990) 6 ANZ Ins Cas 60-967.

6 See, for example, Bremen, J. 'Good Faith and Insurance Contracts — Obligations on Insurers' (1999) 19 (1) *Australian Bar Review* 89 at 91.

Panel agrees that including a provision along these lines would be beneficial.[7] However, the Review Panel believes that a breach of the duty should not amount to an offence, nor attract any penalty.

1.9 The possible implications of a breach of the duty for the purposes of the licensing provisions in section 920A of the *Corporations Act 2001* may require some further consideration if this proposal is implemented. The Review Panel considers that isolated breaches of the duty should not give rise to any risk of a banning order being imposed. However, the ordinary operation of the licensing regime generally should mean that repeated breaches, or very serious breaches, of the duty by an insurer might be grounds for ASIC to consider imposing conditions on an insurer's financial services licence or, in extreme cases, to ask an insurer to show cause why its licence should not be revoked.[8]

Recommendations

1.1 Best practice guidelines relating to claims handling processes by insurers should be developed and included in the relevant industry codes.

1.2 A breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act, although the breach of the IC Act would not be an offence and would attract no penalty.

Interface with *Financial Services Reform Act 2001*

1.10 On 11 March 2002, the *Financial Services Reform Act 2001* (FSRA) introduced into the *Corporations Act 2001* a uniform licensing, conduct and disclosure regime for financial services providers, including insurers.

1.11 It has been suggested that the requirements introduced by the FSRA (especially the disclosure requirements) may overlap with some provisions of the IC Act. Specifically, it was suggested that the standard cover provisions may need reviewing in light of the FSRA product disclosure statement regime.

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7 The Consumers' Federation of Australia (CFA) in its submission dated June 2004 following the release of the proposals paper argued that this recommendation is required because an industry code of conduct alone will not adequately address the issue of claims handling. The reasons being, 'first, the Code is voluntary' and secondly 'the real test of any Code is whether it can be effectively enforced … Under the draft Code however, in effect the CCC (Code Compliance Committee) will only be able to address "a serious material breach or a serious systemic failure". The CCC has limited enforcement powers in relation to other breaches. And sanctions for breaches do not extend to monetary penalties or compensation to consumers who may have been affected by the conduct.'

8 Any action taken by ASIC under section 920A of the *Corporations Act 2001* is subject to due process requirements and a decision is reviewable by the Administrative Appeals Tribunal — section 1317B.

1.12 However, other than the standard cover regime, stakeholders have not identified specific examples of inconsistency or duplication between the FSRA and the IC Act.

1.13 For this reason, this report will only examine the interaction with the FSRA, and the standard cover provisions of the IC Act. Issues associated with the standard cover provisions are considered below.[9]

APPLICATION TO BUNDLED POLICIES INCLUDING COMPULSORY STATUTORY INSURANCE COVER

1.14 Paragraph 9(1)(e) of the IC Act provides that the Act does not apply to contracts entered into or proposed to be entered into for the purposes of a law (including a law of a State or Territory) that relates to workers' compensation; or death or injury to a person arising out of the use of a motor vehicle.

1.15 The Explanatory Memorandum to the Insurance Contracts Bill 1984 noted that workers' compensation insurance and compulsory third party insurance are compulsory forms of insurance and 'subject to different considerations' than other insurance contracts.[10] They were expressly excluded from the terms of reference of the review by the Australian Law Reform Commission that led to the introduction of the IC Act.

1.16 In the High Court case of *Moltoni Corporation Pty Limited v QBE Insurance Limited*,[11] a contract of insurance had been entered into for the purposes of a workers' compensation law, but the contract included other clauses for the purposes of obtaining and providing insurance against the employer's liability to an employee at common law. The Court decided that, in such a case, subparagraph 9(1)(e)(i) excludes the operation of the IC Act from the contract only in so far as it was entered into to provide protection from liability under the workers' compensation statute. However, the IC Act applied in the usual way to the cover that was provided against employer liability arising under common law.

1.17 It was suggested that the *Moltoni* decision has created uncertainty about the application of the IC Act to workers' compensation policies and difficulties for insurers in complying with the provisions of the Act for bundled policies. The Review Panel sought comments on whether the exclusion in subparagraph 9(1)(e)(i) of the IC Act relating to compulsory workers'

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9 See Chapter 5, 'Standard Cover' below.
10 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984, Explanatory Memorandum at page 18.
11 (2001) 205 CLR 149.

compensation should be extended to cover bundled policies in order to prevent such difficulties arising.

1.18 Some submissions opposed such an extension. Arguments against an extension include that:

- the *Moltoni* decision was satisfactory and a pressing case for change has not been made out; and
- to proceed with an extension might lead to bundling for the purpose of avoiding the IC Act.

1.19 One submission pointed out that the issue could also arise in relation to subparagraph 9(1)(e)(ii), which has a similar exclusion for compulsory third party motor vehicle insurance. Such cover could be bundled with cover for property damage.

1.20 In light of the submissions received, the Review Panel considered the following options regarding paragraph 9(1)(e) and its application to policies that are bundled with cover falling outside the excluded cover:

- bring bundled policies within the scope of the exclusion, so the IC Act would not apply to any part of a bundled policy;
- remove bundled policies from the scope of the exclusion, so the IC Act would apply to the whole of the bundled policy;
- give a decision maker a discretion to allow bundled polices that include covers which are strictly outside the scope of the exclusion to benefit from the exclusion; and
- no change, leaving the *Moltoni* decision to stand and uncertainty regarding application of the IC Act to be determined by a court by 'unbundling' as and when required.

1.21 A blanket rule that results in bundled policies being covered by the exclusion has the benefit of certainty for insurers. However, it presents risks to the intended coverage of the IC Act. For example, in those jurisdictions where vehicle owners can deal directly with their compulsory third party insurance cover providers (as opposed to obtaining the cover automatically through the vehicle registration procedure), one could envisage insurers offering bundled third party property cover with compulsory third party personal injury cover, with the result that the third party property insurance is not covered by the IC Act. This is clearly not desirable. Further, the non-compulsory part of the bundled policy may become subject to provisions of legislative regimes in States and Territories that were designed only to deal with the compulsory

insurance component — their application to non-compulsory cover may produce unintended and undesirable consequences.

1.22 To remove bundled policies expressly from the scope of the exclusion could be justified on the grounds that it removes uncertainty and the exclusion was only ever intended to cover compulsory insurance. However, there are risks with that approach. These kinds of compulsory insurance are part of a wider statutory scheme, which has been formulated on the basis that the IC Act does not apply. If the IC Act were made to apply to a subset of insurance contracts that form part of the scheme, there is a significant risk that the result of its operation, particularly the override of State and Territory enactments, would produce undesirable results for both insurers and insureds. Further, it may be problematic to frame a legislative rule to distinguish between additional cover that should result in the bundled policy losing the benefit of the exclusion (for example, cover for property damage bundled with compulsory third party injury cover), and enhancements to the statutory minimum cover (for example, a larger quantum of maximum damages) that should not impact on its excluded status.

1.23 Including in the IC Act a discretion vested in the court to rule that a bundled contract is covered by the exclusion was suggested. However, this would not provide certainty to insurers and insureds at the time the contract is entered into, which is when many of the obligations under the IC Act arise. An alternative which avoids this difficulty is to give an administrative body power to make a determination that a particular bundled policy is excluded from the IC Act. This would require a set of guidelines to be prepared and a new administrative process to be established, which would involve cost. Further, although there would be no need to establish a distinction in legislation between policies that are merely 'enhancements' to statutory cover and those that extend it to an unacceptable degree, ultimately the administrative body would need to make rulings on where the line is drawn.

1.24 A submission from the Insurance Council of Australia Limited identified only one form of bundled policy for which the *Moltoni* decision commonly creates difficulties — that is, the bundling of compulsory workers' compensation cover with cover for employer liability to pay damages for employment related personal injury. The Insurance Council considers that, in respect of such policies, the potential disadvantages of including the bundled policy within the scope of the exception are manageable. In particular, it was submitted the potential application of State and Territory legislation to the additional cover does not create difficulties. The Insurance Council suggested that paragraph 9(1)(e)(i) should be amended so that it extends to any policy entered into for the purposes of workers' compensation and/or for employers' liability to pay damages to workers for employment related personal injury.

1.25 One approach, which is used in connection with insurance products in the *Corporations Act 2001*,[12] is to treat different products that are bundled in a single insurance contract as if they are unbundled. The Review Panel considers that that this treatment does not resolve the difficulties arising from the *Moltoni* decision. However, unbundling would provide an approach for application of the exceptions in subsection 9(1) of the IC Act to bundled contracts.

1.26 The Review Panel acknowledges that the *Moltoni* decision gives rise to uncertainty about contracts that include, but are not restricted to, the compulsory insurance referred to in paragraph 9(1)(e) of the IC Act, which it is desirable to resolve. However, the risks involved with extending the exclusion to bundled policies generally are too great to warrant that step. The Review Panel proposes that the specific issue in *Moltoni* be addressed, but the general rule for applying the subsection 9(1) exceptions to bundled insurance contracts should be that they are treated as if they were unbundled.[13]

Recommendations

1.3 The IC Act should be amended so that insurance contracts that are entered into for the purposes of workers' compensation are excluded from the operation of the IC Act in their entirety, even if the contracts also contain cover for employers' common law liability to pay damages to workers for employment related personal injury.

1.4 In other cases of bundled insurance contracts, the exceptions in subsection 9(1) of the IC Act should apply to each aspect of the bundled cover as if they were included in separate insurance contracts.

INTERFACE WITH *MARINE INSURANCE ACT 1909*

1.27 Generally, the IC Act does not cover marine insurance because contracts covered by the *Marine Insurance Act 1909* are specifically excluded from the scope of the IC Act.[14] However, section 9A of the IC Act, inserted in 1998, brings contracts of marine insurance relating to pleasure craft within the scope of the IC Act.

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12 Subsections 761G(11), 764A(1A) and 764A(1B) of the *Corporations Act 2001*.

13 While the Insurance Council (in its submission dated June 2004 following the release of the proposals paper) supported recommendation 1.3 it submitted, *inter alia*, the term 'employment related personal injury' needed to be carefully defined. The Review Panel believes this is a drafting issue.

14 Paragraph 9(1)(d) of the IC Act.

Water transportation of household goods

1.28 The Australian Law Reform Commission (ALRC) review of the *Marine Insurance Act 1909*[15] in 2001 noted that, since the inclusion of section 9A, the only area of non-commercial insurance the Marine Insurance Act currently covers is the insurance of personal effects or non-commercial goods carried by sea.[16] The ALRC recommended carriage of domestic or household goods should be covered by the consumer protection provisions of the IC Act and a new section 9B should cover water transportation of goods other than goods being transported for a business, trade, profession or occupation carried on or engaged in by the insured. This proposed amendment would remove insurance for the carriage of goods for non-commercial purposes from the scope of the Marine Insurance Act.[17]

1.29 The Review Panel invited comments on that proposal and specifically sought views on whether there would be any negative consequences of adopting it. Most submissions were supportive of the proposal. The only negative consequence identified was that to have the IC Act cover insurance for a particular type of water transportation and the Marine Insurance Act covering the remainder might lead to some uncertainty about the respective coverage of the two Acts. However, it was also noted that if two pieces of legislation are to remain, as is proposed, it is inevitable that some demarcation issues will arise.

1.30 Following the release of the proposals paper it was also submitted that 'by catching this type of cover under the IC Act, [as suggested in recommendation 1.5] it will bring such insurance within the scope of the retail client definition under the Corporations Act, thereby imposing all of the retail client requirements on the providers of this insurance'. 18 The 'retail client' definition of the Corporations Act19 states that certain general insurance products are provided to a person as a 'retail client', including personal and domestic property insurance. Regulation 7.1.17 of the Corporations Regulations 2001 provides that personal and domestic property insurance does not include insurance to which the Marine Insurance Act applies. If the Marine Insurance Act no longer covers insurance for water transportation of household goods, insurers offering such policies will have to provide disclosure under the FSRA. To allow insurers time to adjust to this change a transitional period may be required.

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15 Australian Law Reform Commission 2001, *Review of the Marine Insurance Act 1909,* ALRC 91, Australian Law Reform Commission, Sydney.
16 ALRC 91, paragraph 8.16.
17 ALRC 91, recommendation 2.
18 See submission by Mark Radford dated June 2004.
19 'Retail client' is defined in section 761G of the *Corporations Act 2001*.

1.31 The Review Panel considers that the Marine Insurance Act does not provide sufficient consumer protection arrangements for insurance of a domestic/household character. The benefits of having appropriate consumer protection arrangements for carriage of domestic or household goods outweigh any detriment arising from possible uncertainty about the coverage of the IC Act and the Marine Insurance Act.

Recommendation

1.5 The IC Act and/or *Marine Insurance Act 1909* should be amended so that the IC Act covers insurance of the water transportation of domestic or household goods, as recommended by the Australian Law Reform Commission.

Inland waters

1.32 A further issue surrounding the interface between the Marine Insurance Act and the IC Act arises out of the definition of 'contract of marine insurance' in the Marine Insurance Act. As mentioned above, if a policy is a contract of marine insurance under that Act, the IC Act does not apply. Some concern was expressed in submissions, about the implications of the decision of the High Court in *Gibbs v Mercantile Mutual Insurance (Australia) Ltd*.[20] The majority of the Court found that a contract of marine insurance could extend to a vessel that was only traversing an estuary, rather than the open sea. The implication of this was that the IC Act did not apply to the insurance contract. The nature of the concern is that some insureds might assume that, as the insured vessels in question do not traverse the open sea, the Marine Insurance Act has no application and therefore, the IC Act would apply to the relevant insurance contracts. The decision in *Gibbs* means that such an assumption would not always be correct.

1.33 The ALRC in its review[21] noted this potential uncertainty of the interface between the IC Act and the Marine Insurance Act arising from different interpretations of 'sea' in the Marine Insurance Act. The ALRC considered that, as a matter of policy, the coverage of the Marine Insurance Act should extend to inland waterways. There was no policy justification for commercial vessels (as opposed to pleasure craft, which are already carved out from the Marine Insurance Act under section 9A of the IC Act) operating on inland waters to be treated under a different legal regime to those commercial vessels operating at sea. The ALRC recommended that the uncertainty arising from the sea/inland waters distinction be addressed by amending the Marine Insurance Act to

20 (2003) 199 ALR 497; (2003) 77 ALJR 1396; (2003) 12 ANZ Ins Cas 61-570.
21 ALRC 91, paragraphs 8.73–8.86.

make it clear that the scope of that Act extends to risks on inland waterways.[22] The Review Panel considers that if the ALRC's recommendations on this issue are adopted, the difficulties will be appropriately addressed. Accordingly, the Review Panel does not propose any changes to the IC Act to address concerns arising from the *Gibbs* decision.

APPLICATION TO DISCRETIONARY MUTUAL FUNDS, DIRECT OFFSHORE FOREIGN INSURERS AND INSURANCE-LIKE PRODUCTS

1.34 In response to recommendations of the HIH Royal Commission, on 12 September 2003, the Treasurer announced a review of the protection of consumers and third parties in relation to products supplied by discretionary mutual funds (DMFs) and direct offshore foreign insurers (DOFIs) in Australia.[23] The Issues Paper noted the DMF/DOFI review and sought comments on whether there should be any changes to the application of the IC Act to DMFs and DOFIs, as well as insurance-like products.

Discretionary mutual funds

1.35 DMFs provide a form of cover to their members that functions like insurance. However, as the cover is discretionary, it does not fall within the scope of a 'contract of insurance' for the purposes of the IC Act.[24]

1.36 DMFs have been established to form a variety of purposes and are structured in various ways. Most take the legal form of a company limited by guarantee or an unincorporated discretionary trust. There are a range of other forms, including statutory discretionary mutual trust schemes, local government mutual funds, informal non-discretionary mutual trusts and mutual aid schemes offering insurance. Some types of DMFs hold an Australian Financial Services Licence issued under the *Corporations Act 2001* and some are regulated as managed investment schemes.

1.37 Some submissions to the Review Panel have argued that the IC Act should be extended to DMFs in the interests of regulatory neutrality and to ensure that consumers are adequately protected. Others have expressed caution along the lines that not all DMFs are alike and to apply the IC Act to some types would be unnecessary and inappropriate.

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22 ALRC 91, recommendation 5.

23 See Treasurer's media release No 082, 12 September 2003, available at http://www.treasurer.gov.au/tsr/content/pressreleases/2003/082.asp.

24 See ASIC's submission to the Review of Discretionary Mutual Funds and Direct Offshore Foreign Insurers, available at http://dmfreview.treasury.gov.au/content/submissions.asp?NavID=4.

1.38 The report of the DMF/DOFI review recommends that the preferred regulatory approach is to require discretionary mutual cover to be regulated by the Australian Prudential Regulatory Authority as a contract of insurance. The review notes that a way to achieve this is to provide in legislation that all insurance-like cover must be provided in the form of an insurance contract. If this approach were to be implemented, those products would fall within the scope of the IC Act, unless some other steps were to be taken.

1.39 The DMF/DOFI review[25] recommends that there should be a facility to permit exemptions from the proposed requirements to offer the cover in the form of an insurance contract, based on the level of risk covered by the fund. In the case of products falling within the exemptions, the consumer protection framework applying to DMFs would be enhanced by:

- improving disclosure requirements to consumers, including legislative prohibition of the terms 'insurance' and 'insurer' and legislative compulsion of disclosure of the fact that the cover is 'discretionary' and provided by an entity not prudentially regulated; and

- requiring, by regulation under the *Corporations Act 2001*, certain consumer protection provisions applying to insurance products under the IC Act (for example, duty of information disclosure, compulsory renewal notices for members/policyholders) to apply also to DMFs.

1.40 The DMF/DOFI review also recommends that ASIC, under Australian Financial Service (AFS) licence conditions, would collect and collate data on business written by DMFs.

1.41 The Review Panel considers that adoption of the DMF/DOFI review's recommended approach on this issue would address the issue of the application of the IC Act to DMF products. Accordingly, the Review Panel does not propose to make any further recommendations in relation to the application of the IC Act to DMFs.

Direct offshore foreign insurers

1.42 Section 8 of the IC Act extends to insurance contracts the proper law of which is or would be, without an express provision otherwise in the contract, the law of a State or Territory. Insurance contracts issued by DOFIs may therefore fall within the scope of the IC Act.[26] However, determining whether the 'proper law' is the law of a State or Territory may involve the application of

25 See *Key Findings of the Review of Discretionary Mutual Funds and Direct Offshore Foreign Insurers*, available at http://dmfreview.treasury.gov.au/content/Report.asp?NavID=9.

26 See, for example, *Akai Pty Ltd v People's Insurance Co Ltd* (1996) 188 CLR 418.

private international law rules. If a foreign law governs the contract, it can affect the insured and third party claimants.

1.43 The Issues Paper invited comments on what, if anything, should be done to make the IC Act's application to DOFIs more effective. The submission of the Insurance Council of Australia recommended that section 8 of the IC Act be clarified to ensure that all contracts issued by DOFIs to Australian insureds or in respect of Australian risks should be expressly subjected to the provisions of the IC Act. The submission also argued that consideration should be given to appropriate mechanisms to ensure that Australian insureds are practically able to enforce the rights they have under the IC Act against DOFIs.

1.44 The Review Panel notes that the Australian Law Reform Commission considered two options for ensuring the IC Act had appropriate coverage in terms of territoriality.[27] The first option was to set out in the legislation the intended territorial application, as suggested by the Insurance Council submission. The second approach, which was adopted, was to include a provision (section 8) to render choice of law clauses ineffective.

1.45 Notwithstanding that the majority of the High Court has taken an expansive view of the operation of section 8,[28] there has been some doubt over its operation. The Review Panel considers that a more direct statement about the intended scope of the IC Act, possibly along the lines suggested in the Insurance Council submission, is likely to be helpful particularly in circumstances where a foreign court is called upon to determine questions of the IC Act's applicability. This measure should go some way toward addressing the issue of practical enforcement by consumers.

Recommendation

1.6 The IC Act should be amended to clarify its intended territorial application to all contracts issued by direct offshore foreign insurers to Australian insureds or in respect of Australian risks.

1.46 A number of submissions and the DMF/DOFI review noted that, from 11 March 2004, some of the disclosure requirements formerly applying in respect of products offered by DOFIs under the *Insurance (Agents and Brokers) Act 1984* no longer apply in all cases because the replacement provisions under

27 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 15.
28 See *Akai Pty Ltd v People's Insurance Co Ltd* (1996) 188 CLR 418.

Chapter 7 of the Corporations Act[29] apply only to products issued to 'retail clients'.[30] Under those requirements, potential insureds are advised about matters such as the lack of coverage by the *Insurance Act 1973* and put on notice to inquire further about the financial soundness of the insurer and the place where any disputes may be determined. It has been suggested that those requirements should be extended to wholesale clients in addition to retail clients. The Review Panel notes that this issue is canvassed by the DMF/DOFI review and does not make any recommendation in this regard.

1.47 Another issue mentioned in submissions was the possible disadvantage to Australian insurers *vis-a-vis* DOFIs in relation to 'other insurance' provisions affected by section 45 of the IC Act. That issue is dealt with below in Chapter 8.

Other insurance-like products

1.48 There are also other insurance-like products (for example, debt waivers, some extended product warranties and indemnities) which share similar characteristics with insurance contracts. The Review Panel sought comments on whether any of these products should be subject to the IC Act.

1.49 The only specific products mentioned in submissions were extended warranties for cars and white goods. In favour of applying the IC Act to those products, it was argued that they are equivalent to insurance but in a different form. The cost of the extended warranty is effectively the premium and the risk covered is that the product will require repair within the warranty period. The fact that it is not labelled an insurance contract should not make a difference to its regulatory treatment.

1.50 There are arguments against applying the IC Act to extended warranty products. Many of the IC Act provisions, such as those dealing with subrogation of claims, duty of disclosure and fraud and misrepresentation by an insured, would appear to be unnecessary in a situation where a manufacturer is offering an extended warranty on a new product. Generally, the protections in the IC Act for both insureds and insurers have been developed with a view to insurance of covering claims that would be of potentially major significance to most consumers. To apply all the provisions of the IC Act to a product directed at, for example, covering the potential cost of repairing a dishwasher, does not seem justified.

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29 See, in particular, paragraph 1013D(4)(c) of the *Corporations Act 2001* and Corporations Regulation 7.9.15 for the relevant requirements for inclusion in the Product Disclosure Statement.

30 Retail clients are defined in section 761G of the *Corporations Act 2001*.

1.51 The main distinction between an extended warranty and an ordinary warranty is that the 'premium' is paid separately from the purchase price of the good. No examples of difficulties faced by consumers or extended warranty providers in respect of that distinction have been identified that would make the provisions of the IC Act appropriate to apply in respect of extended warranties but not in respect of ordinary warranties.

1.52 In light of those considerations, the Review Panel does not consider that a sufficient case has been made that the IC Act should be amended to bring extended product warranties within its scope.[31]

31 The Review Panel does not consider that its conclusion in this regard is relevant to the question of how the products or product providers in question are regulated under other laws including the financial services provisions of the *Corporations Act 2001*.

CHAPTER 2: DEFINITIONS AND PROCEDURAL PROVISIONS

2.1 This Chapter deals with:

- the definition of entering into a contract of insurance in section 11 of the IC Act; and
- the types of communication methods allowed under the IC Act.

ENTERING INTO A CONTRACT OF INSURANCE

2.2 Throughout the IC Act there are references to the entering into a contract of insurance. Some examples are:

- section 21 — insured's duty of disclosure before entering into a contract;
- section 22 — insurer's duty to inform insured of duty of disclosure before a contract is entered into;
- section 25 — misrepresentation by life insured before a contract is entered into;
- sections 28 and 29 — remedies of insurer for non-disclosure and misrepresentation prior to a contract being entered into;
- sections 35 and 37 — notification by insurer of certain provisions and unusual terms before a contract is entered into; and
- section 68 — insurers must clearly notify subrogation provisions before a contract was entered into.

2.3 In the IC Act as originally enacted,[32] subsection 11(9) stated that a reference to the entering into of a contract of insurance should be read as including a reference to an agreement to renew, vary or extend a contract, or the reinstatement of a contract. Accordingly, on each renewal or variation of a contract (whether life or general) all the rights and obligations that arise on entering into a contract (such as duty of disclosure, duty of insurer to inform insured of certain matters) applied as if the parties were entering a contract afresh.

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32 Act No. 80, 1984.

2.4 An amendment made in 1986 altered the definition provisions in section 11 so that references to 'entering into a contract of insurance' now include:

- in the case of life insurance, an agreement to extend or vary a contract (but not to renew);
- in the case of general insurance, an agreement to renew, extend or vary a contract; and
- in either case, the reinstatement of a contract of insurance.[33]

2.5 The same amending Act[34] also added new subsection 11(10) which has the effect that an insurer does not need to comply with various obligations to provide information to the insured on renewal, extension or reinstatement, nor variations (in some cases). Some stakeholders have commented that it is undesirable that the obligations of an insurer to inform an insured of the duty of disclosure under section 22 do not apply to renewals. That issue is dealt with below in Chapter 4 — 'Disclosures and misrepresentations'.

2.6 The Issues Paper invited submissions on whether, aside from the application of the provisions regarding duty of disclosure to renewals, the provisions of the IC Act as they apply to renewals, extensions, variations and reinstatements of insurance contracts were appropriate.

2.7 A number of submissions on this point were made. Most were along the lines that the operation of subsections 11(9) and (10) were appropriate.

2.8 One issue was identified regarding the operation of subsection 11(9) in circumstances where an insured takes an original life insurance policy and then increases that cover at a later point, where a material change to the risk, which occurs in that interval, is not disclosed at the time of the increase application. In the event of a claim in such circumstances, arguably the life insurer could avoid the entire policy, because the increase in cover is to be treated, under section 11(9), as the entering into of a new contract of insurance.

2.9 To address this issue, the Investment & Financial Services Association Ltd suggested that the IC Act could be amended so that life insurers' rights relating to non-disclosure/misrepresentation in such circumstances are restricted to the part of the cover affected by the non-disclosure or misrepresentation (similar to how subsection 28(3) operates in respect of

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33 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, paragraph 3.37.

34 Sections 2, 3 and Schedule 1 of the *Statute Law (Miscellaneous Provisions) Act (No. 2) 1986*.

general insurance). The Review Panel agrees that this issue is best dealt with by addressing the remedies of life insurers in those circumstances, rather than a change to the operation of subsections 11(9) and (10). Remedies of life insurers are dealt with in detail below at Chapter 7.

COMMUNICATION METHODS

2.10 The IC Act specifies that some communications must be in writing. Most of these provisions impose obligations on the insurer to advise the insured of something in writing, often within set time limits.[35] Examples are:

- section 22 — insurer to inform insured of duty of disclosure; and
- section 40 — insurer to inform insured of the nature of certain policies.

2.11 Those requirements are modified by the operation of section 69, which permits some information to be given to insureds outside the limits imposed in certain circumstances. Section 69 allows insurers to provide information orally in some instances, provided it is given later in writing.[36] There are also provisions that require an insured to notify an insurer in writing of some occurrences.[37]

2.12 Section 77 provides that notices and other documents must be given personally or by post.

Electronic communication

2.13 In a number of other contexts, steps have been taken to remove legal barriers to the use of new communications methodologies. The *Electronic Transactions Act 1999* provides that, in general, where a Commonwealth law requires a notice to be given in writing, it may be given by electronic communication provided that the recipient consents. However, the Electronic Transactions Regulations 1999 exclude the IC Act from the scope of those provisions.

2.14 The Issues Paper noted that, in line with law reform elsewhere, it seems desirable to recognise the increasing use of electronic communications in the context of the IC Act and to facilitate electronic communication where possible, so long as any consumer protection issues arising in the context of insurance

35 Those provisions are sections 22, 35, 37, 39, 40, 44, 49, 58, 59, 62, 68 and 74 of the IC Act.
36 Issues surrounding the provision of oral information regarding the duty of disclosure are dealt with below in Part 4 — 'Disclosures and misrepresentations'.
37 Sections 41 and 75 of the IC Act.

contracts can be satisfactorily dealt with. Comments and suggestions were invited on that proposition and suggestions for any exceptions and/or necessary safeguards.

2.15 Without exception, submissions supported the proposition that the IC Act should be updated to take advantage of electronic communication methods.

2.16 As to safeguards, some support was expressed for the requirements suggested in the Issues Paper. In particular, submissions supported the inclusion of requirements that the recipient must consent to electronic communication, that the communication must be able to be printed and retained, and that there are suitable rules regarding time of receipt. A number of submissions noted that, so far as possible, the scheme in the *Electronic Transactions Act 1999* should be used as the model.

2.17 It was suggested that, if an insurer is going to impose any sanction on an insured in reliance on a document or notice, then they should first either dispatch a hard copy of the communication and/or have received an acknowledgement of the electronic receipt of the document. This proposal may be appropriate in relation to a notice of variation of a life insurance contract under section 29, and notice of a proposed cancellation under section 59.[38] It would not seem feasible to apply in respect of other notices required to be given to the insured in writing, as other notices are given prior to the contract being entered into. At the time of providing such a notice, the insurer would not usually know whether it will seek to rely upon the notice in connection with imposition of a sanction or not, because any sanction would usually not arise until there was a disputed claim.

2.18 There are two possible approaches to give effect to the proposal that communications under the IC Act be made electronically. The exemption from the scope of the *Electronic Transactions Act 1999* could be retained, and a free-standing scheme for electronic communication included in the IC Act itself. Alternatively, the IC Act could be brought within the scope of the Electronic Transactions Act, with consequential changes made to the IC Act to ensure consistency and to include any safeguards either generally or in respect of particular communications. The Review Panel considers that the latter approach is preferable, and notes that this is consistent with the approach being considered by the Uniform Consumer Credit Code Management Committee's consideration of the parallel issue in the context of the Uniform

38 For example, Investment & Financial Services Association Limited suggests cancellations and variations require traditional means of communication.

Consumer Credit Code.[39] The relevant provisions in the *Corporations Act 2001* and regulations made under it could be considered as models for the safeguards.

Recommendations

2.1 Amendments to the IC Act and other Acts and regulations should be made so that communications under the IC Act may be made electronically. They should be subject to the *Electronic Transactions Act 1999*, and subject to appropriate safeguards including:

- clarity;
- consent by the recipient to electronic communication and nomination by the recipient of an information system for that purpose;
- ability to print and retain the communications; and
- certainty of time and place of origin and receipt.

2.2 There should be a facility to provide in regulations circumstances in which specific types of notices or documents required under the IC Act must be communicated by traditional means in addition to, or instead of, by electronic means.

Other communication methods

2.19 In response to the Issues Paper, some other suggestions were directed at aligning and harmonising communication methods under the IC Act with the communication methods in the *Corporations Act 2001*. The particular suggestions were in relation to:

- giving documents to agents of insureds; and
- giving information orally.

Giving documents to agents of insureds

2.20 Subsection 71(1) of the IC Act relieves an insurer from certain disclosure obligations where an insurance broker (other than an insurance broker acting under a binder) arranges the insurance contract. However, there is no specific

39 Clyde, I. 2003, *Click here for details: e-commerce and consumer credit*, available at http://www.consumer.vic.gov.au/cbav/fairattach.nsf/Images/ecommerce_consumercredit/$File/ecommerce_consumercredit.pdf.

statutory obligation on insurance brokers to pass on to the insured the relevant disclosures (for example, the broker does not have a specific statutory obligation to notify the insured of the duty of disclosure or unusual terms of the contract).

2.21 Since the enactment of the IC Act, the *Insurance (Agents and Brokers) Act 1984* has been repealed and replaced with provisions in the Corporations Act. The equivalent provisions in the Corporations Act, however, do not make a significant distinction between 'insurance agent' and 'insurance broker'.

2.22 It was suggested the IC Act should be amended so that:

- in general, giving a document or information to an agent for the intending insured (where the agent is an insurance broker or Australian Financial Services licensee) does not automatically satisfy the insurer's disclosure obligations under the IC Act; but

- as an exception to the general rule, giving a document or information to such an agent will satisfy the insurer's disclosure obligations where the insurer is satisfied, on reasonable grounds, that the insurance agent (or Australian Financial Services licensee) will provide the required disclosure to the insured within the relevant time period.

2.23 Such a requirement would put the onus on the insurer to 'look behind' the arrangement between an insured and their agent and, unless the insurer is satisfied on reasonable grounds that the information will be passed on in a timely way, they would be required to provide the disclosure directly to the insured in addition to, or instead of, the agent. Most insurers dealing with agents (for example, authorized representatives) would have a written agreement with them and it would be usual to incorporate in such an agreement a term requiring the agent to convey mandatory disclosure information to the insured in a timely way.

2.24 The Review Panel considers that insurers satisfying themselves in this way could be a reasonable and appropriate safeguard to protect insureds against the failure on the part of intermediaries of forwarding on information in a timely way.

Giving information orally

2.25 Subsection 69(1) of the IC Act provides that, where it is not reasonably practicable for an insurer to give information on a contract of insurance in writing before a contract is entered into, the insurer may instead comply with the IC Act disclosure obligations by giving the information:

- orally prior to entering into the contract; and

- in writing within 14 days after the date on which the contract was entered into.

2.26 It was suggested that this requirement should be aligned with the Corporations Act provisions for giving disclosure documents (such as Financial Service Guides and Product Disclosure Statements) in time critical cases. Under those rules, provision of oral information is only permitted if a client expressly instructs that they require a financial service either immediately or within a fixed time period and it is not reasonably practical for the information to be provided in writing within the available time period. It was also suggested that the 14 day period under the IC Act is too long and this should be reduced to five days for consistency with comparable periods under the *Corporations Act 2001*.

2.27 The Review Panel considers that, in the majority of 'consumer' types of insurance (such as motor vehicle, home contents and so on), it will often be the case that the insured will wish the contract to commence either immediately or within a short period. However, the Review Panel also notes that, with the use of electronic communication methods, documents or information can be transmitted in writing much faster than using traditional written methods. Oral communication of mandatory disclosures prior to the entering into of a contract is 'second best' because providing information in writing overcomes difficulties of proof and gives insureds a better opportunity to examine and reflect upon the information provided.[40] The Review Panel considers that pre-contractual mandatory disclosures should be permitted to be given orally only in circumstances where, due to the requirements of the insured, there is no reasonably practicable other method.

Time critical situations where it is *not* reasonably practicable to give information orally

2.28 Subsection 69(2) provides that, where it is not reasonably practicable to give the information in writing *or orally* prior to entering into the contract of insurance, the insurer can instead give the information in writing within 14 days from the date the contract is entered into.

2.29 It was suggested that subsection 69(2) is potentially inconsistent with the rationale of underlying provisions such as section 35 and 37 of the IC Act, being to give intending insureds adequate information to make an informed decision about whether to enter into the contract. If, after receiving the mandatory disclosures, the insured decides that they do not want the product, they would need to rely on terms of the contract (if any) that allow the insured

40 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 44.

to cancel the contract. This would typically require the insured to pay all or part of the premium.

2.30 Accordingly, it was suggested that section 69(2) should therefore be restricted in its operation to:

- interim contracts; or
- situations where there is a statutory cooling off period or similar contractual cooling off rights.

2.31 It was noted that, in such situations, the risk of an insured being disadvantaged due to the lack of disclosure before entering into the contract is substantially reduced. The cooling off period could be the cooling-off regime under Division 5 of Part 7.9 of the Corporations Act or similar contractual cooling-off rights and would enable an insured to obtain a refund of premium if, on receipt of the relevant disclosures, they realise that the insurance is not suitable.

Conclusion

2.32 Most of the requirements in the IC Act that require an insurer to provide an insured with certain information in writing, especially prior to entering into an insurance contract, are designed to ensure the prospective insured party is sufficiently informed about the nature of the contract and may determine whether the contract is suitable for their purposes. The Review Panel believes that there is merit in harmonizing provisions in the IC Act that relieve insurers from the usual requirements under the IC Act for written disclosures to insureds (through use of agents or alternative disclosure methods in cases of urgency) with equivalent provisions under the *Corporations Act 2001*.

2.33 The Review Panel considers that further consideration and consultation regarding the details of the harmonization is necessary in order to ensure that an appropriate system is developed for all kinds of insurance, insurers and agents, including insurers that do not deal with retail clients. It is possible that not all provisions can or should be harmonized. For example, we doubt whether the five day rule for providing notices prescribed by the *Corporations Act 2001* is appropriate for the IC Act.[41] The requirements under the Corporations Act have only recently taken effect and it would be desirable to take into account the practical experience of application of those rules.

41 See submission by the Insurance Council of Australia Limited, dated June 2004.

Recommendation

2.3 The provisions in the IC Act that permit alternatives to direct written communication between insurers and insureds should be harmonized, to the extent reasonably practicable, with equivalent provisions under the *Corporations Act 2001*.

CHAPTER 3: POWERS OF AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

3.1 Part IA of the IC Act specifies that ASIC has responsibility for administering the IC Act. Further, Part IA gives ASIC certain powers in relation to the IC Act.

3.2 The express powers ASIC has under the IC Act overlap with existing powers under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

3.3 It has been suggested that Part IA of the IC Act should be repealed and in administering the IC Act, ASIC should rely solely upon its powers provided in the ASIC Act.

3.4 The Review Panel notes that this issue is being dealt with by the Government as part of a process to harmonise and rationalise powers available to ASIC, currently contained within a number of Acts administered by the Commission.

3.5 It has been suggested to the Review Panel that it would be desirable to include a power for ASIC to intervene in proceedings in matters arising under the IC Act. ASIC has similar powers in, for example, section 1330 of the Corporations Act and section 12GO of the ASIC Act. Although ASIC has appeared in past cases at the discretion of the court, a statutory power would provide certainty and would give ASIC rights to adduce evidence and raise issues in addition to those raised by the parties. Such a power would allow ASIC, as the body charged with administering the IC Act, to fulfil this function better.

3.6 The Review Panel considers that an intervention power in favour of ASIC would not greatly extend the scope of the IC Act but would be a desirable enhancement. It would be consistent with ASIC's powers in other areas of its responsibility.[42] With the constraints on its resources, ASIC is unlikely to abuse this power.

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42 The Insurance Council of Australia Limited submits that such a proposal would, inter alia, 'remove the court's present discretion to determine whether ASIC should be allowed to intervene in proceedings relating to matters arising out of the IC Act' (see submission dated June 2004 at page 17). The Investment & Financial Services Association Ltd submitted that any extension of ASIC's powers 'should be limited to circumstances where such proceedings are in the interest of the public'. (see submission dated 11 June 2004)

Recommendation

3.1 The Australian Securities and Investments Commission should be given a statutory right to intervene in any proceeding relating to matters arising under the IC Act.

CHAPTER 4: DISCLOSURE AND MISREPRESENTATIONS

4.1 Part IV of the IC Act is concerned with disclosures and misrepresentations, these topics being fundamental to a contract of insurance. This Chapter addresses:

- the insured's duty of disclosure;
- the insurer's obligations to inform an insured of the insured's duty of disclosure; and
- the situation where intermediaries (brokers and agents) provide information to insurers on behalf of insureds.

WHAT THE INSURED MUST TELL THE INSURER IN ORDER TO SATISFY THE DUTY OF DISCLOSURE

4.2 There are two aspects of the duty of disclosure. First, there is a general duty not to misrepresent material facts. Second, there is a duty to disclose material facts. Both aspects of the duty protect the insurer from accepting a risk which is greater than it appears to be.[43]

4.3 Sections 21 and 21A of the IC Act are the main provisions covering the insured's disclosure obligations. Section 21 provides that the potential insured must disclose to its insurer all information that is known to it and that is relevant to the insurer in making its decision whether it should accept the risk and, if so, on what terms. Section 21A requires the insurer to provide the insured with specific questions that are relevant to it in making its decision whether to accept the risk, thereby giving some assistance to the insured in fulfilling the duty of disclosure obligations. However, section 21A only applies to 'eligible contracts of insurance', these being contracts of insurance for new business covering, *inter alia*, motor vehicles, home contents and travel insurance.[44] While the section 21 requirements must be satisfied before a

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43 Kelly D. and Ball, St L. 2001, *Kelly and Ball principles of insurance law,* 2nd edn, (loose leaf) Butterworths, Sydney at paragraph 2.0010. The late Professor Sutton explained the difference between misrepresentation and non-disclosure and says that while they are based on different principles there is a close affinity. 'Thus, non-disclosure is concerned with the assured's duty to volunteer material information, while misrepresentation looks to her or his obligation to reply accurately to material questions asked by the insurer and not to volunteer material statements which are false. Misrepresentation is essentially a sin of commission while non-disclosure is a failure to reveal what should be divulged.' Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, paragraph 3.4.

44 Regulation 2B of the Insurance Contracts Regulations 1985.

contract of insurance is entered into, including renewals, section 21A does not apply to renewals.[45]

4.4 The IC Act deems that some omissions or statements do not amount to a misrepresentation. For example, section 27 provides that if a potential insured fails to answer questions, or provides an obviously incomplete or irrelevant answer to a question, they are not taken to have made a misrepresentation. In those circumstances an insurer is under an obligation to make further enquiry. Also, where a person makes a statement in connection with a contract of insurance that is untrue, he or she will not be considered to have made a misrepresentation if a reasonable person in the circumstances would have held the same belief.[46]

Duty of disclosure requirements

4.5 At common law a potential insured was required to disclose all material facts to its insurer. This is explained in the Explanatory Memorandum to Insurance Contracts Bill 1984:

> 'Some lines of authority support the proposition that the insured's obligation is to disclose every material fact known to him and which a reasonable man would realise to be material. Other authorities, and particularly more recent Australian cases have rejected this approach in favour of the "prudent insurer" test i.e. a fact is material if it would have reasonably affected the mind of a prudent insurer in determining whether it will accept the insurance, and if so, at what premium and on what conditions.'[47]

4.6 These requirements were clarified by the IC Act, in particular by specifying the test of materiality and ameliorating the 'prudent insurer' test.[48] Now, subsection 21(1) of the IC Act provides that a potential insured must disclose to its potential insurer:

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45 Subsection 21A(1) of the IC Act.

46 Subsection 26(1) of the IC Act.

47 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984 Explanatory Memorandum at page 34. For a history of the duty of disclosure see for example Tay, Alan. 'The duty of disclosure and materiality in insurance contracts – a true descendant of the duty of utmost good faith', (2002) 13 *Insurance Law Journal 183*; Boyd, Guy L. 'The duty of disclosure in life insurance: is the balance struck by Part IV of the Insurance Contracts Act appropriate?' (2001) 13 *Insurance Law Journal* 59.

48 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984 Explanatory Memorandum at page 35. See also, Fung, Adrian. 'Section 21 of the Insurance Contracts Act 1983 [sic] – The death and rebirth of the "prudent insurer" test?' (2001) 13 *Insurance Law Journal* 108.

- every matter that it knows will be relevant to the decision of whether the insurer will accept the risk, and if so, on what terms (a subjective test); and

- every matter that a reasonable person in the circumstances could be expected to know to be a relevant matter (an objective test).

4.7 Some stakeholders have raised the question of whether the mixed subjective/objective test should be reassessed. The main criticism of section 21 is that it puts an unreasonable burden on insureds in that they are expected to know what the insurer regards as relevant.[49]

4.8 One suggested solution is to replace subsection 21(1) of the IC Act with a section 21A equivalent, namely the insurer must ask a potential insured specific questions that reflect the insurer's underwriting guidelines.[50] The potential insured must answer any questions asked of them fully and honestly. This would resolve the problem that is said to be found in the law that an insured must, in effect, answer questions it was not asked. If this were to be done, the existing section 21A would be redundant and could be removed. Subsections 21(2) and (3) would remain.

4.9 Such an approach is not supported by those underwriting large commercial risks. One submission explained:

> 'We are presented with a description of the risk and then follow a process of interaction between us and our insureds via the brokers whereby we learn more about the risk and we will ask new questions as we go along the process. We do not in principle know which questions we will ask until we are confident how much premium to charge and what cover conditions to offer. We believe that the public interest is served far better by this approach than by the predominantly statistical methods employed in the underwriting of mass market business and we are able to offer much more competitive premiums and terms as a consequence.'

4.10 Australian Associated Motor Insurers Limited (AAMI) has advised that it does not rely on the duty of disclosure provisions found in the IC Act. It believes that for the type of insurance it sells the duty of disclosure obligations

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49 *Cf* submission by Phillips Fox of 21 April 2004 at page 3. Phillips Fox state that such an argument is overstated. This is because '… it ignores section 21(1)(b) which expressly addresses this concern by limiting the duty to matters which "… a reasonable person in the circumstances could be expected to know to be" … relevant to the insurer.'

50 See for example submissions on the Issues Paper by National Insurance Brokers Association of Australia; Brendan Pentony dated 13 April 2004; and Legal Aid Commission of New South Wales dated April 2004. *Cf* MLC's supplementary submission on the Issues Paper.

are outdated.[51] Instead, it asks potential insureds specific questions and warns them to answer questions fully and honestly. It does not have a general 'catch all' question asking a potential insured to tell them anything else that might be important.

> 'AAMI believes that it is now time for the duty of disclosure to be removed for personal lines general insurance products. There appears to be no justification for its continuing application for these standard insurance products where underwriting of risk is no longer a bespoke process. Insurers have clear underwriting guidelines on comprehensive historical data that effectively define what information a prospective customer needs to provide to enable a risk to be accepted. The risk that information outside these criteria will be relevant is a remote risk that should be borne by the insurer rather than an unsophisticated consumer.'[52]

4.11 AAMI also state that following renewal of a policy it will no longer seek to raise misrepresentations made at inception of a policy against an insured.

4.12 Life insurers have advised that they oppose the suggestion that section 21A of the IC Act should be extended to include life insurers.[53] For example, MLC stated that:

> 'Such an approach would place unfair burden on life insurers and remove the general duty on the insured to disclose relevant matters the insured alone knows. Insurers cannot be expected to address all possible matters of relevance.
>
> Proposals are already lengthy and to add to current lists of questions is both impractical and commercially unrealistic. Life insurers are not only concerned about health risks. Financial, occupational, pastime and moral risk are all important to life insurers. Not all possible questions can be included in the application.
>
> Further, it needs to be reiterated that Life Ins. Policies are "guaranteed renewable." They involve significant liabilities and in the case of income protection offer potentially long term benefits and large sums of money. In these circumstances, full disclosure is critically important as the life

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51 AAMI sells motor vehicle, home and compulsory third party insurance: *AAMI Customer Charter Annual Report 2002-2003*, at page 29.

52 See submission by AAMI dated 16 April 2004.

53 *Cf* submissions on the Issues Paper by the Consumers' Federation of Australia; Brendan Pentony dated 13 April 2004; the Legal Aid Commission of New South Wales dated April 2004 and the Insurance Enquiries and Complaints Limited's Panel dated March 2004.

> insurer only gets one chance to assess the risk. Any watering down of the duty of disclosure is unfair to the insurer.'[54]

4.13 The Investment & Financial Services Association Ltd (IFSA) also submits that section 21A of the IC Act should not be expanded to include life insurers. The reason being that 'it remains the case that prospective lives may know more about their personal information relative to the risk being underwritten by the life company, such as to make it an inequitable burden on insurers to be expected to ask all the questions which in a definite way represents, for every prospective life insured, a complete list of the matters relevant to the risk being proposed for'.[55]

4.14 The Australian Life Underwriting and Claims Association are in agreement with IFSA on this point, the reason being:

> 'Retail life insurance (as distinct from group life) is generally fully underwritten. Life underwriters are skilled professionals, who seek information about a person's health and finances. It is impossible for them to think of and ask all relevant questions. It is vital in life insurance that the onus remain on the insured to disclose relevant matters.' [56]

Conclusion

4.15 From the submissions received it appears that from a consumer perspective the main concern is that section 21 of the IC Act puts an unreasonable burden on insureds in that they are expected to know what the insurer regards as relevant. In effect, section 21 requires a prospective insured to know the underwriting guidelines of the insurer, which vary between insurers.

4.16 The Review Panel believes that this concern is legitimate and should be remedied, especially in relation to personal lines insurance. However, it also accepts that for other insurance, including bespoke insurance, this concern is not as relevant. It also accepts that section 21A of the IC Act is not suitable to apply to life insurance. Therefore, the Review Panel suggests the approach outlined below. This proposal addresses both general and life insurance and is linked to the issue of insurers' remedies (see Chapter 7) and must be considered in this context.

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54 See supplementary submission on the Issues Paper of MLC.
55 See submission on the Issues Paper by Investment & Financial Services Association Limited dated 19 April 2004.
56 See submission on the Issues Paper by Australian Life Underwriting and Claims Association.

General insurance

4.17 In relation to 'eligible contracts of insurance' a potential insurer will, as is currently required, need to comply with section 21A of the IC Act, in that specific questions must be asked of a potential insured. However, such an insurer would not be entitled to ask a potential insured any general 'catch all' type questions (thus paragraph 21A(4)(b) would need to be repealed[57]). If paragraph 21A(4)(b) was repealed, some modifications may be required to the prescribed form of words under section 22 of the IC Act concerning how insureds are informed about the duty of disclosure.[58]

4.18 The Review Panel agrees with Phillips Fox that the mixed objective/subjective duty of disclosure test used in section 21 would be elucidated if it was required to be applied by having regard to the following factors:

(a) 'the nature and extent of the cover provided by the contract of insurance;

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

(c) the circumstances in which the contract of insurance is entered into including the nature and extent of any questions asked by the insurer.'[59]

4.19 Phillips Fox suggest the criteria are needed because:

> 'The reference in s21(2)(b) to "a reasonable person in the circumstances" has given rise to a hybrid objective subjective test which governs the extent of the duty of disclosure in circumstances where the relevant fact is not known by the particular insured to be relevant to the insurer's decision (or where the insurer cannot prove it to be so).
>
> The objective/subjective test has not been applied consistently by the courts particularly in respect of whether the test requires/allows the courts to have regard to subjective or intrinsic matters such as the particular insured's education or cultural background or level of business acumen.

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57 *Cf* submission on the Proposals Paper by Mark Radford at page 8 where he says '… by removing the exceptional circumstances provision under subsection 21A(4)(b) as is proposed, any protection it could have provided for fraudulent non disclosure is removed.'

58 Amendments to Part 2 of Schedule 1 of the *Insurance Contracts Regulations 1985* may be required: see submission by the Banking and Financial Services Ombudsman Limited, dated 2 June 2004.

59 See submission from Phillips Fox, dated 21 April 2004, page 3.

> The ALRC Report clearly favoured an approach which had regard to the individual idiosyncrasies of the insured including such factors as literacy, knowledge, experience and cultural background. The Bill proposed by the ALRC used the phrase "a reasonable insured in the circumstances of the insured".
>
> However, the Act was amended prior to being passed, following concerns by Insurers that this test was indistinguishable from a subjective test. The words "of the insured" were removed from the draft legislation in order to "clarify the operation of the test". The difficulties in interpretation referred to above arise from the uncertainty as to the intention underlying this amendment.
>
> It is submitted that further prescription is required in relation to this test so as to ensure that the duty of disclosure operates consistently and in accordance with the appropriate legislative policy.'[60]

4.20 The Review Panel believes that the interpretation of section 21 of the IC Act, which recognised that the duty of disclosure test is a mixed objective/subjective test, should be maintained, but that including in the section some form of words adopting the criteria suggested by Phillips Fox will assist in determining difficult cases. The previous attempts to draft this test in legislative form have not been straightforward, as shown by the history above, and consultation will be required to ensure that the draft is clear and leads to consistent interpretation.

4.21 The Review Panel is not recommending substantive change to section 21. However, it believes non-exclusive factors could be used to assist interpret section 21 in difficult cases.

4.22 On renewal, if an insurer wishes to rely on the insured's disclosure obligations, a fresh round of questions must be sent to the insured.[61] In practice this may simply be a request for an update to the answers provided at inception. Of course, some insurers may wish to continue their present practice of not asking for further disclosure at renewal and ignoring misrepresentations made at inception following subsequent renewals.

4.23 The Insurance Council claims that amending section 21A so that it applies on renewals would 'cause significant increases in the costs incurred by insurers' (which would inevitably be passed on to insureds) and requires a full

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60 See submission from Phillips Fox, dated 21 April 2004, page 3.

61 This recommendation does not directly affect variations, extensions and reinstatements of policies. What is being addressed are routine renewals.

cost benefit analysis.[62] The Review Panel believes that its recommendation provides a fair balance between insurer and insured, but suggests that a lengthy transitional period be allowed so that the changes can be incorporated over time into the insurance companies' usual business practice.

4.24 In relation to breaches by the insured see Chapter 7 entitled 'Remedies of Insurer'.

Life insurance

4.25 In formulating its proposal in relation to the disclosure requirements for life insurance, the Review Panel is mindful of the concerns raised by life insurers that section 29 of the IC Act does not provide appropriate outcomes for disclosure breaches with respect to life insurance. This is because of the drafting of the section (the reference to 'a contract') and because products sold by life insurers have markedly changed since the enactment of the IC Act. Now 'bundled contracts' are very common, these being where a number of covers are sold within the one insurance policy; for example, death, disability and trauma or crisis cover. (For further information see Chapter 7.)

4.26 The Review Panel believes that, for the purposes of Part IV of the IC Act, life insurance contracts should be 'unbundled', so that the statutory requirements that must be satisfied will depend on the specific insurance cover in question.

4.27 Once a bundled life insurance policy is 'unbundled' (for Part IV of the IC Act purposes) the duty of disclosure requirements will depend on the type of cover, so that different disclosure requirements will apply to the different components of the cover.

Recommendation

4.1 Section 21 of the IC Act should be amended to include non-exclusive factors that can be taken into account when determining the application of the duty of disclosure test.

4.2 Section 21A of the IC Act should be amended so that:

- it applies on renewal; and
- paragraph 21A(4)(b) is repealed.

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62 See submission from the Insurance Council of Australia Limited, dated June 2004.

WHEN SHOULD AN INSURED BE MADE AWARE OF ITS DUTY OF DISCLOSURE OBLIGATIONS?

4.28 Another concern raised by stakeholders is that many insureds do not realise that the duty of disclosure obligations still apply between the date of application for the policy and the date the policy comes into effect. The Review Panel has been advised that in some circumstances the time between providing the disclosure and the commencement of the contract can be some months. It has been further advised that in these situations some insurance companies ask the insured, immediately prior to the policy coming into effect, to sign a further document asking them if they have anything to disclose since filling out the original disclosure form. However, this is not universal practice.

4.29 The Review Panel believes that if an application for insurance is not promptly accepted by the insurer, the insurer must provide to the insured, at the time when the insurance policy is issued, a reminder that the duty of disclosure obligations continued until the time the policy is entered into. This requirement could be satisfied for example by the insurer, when sending out its letter offering a policy, reminding the potential insured that the duty of disclosure obligations have remained in effect and the potential insured should check the information previously provided is still accurate before accepting.

4.30 This proposal will ensure that if anything has happened between the date the potential insured gave the potential insurer the relevant details and the date of effect of the policy, the potential insured will be reminded of its need to comply with its disclosure obligations. And if the potential insured makes some disclosure the normal remedies would apply and there may be a renegotiation of the contract.

Recommendation

4.3 The IC Act should be amended so that the insurer must provide to the insured, at the time when the insurance policy is issued, a reminder that the duty of disclosure obligations continue until the time the policy is entered into.

MISREPRESENTATION BY LIFE INSURED

4.31 An additional issue that affects contracts of life insurance arises where a misrepresentation is made to the insurer by a person who, under the contract of insurance, becomes the life (or one of the lives) insured. Section 25 of the IC Act provides that where such a misrepresentation is made prior to the contract being entered into the misrepresentation is deemed to be made by the insured.

4.32 The reason for this provision was explained as follows:

> 'Clause 25 ensures that the life insured's statements and representations are attributed to the insured, the proposed law will achieve the same result as an insurer achieves at present by means of a contractual term. Rather than the insured's warranting the truth of the life insured's statements, however, those statements will, if incorrect, be treated as misrepresentations in the same way as the insured's own statements will be treated as misrepresentations rather than warranties'.[63]

4.33 It has been suggested that section 25 of the IC Act should be expanded to include a non-disclosure by a life insured. The effect of this would be to extend the insured's duty of disclosure to any life insured under the contract. The Review Panel believes that if the duty of disclosure is to be extended, so should the insurer's obligations under section 22 of the IC Act to give the life insured notice of the duty. It would be unfair to expect a life insured to comply with a duty of disclosure unless they are first clearly informed of that duty.

Recommendations

4.4 Section 25 of the IC Act should be expanded to include a non-disclosure by a person whose life is insured under the contract.

4.5 Section 22 of the IC Act should be expanded so that the insurer must give the life insured notice of the duty of disclosure.

PRESCRIBED WORDS TO INFORM THE INSURED ORALLY OF THE INSURED'S DUTY OF DISCLOSURE

4.34 Section 22 of the IC Act provides that before a contract of insurance is entered into, the insurer is required to clearly inform the insured, in writing, of the general nature and effect of the duty of disclosure. However, section 69 allows for information to be given to an insured orally where it is not 'reasonably practicable' for it to be given in writing. Written information must, however, be provided to the insured within 14 days of the contract being entered into.

4.35 The regulations to the IC Act[64] provide a form of words that can be used when giving oral information about certain 'eligible contracts of insurance'

63 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984 Explanatory Memorandum at page 39.
64 Subregulation 3(2) and Schedule 2 of the Insurance Contracts Regulations 1985.

that will satisfy section 69 of the IC Act, but there is no prescribed form of words to be used for other contracts.

4.36 While most issues concerning section 22 have been addressed in the proposed outcome for the disclosure requirements above, one issue remains and that is whether the prescribed words for informing insureds about the duty of disclosure orally apply to all contracts of insurance and not just 'eligible contracts of insurance'.

4.37 Of the submissions received on this point, the majority supported the view that all contracts of insurance should be covered by the prescribed words.[65] The Review Panel agrees with this view. Indeed, Phillips Fox suggested that 'an insurer [should also] be required to notify the insured of the obligations of disclosure on an occasion of a significant variation'.[66]

Recommendation

4.6 The prescribed form of words for notifying an insured of the general nature and effect of the duty of disclosure for oral disclosures should apply to all contracts of insurance and not just 'eligible contracts of insurance'.

BROKERS AND AGENTS (INTERMEDIARIES)

4.38 Where an insured uses the services of an intermediary (for example, a broker or agent) in order to obtain insurance the law is not clear whether a non-disclosure or misrepresentation by the insured's intermediary to the insurer can be said to be that of the insured. There has been a suggestion by the High Court of Australia that a misrepresentation or non-disclosure to an insurer by an insured's intermediary may not be a misrepresentation or non-disclosure by the insured.[67]

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65 See for example submissions on the Issues Paper by National Insurance Brokers Association of Australia; Phillips Fox dated 21 April 2004; Brendan Pentony dated 13 April 2004; MLC's supplementary submission; Investment & Financial Services Association Limited dated 19 April 2004; and Insurance Enquiries & Complaints Limited's Panel dated March 2004.

66 See submission by Phillips Fox dated 9 June 2004.

67 See *Permanent Trustee Australia Limited v FAI General Insurance Company Limited (in liq)* (2003) 197 ALR 364; (2003) 12 ANZ Ins Cas 61-565 per McHugh, Kirby and Callinan J.J. where it was said (at paragraph 30) that: 'the knowledge of which the subsection [that is, subsection 21(1) of the IC Act] speaks, either actual or constructive, is the knowledge of the insured, and not of any insurance intermediary … This is at least to suggest that the reference to the insured is intended to be a reference to the insured personally and not to its agent or broker. However, it is not essential to our reasons to determine this point.'

4.39 While several submissions were received on this issue the Review Panel believes that the law does not require amendment. It is not always clear whether an agent acts for an insurer or an insured. Where an agent acts for an insurer, such a general rule would clearly be unfair to the insured. In the few cases where the position is not clear by virtue of the principles of agency, it is preferable that the issue continue to be considered on its merits.

CHAPTER 5: STANDARD COVER

5.1 Part V, Division 1 of the IC Act creates a standard insurance cover regime for certain prescribed contracts. Where a contract is not prescribed, section 37 of the IC Act applies generally to require insurers to notify insureds of unusual policy terms before the insured enters the contract.

THE OPERATION OF THE STANDARD COVER PROVISIONS

5.2 Section 35 of the IC Act requires an insurer to bring to the attention of an insured, before the contract is entered into, the terms of the insurance contract that differ from the standard terms of a prescribed contract.[68]

5.3 The regulations made under the IC Act currently prescribe motor vehicle insurance, home buildings insurance, home contents insurance, sickness and accident insurance, consumer credit insurance and travel insurance.

5.4 It was claimed during consultation that the practical effect of the current standard cover regime has diverged from that which was originally intended. Stakeholders have suggested that:

- disclosure should occur in a document separate to the policy (either through a product disclosure statement (PDS) or otherwise);
- section 35 (and the associated regulations) are no longer relevant and could be replaced by a broader section 37; and
- sections 35 and 37 duplicate the product disclosure statement (PDS) regime and are thus no longer necessary.

Disclosure through the policy document

5.5 In its report on 'Insurance Contracts,' the ALRC recommended a standard cover regime be introduced into Australian insurance law. The ALRC stated that:

> 'Under such a regime, it would be possible for an insurer to derogate from the standard prescribed, but it could only do so if it specifically drew to the insured's attention the relevant limit on cover.'[69]

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68 Section 35 of the IC Act.

5.6 The ALRC also considered a scheme of standard contracts in Australia. However, it rejected that notion for several reasons, including that it would inhibit product development in response 'to the demands and needs of the public'.[70]

5.7 While the ALRC found that many misunderstandings in insurance arose because policy documents were often unavailable to an insured before they entered the insurance contract,[71] the ALRC did not recommend the introduction of standard cover as a means of ensuring that insureds received a copy of the policy. Rather, the ALRC discussed disclosure under the standard cover provisions as being in a document separate to the policy:

> 'If policies remain unread, might not the same be true of lengthy warnings concerning the limits on standard cover? Such an objection is defective for two main reasons. First, the standards concerning legibility and comprehensibility of notices required by this report would reduce the factors which inhibit reading and comprehension of existing policies. Secondly, the length of the notification which would be required would bear no resemblance to a full policy document.'[72]

5.8 Nevertheless, on introduction of the Insurance Contracts Bill, a substantial change was made to the original ALRC recommended regime. That change had the effect that unusual terms under section 37 could be notified by providing a copy of the policy document.

5.9 Section 37 of the IC Act originally stated:

> 'An insurer may not rely on a provision included in a contract of insurance (not being a prescribed contract) of a kind that is not usually included in contracts of insurance that provide similar insurance cover unless, before the loss occurred —
>
> (a) the insurer gave to the insured a copy of the policy document or of the provision; or
>
> (b) the insurer clearly informed the insured in writing of the effect of the provision.'[73]

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69 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 57.
70 ALRC 20, paragraph 55. The ALRC report contains further discussion about standard contracts at paragraph 54-56.
71 ALRC 20, paragraph 48.
72 ALRC 20, paragraph 72.
73 Original section 37 of the *Insurance Contracts Act 1984* No. 80 of 1984.

5.10 The Parliament made three further amendments to sections 35 and 37 of the IC Act over the course of 1985 and 1986. These amendments ensured that disclosure, for the purposes of sections 35 and 37, could be satisfied by providing the insured with a copy of the policy document (so long as the policy contained the relevant non-standard or unusual terms).

5.11 The Explanatory Memoranda to the amending Bills provide:

> 'The proposed amendment of sub-section 35(2) derives from the existence of some degree of uncertainty on the part of insurers as to whether they need to provide a special notice, which specifies the extent of any deviation from the standard cover to be prescribed by regulation, in addition to the policy document itself. The amendment makes it clear that an insurer's requirement to notify the insured can be satisfied by providing a copy of the policy document itself, subject to that document clearly informing the insured of the extent of the cover provided.'[74]
>
> …
>
> 'Proposed amendment to section 37 is designed to bring the wording regarding ways in which an insurer can satisfy the requirement to clearly inform the insured in writing of any unusual term of an insurance contract into line with sub-section 35(2).'[75]

5.12 These amendments allowed insurers more flexibility in deciding how non-standard or unusual policy terms should be disclosed.

5.13 The Review Panel is not convinced that reducing this flexibility, such as by requiring disclosure of non-standard and unusual policy terms in a separate document to the policy, would necessarily lead to insureds better understanding the limitations of their insurance policy.

5.14 Rather, the Review Panel believes that it is more important that disclosure of non-standard and unusual policy terms be disclosed in a manner an *average insured* will be aware of and understand.

'Clearly inform'

5.15 Generally the words 'clearly inform', as used throughout the IC Act, mean 'to make known with some precision' and merely giving the insured a

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74 Australia, Parliament 1985, House of Representatives, Statute Law (Miscellaneous Provisions) Bill (No. 1), Explanatory Memorandum at page 55.

75 Australia, Parliament 1986, House of Representatives, Statute Law (Miscellaneous Provisions) Bill (No. 2), Explanatory Memorandum at page 33.

document containing the relevant provisions among a host of other provisions may well fail to clearly inform the insured of his or her rights and obligations.[76]

5.16 Despite that, it has been held that subsection 35(2) of the IC Act means that giving the insured a document containing the relevant provisions *will* usually be enough for the insurer to satisfy this requirement. There may be, however, 'special circumstances in which the complexity of or confusions within the document' prevent this from being so.[77]

5.17 The reason that 'clearly inform' leads to a different result in different contexts is because of the additional wording found in subsection 35(2) (and section 37) after the requirement to 'clearly inform'. Subsection 35(2) provides, *inter alia*, that 'the insurer clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise).' The words in parentheses are not used elsewhere in the Act in conjunction with the requirement to 'clearly inform'.

5.18 Einstein J. in *Hams v CGU Insurance Ltd* found that the words contained in the parenthesis in subsection 35(2) appear:

> '… in most circumstances to result in the provision of such a document in and of itself satisfying the requirement to clearly inform. There may however be special circumstances in which the complexity of or confusions within the document containing the relevant provisions (which one would expect would usually be the Insurance Policy itself) could be such that the mere provision of the Policy did not establish that the insurer had effectively informed the insured of relevant limitations.
>
> Hence I accept as correct the proposition that the words in parenthesis mean that providing a document containing the provisions is one of a number of mechanisms by which an insurer may clearly inform the insured. In each case the content of the document and all of the circumstances of its provision would need to be considered in order to determine if the insurer had effectively informed the insured of the limitation.'[78]

5.19 *Hams* case was recently considered by the Northern Territory Court of Appeal in *Marsh v CGU Insurance Limited t/as Commercial Union Insurance*.[79] Mildren J (Thomas J agreeing) held that:

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76 *Suncorp General Insurance Limited v Chiehk* (1999) 10 ANZ Ins Cas 61-442.
77 *Hams v CGU Insurance Ltd* (2002) 12 ANZ Ins Cas 61-525, Einstein J at [242]
78 (2002) 12 ANZ Ins Cas 61-525 at [242] and [243].
79 *Marsh v CGU Insurance Ltd t/as Commercial Union Insurance* [2004] NTCA 1.

> 'In Hams v Anor v CGU Insurance Limited (2002) 12 ANZ Insurance cases 61-525, Einstein J held that the provisions of s35(2) of the Insurance Contracts Act (Cth) could be met if the insurer provided to the proposed insured a document such as the proposed policy, which contained the relevant wording. I agree. Plainly, the words in parenthesis in s35(2) clearly contemplate such a possibility. Whether the policy wording in fact "clearly informed" the insured that there was no cover for flood is a question of fact to be determined by an examination of the document in question. I do not consider that it is necessary for the relevant exclusion to be predominantly displayed in bold capitals over the front cover in order for the insurer to succeed on this question … Furthermore, the language of s35(2) suggests that the proposed insured can be clearly informed merely by providing the insured with a copy of the policy that shows the exclusion in clear and unambiguous terms … Even though s35 is plainly beneficial legislation, a fair reading of s35(2) does not warrant the conclusion that the result need go further than provide for the relevant exclusion in the policy wording in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding if that person reads the policy in question.'[80]

5.20 Judicial interpretation of the term 'clearly inform' in section 35 shows that the term has become a test of the clarity of the drafting for the required disclosure. It should also be noted that the clarity test in section 35 is the same as the test in section 37.

5.21 A number of submissions claimed that insurers do not disclose non-standard and unusual policy terms in an effective or meaningful manner.[81]

5.22 We rejected above the suggestion of some stakeholders that an insurer should be required to clearly make known to the insured the limitations of an insurance policy by providing a separate document explaining the non-standard and unusual policy terms, or by highlighting the non-standard or unusual terms.[82] Nevertheless, the Review Panel believes these proposed

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80 *Marsh v CGU*, at [11].

81 See submission from the Law Council of Australia dated 27 April 2004, at page 11.
See submission from the Insurance Enquiries and Complaints Limited Panel dated March 2004, at page 2.

82 See submission from the Legal Aid Commission of New South Wales dated April 2004 at page 15.
See submission on the Issues Paper from the Consumers' Federation of Australia (CFA) at page 17. The CFA suggested that '… all non-standard terms [should be] separately collected and disclosed at the front of the contract (using plain language, with a reasonable font size, with an explanation of the purpose of the disclosure and so on).'

solutions may assist consumers more easily identify non-standard policy terms. The Review Panel encourages the insurance industry, in consultation with consumers and consumer advocates, to seek to improve the ways in which they make known to insureds non-standard policy terms. The Review Panel does not propose limiting the documents through which disclosure may occur.[83]

5.23 The Review Panel does not believe that these suggestions, even if implemented, would adequately address the principal problem, being that certain non-standard and unusual terms are lengthy, complex and often have to be read in conjunction with the policy to be fully understood.

5.24 The Panel concludes that the difficulty insureds have in understanding the effect of such terms demonstrates the shortcomings of the present requirement, namely 'clearly inform'.

5.25 The Review Panel believes that many consumer concerns would be addressed if insurers were to draft documents (or the relevant parts) disclosing non-standard and unusual terms in a 'clear, concise and effective manner'. These words already describe the obligations of insurers under the FSRA in relation to disclosure documents for 'retail clients'.

5.26 Given that *Hams* case has already found the term 'clearly inform' in section 35 to require clear and effective disclosure, the Panel does not consider such an amendment to be onerous for insurers. However, the Panel does believe that the additional requirement of 'concise' disclosure will simplify disclosure documents and greatly enhance the readability of non-standard and unusual policy terms.

5.27 Such a change to the clarity test of sections 35 and 37 will also more easily allow a rationalisation of the standard cover regime and the PDS regime, which is considered later in this Chapter.[84]

See also submission from the CFA dated June 2004. The CFA recommend considering a 'Schumer box' for standard cover contracts. The 'Schumer box' would, at the front of the policy, alert consumers to any variation from standard cover.

83 Some stakeholders appeared to mistakenly believe that the Review Panel intends to limit the documents through which non-standard and unusual term disclosure may occur. See submission from the Insurance Council of Australia Limited (ICA) dated June 2004.

84 The Review Panel appreciates that the PDS regime only applies to 'retail clients.' General insurance products deemed to be provided to 'retail clients' include products to which both sections 35 and 37 apply, for example, section 37 applies to the retail products medical indemnity insurance and personal and domestic property insurance.
The Review Panel does not believe it is onerous for 'wholesale' general insurance products to include unusual term disclosure in a 'clear, concise and effective manner.'

5.28 We recognise that a revision of this kind imposes a burden on insurers who will need to reconsider the drafting of many policies and possibly other documents. We suggest, therefore, that consideration be given to a transitional period of approximately two years, during which insurers would be held to the present test rather then any revised test.

Recommendation

5.1 The clarity test of 'clearly inform' in sections 35 and 37 of the IC Act should be replaced by a requirement that the information be presented in a 'clear, concise and effective manner'.

Should section 35 be removed and section 37 be expanded?

5.29 Some stakeholders have suggested that disclosure required by section 35 could be incorporated into section 37 of the IC Act. This has been suggested as a preferred approach to that of modernising the standard cover regulations.[85]

5.30 Both sections 35 and 37 require insurer disclosure, if the insurer wishes to be able to rely upon all terms (including non-standard and unusual) of the insurance contract.

5.31 Under section 37, if the insurer does not disclose the unusual terms of a policy before the contract is entered into, then the unusual terms become void.

5.32 However, under section 35, if an insurer does not disclose the non-standard terms of a policy before the contract is entered into, the insured will instead be allowed standard cover.

5.33 This difference in outcomes between sections 35 and 37 must be borne in mind when considering a rationalisation of the two sections.

5.34 The Review Panel considers that an expansion of section 37 to apply to what is currently a prescribed contract,[86] would reduce the protection available to insureds under prescribed contracts.

5.35 The Review Panel believes that the additional protection offered by section 35 is clearly a better remedy for consumers, in relation to prescribed contracts, than that provided by section 37. It allows an insured an 'expected'

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85 See submission by the Insurance Enquiries and Complaints Limited Panel dated March 2004, at page 2.

86 The prescribed contracts of insurance are motor vehicle insurance, home buildings insurance, home contents insurance, sickness and accident insurance, consumer credit insurance and travel insurance.

level of insurance coverage in the event that non-standard contract terms are not disclosed to the insured, and in this regard remains a relevant and important provision of the IC Act.

5.36 Further, the Panel cannot see any way to amend section 37 to afford similar protection to that provided by section 35, without prescribing standard cover.

Standard cover regulations

5.37 Through the course of this Review it has become evident that the standard cover regulations have not kept pace with market developments.

5.38 A number of stakeholders have suggested that the standard cover regulations require modernising and updating.[87]

5.39 The Review Panel considers that, even though the regulations have in part become outdated, generally the standard cover regime has operated satisfactorily.

5.40 However, the Review Panel recommends that the regulations be modernised where necessary. This should be considered carefully, as hasty amendments may result in the emergence of deficiencies in the standard cover regime. It may be appropriate to establish a process, such as a consultative committee, for this purpose, which would include representatives from the insurance industry and consumer representative bodies.

Recommendation

5.2 The standard cover regulations should be updated and modernised following a suitable process of consultation with stakeholders including the insurance industry and consumer representatives.

STANDARD COVER AND THE *FINANCIAL SERVICES REFORM ACT 2001* (FSRA)

5.41 The FSRA amended the *Corporations Act 2001* to introduce a uniform licensing, conduct and disclosure regime for financial service providers, including insurers, which took full effect on 11 March 2004.

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87 See submission from the Legal Aid Commission of New South Wales dated April 2004 at page 18 and submission on the Issues Paper from the Consumers' Federation of Australia (CFA) at page 16.

5.42 The FSRA disclosure regime includes specific disclosure requirements for some insurance products.[88] In particular, a product disclosure statement (PDS) for insurance must contain 'information about any other significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product.'[89]

5.43 It has been argued that this requirement (and possibly others) of the PDS is a duplication of the disclosure required to satisfy the standard cover provisions. The Insurance Council of Australia Limited suggested duplication between the two regimes is sufficient reason to repeal the standard cover regime.[90]

5.44 However, there are a number of important differences between the PDS regime and the standard cover regime (that is, Part V Division 1 of the IC Act). The FSRA disclosure regime does not apply in relation to the issue or sale of every insurance product. Disclosure is only required where a product is sold to a 'retail client'.[91] The application of the standard cover regime is not similarly limited, and potentially applies to the sale of all types of insurance, and to all types of insureds.[92]

5.45 The remedies available to an insured and the liability of the insurer differ under each regime. Under the IC Act, if the insurer fails to notify the insured of non-standard terms, the contract reverts to that of standard cover. If an insurer fails to notify the insured of unusual policy terms, the insurer cannot rely upon those unusual terms of the contract.

5.46 However, if an insurer fails to fulfil its PDS obligations, the FSRA would, for example, allow ASIC to take action against the PDS issuer, or allow an insured to take civil action for any resultant loss or damage. The standard cover regime seems to provide more effective consumer protection.

5.47 This was reflected in a number of submissions. For example, the Legal Aid Commission of New South Wales submitted:

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88 Disclosure is required where an insurance policy is sold to a retail client, as defined under section 761G of the *Corporations Act 2001*. Subsection 761G(5) provides that where a general insurance product is sold to a person or small business, the person or business is generally to be treated as a 'retail client.' General insurance products specifically include those products prescribed in regulations under the IC Act, that is, motor vehicle insurance, home building insurance, home contents insurance, sickness and accident insurance, consumer credit insurance and travel insurance.

89 Paragraph 1013D(1)(f) of the *Corporations Act 2001*.

90 See submission from the Insurance Council of Australia Limited dated April 2004 at pages 8 and 21.

91 'Retail client' is defined in section 761G of the *Corporations Act 2001*.

92 Specifically, section 37 of the IC Act has no restrictions on its application.

> '… we strongly support the continued existence of the standard cover provisions as an important means to protecting the interests of insureds. PDS has neither the same purpose nor outcomes that standard cover provisions afford consumers today.' [93]

And Australian Associated Motor Insurers Limited (AAMI) stated:

> 'The purpose of the two regulatory schemes is different. The PDS regime in the Corporations Act is about ensuring comparability and comprehension of product documentation. The standard cover provisions are about providing a baseline set of words that apply where the insurer has failed to provide notice of the actual policy terms.
>
> The Corporations Law provides that where a consumer has not received proper notice of the PDS provisions, the remedy is damages. In the standard cover regime, the remedy is that the standard cover provisions apply in the event of a claim. That remedy is an effective consumer protection mechanism that should not be removed'.[94]

5.48 While the Review Panel does not support the repeal of the standard cover provisions, there is clearly benefit in reducing duplication (and hence compliance costs) between the provisions and the PDS regime where such duplication may exist.

5.49 In investigating a rationalisation of these two regimes, the Review Panel has concluded that there is nothing currently restricting IC Act disclosure through a PDS.

5.50 Specifically, the standard cover provisions, and more generally, the IC Act, do not prohibit standard cover disclosure from being included as part of another document (such as a PDS), so long as such disclosure meets the clarity test of 'clearly inform' and is provided 'in writing'.

5.51 To the extent, if any, that an insurer is not already required to include standard cover related disclosures through a PDS,[95] the insurer is allowed to include other information in the PDS,[96] provided that such information continues to meet all other requirements of the Corporations Act including the need for information to be worded and presented in a clear, concise and effective manner.

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93 See submission from the Legal Aid Commission of New South Wales dated April 2004 at page 13.
94 See submission from the Australian Associated Motor Insurers Limited (AAMI), dated 16 April 2004 at page 4.
95 Under section 1013D of the *Corporations Act 2001*.
96 Paragraph 1013C(1)(b) of the *Corporations Act 2001*.

5.52 Should the clarity test in the standard cover regime be changed to that of 'clear, concise and effective' then rationalisation of the two regimes will be easier. However, even without such a change, it is clearly open to insurers to provide standard cover disclosure through a PDS, in a 'clear, concise and effective manner'.

5.53 While the Review Panel sees no existing barriers to providing standard cover disclosure through the PDS, to affirm this position the Review Panel recommends that the IC Act be amended to clarify that standard cover disclosure may specifically occur through a PDS.[97]

5.54 It is also noted that if information required by section 37 of the IC Act was provided through a PDS, this could only occur where an insurance product was sold to a retail client. As such, section 37 disclosure would have to continue to occur through the provision of the policy document or a separate document where a PDS was not required.

Recommendations

5.3 Sections 35 and 37 should be amended so that the product disclosure statement (PDS) is specified as one of the documents through which disclosure of non-standard and unusual policy terms can occur.

- Such disclosure would need to satisfy both the requirements of the standard cover provisions under the IC Act and the requirements of the PDS regime.

5.4 Consideration should be given to the need for regulations under the *Corporations Act 2001* that would clarify:

- that a PDS may include information that satisfies the disclosure requirements of the standard cover provisions of the IC Act; and
- that where an insurer fails to fulfil its standard cover disclosure obligations through the provision of a PDS, then the insured may rely upon the remedies of the IC Act as well as the remedies of the *Corporations Act 2001*.

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97 In its most recent submission, the Insurance Council of Australia Limited (ICA) contended '… parts of the IC Act, most notably the standard cover and unusual term provisions have produced an imbalance between the interests of insurers and insureds following the passage of the *Financial Services Reform Act* (FSRA).'
See submission from the ICA, dated June 2004, at page 6. The Review Panel has addressed this concern of the ICA (and others) by proposing a way that insurers may harmonise the standard cover provisions and the PDS regime.

CHAPTER 6: REMEDIES OF INSURED

6.1 This Chapter discusses the remedies available to an insured party for a breach by an insurer, in particular:

- remedies for unfair contractual terms; and
- remedies if payment of a claim is unreasonably delayed.

REMEDIES FOR UNFAIR CONTRACTUAL TERMS

6.2 Section 13 of the IC Act implies into insurance contracts a duty of the utmost good faith, owed by each party to the other, in respect of any matter arising under or in relation to the contract.

6.3 If there is a breach of the duty by the insurer that causes loss to the insured, that could found a claim for damages for a contractual breach. Further, section 14 provides that a party may not rely on a contractual term if to do so would be to fail to act with the utmost good faith.

6.4 Section 15 of the IC Act expressly excludes insurance contracts from the operation of any Act (Commonwealth, State or Territory) that provides relief in the form of judicial review of harsh or unfair contracts. It also excludes relief under other Acts for insureds from the consequences in law of making a misrepresentation, except for relief in the form of compensatory damages.

6.5 In the review that led to the introduction of the IC Act, the ALRC considered that the prospect of facing an action for breach of duty under section 14 was sufficient to encourage insurers to draft policies carefully and to act fairly in strictly enforcing policy terms. The ALRC reported that, in light of the proposed section 14, it was unnecessary for insurance contracts to be subject to a facility for judicial review of unfair contractual terms.[98] The risk of differences in such laws between jurisdictions causing difficulties was noted.[99]

6.6 The Issues Paper included an invitation to comment on whether it was appropriate for the restriction in section 15 of the IC Act to be retained and, if so, whether there were any remedies under other laws whose use should be similarly restricted in the context of insurance contracts.

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98 Such as those found in, for example, the *Contracts Review Act 1980* (NSW).

99 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 51.

6.7 Submissions were starkly divided on the ongoing need for section 15 with strongly held views being expressed both in favour and against its retention.

6.8 Those against its retention argue that:

- insurance contracts are not so different from all other contracts that they should be immune from the general law regarding unfair contracts;

- the duty of utmost good faith in sections 13 and 14 has not been sufficient to encourage insurers to act fairly in drafting policies and enforcing their terms; and

- the provisions in sections 13 and 14 and the dispute resolution bodies interpreting them can only assist individual consumers — they cannot address systemic issues and indications are that there are systemic problems with unfair terms in insurance contracts.

6.9 Those in favour of its retention unaltered argue that:

- insurance contracts are not 'immune' from general consumer protection avenues — rather they are dealt with under specific legislation which takes account of the complexities of insurance contracts and the fact that liability is reinsured, often on an overseas market, and re-insurers will not necessarily be bound by Australian judicial review;

- insureds have adequate protection arising from the duty of utmost good faith in sections 13 and 14 and although the use of those provisions has been limited, the response should be to encourage their use, not make available a multitude of other remedies;

- external dispute resolution bodies provide a low cost and speedy means of resolving disputes in the insurance contracts framework — it is undesirable to encourage use of litigation.

6.10 One submission strongly opposed alteration of section 15 but noted that, if any change were to be made, it should be confined to mass personal (consumer) risks. The submission argued that allowing a court to re–write commercial insurance contracts would 'wreak utter havoc' in the commercial insurance environment.

6.11 One of the dispute resolution bodies suggested that this is a complex issue that should be deferred.

6.12 Following the release of the Proposals Paper the Consumers' Federation of Australia questioned the argument that section 15 be retained because of concerns about re-insurance and complexity:

> 'With respect, in relation to consumer contracts, this is a matter to be resolved between insurers and their re-insurers. What is of concern to individual consumers is the right to remedies in the event of unfair or unconscionable conduct by insurers.
>
> Similar issues arise in the context of consumer mortgages, however, the financial services industry has not sought, (and nor would it obtain) exemption from such basic consumer protection principles as statutory unconscionability etc.
>
> The Proposals Paper also notes that the complexities of insurance contracts have been suggested as a reason for the retention of section 15. However, it might equally be argued that other products (for example, superannuation products) have the same level of complexity or otherwise of insurance products does not seem to be an adequate reason to retain section 15.' [100]

6.13 The Standing Committee of Officials of Consumer Affairs (SCOCA) has appointed a Working Party to review the issue of unfair contract terms generally. The Working Party's comprehensive discussion paper[101] has been developed with a view to investigating the need for nationally consistent regulation of unfair contract terms. It includes consideration of such issues as whether business to business transactions, including insurance contracts, should be excluded from the scope of any national model.

6.14 The Review Panel considers that the arguments are finely balanced. The ALRC's concerns about the application of the laws of different jurisdictions are still valid. Similarly, the concerns about the potential for judicial review of insurance contracts to re-open carefully negotiated commercial arrangements after the event are well-founded. If a nationally consistent model for review of consumer unfair contracts is developed, the balance of consideration may shift and the issue should be revisited.

6.15 The Review Panel considers that the consequences of repealing section 15 are too uncertain to warrant taking that step. However, the Review Panel

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100 See submission on the Proposals Paper by the Consumers' Federation of Australia dated June 2004.

101 Standing Committee of Officials of Consumer Affairs — Unfair Contract Terms Working Party 2004, *Unfair Contract Terms: A Discussion Paper*, available at: http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/CD456F7C38F523684A256E240014EF7C?OpenDocument&L1=Publications.

believes section 14 warrants consideration. Section 14 applies where reliance 'on a *provision of the contract* of insurance would be to fail to act with the utmost good faith …' (emphasis added). The Review Panel considers that section 14 should be amplified so that it applies in other circumstances. For example, it could provide relief where an insurer has failed to provide notice as required under subsection 40(2) or the proposed amendments to section 40. The section should also reflect clearly the fact that the rights and obligations of the parties are subject to a range of 'provisions' in the IC Act, whether they be by way of express terms of the contract or otherwise. This would include implied terms of the contract, or by way of operation of law.

6.16 The Review Panel believes that sections 13 and 14 of the IC Act, relating to the duty of utmost good faith, have potential to be utilised by insureds in connection with insurer conduct that might otherwise be dealt with under statutes dealing with unfair contracts or unconscionable conduct. This capacity will be enhanced further if the Review Panel's proposal for treating a breach of the duty of utmost good faith in Chapter 1 is adopted.

Recommendation

6.1 Section 14 of the IC Act should be amended so that it applies to provisions that are implied or imposed by the IC Act.

INTEREST ON DELAYED PAYMENTS

6.17 Under section 57 of the IC Act, an insurer who has unreasonably withheld payment of money to a person under a contract of insurance may be liable to pay interest to that person at the rate prescribed in the regulations (currently calculated under a formula that is based on 3 per cent above the Treasury 10 year bond rate).[102]

6.18 The Issues Paper noted the following comments about interest:

- the interest rate should be increased as currently there is no incentive to insurers to finalise claims; and
- the application of section 57 is difficult because it is only payable to a person where there has been an 'unreasonable' withholding of moneys.

102 Regulation 32 of the *Insurance Contracts Regulations 1985*.

6.19 One suggestion is that the allowable delay should be 21 days, subject to adjustment for:

- any consumer induced delay; or
- a delay which the insurer could establish was reasonable in the particular circumstances.

6.20 Unreasonable delay on the part of an insurer in paying claims could amount to a breach of the duty of utmost good faith in section 13 of the IC Act. In such a case it may be that the insured, in addition to receiving statutory interest under section 57, could seek to claim for compound interest for the period the insured was denied access to the monies, pursuant to principles in *Hungerfords* case.[103] However, the law on whether such a claim is permissible under the IC Act is not finally settled.[104]

6.21 Another possible measure to address issues of unreasonable delay is the award of punitive or exemplary damages in tort, which has occurred in some jurisdictions, in cases where insurers act unreasonably in settling claims. The ALRC in its review of insurance contracts expressly rejected introducing a tort of bad faith in Australia. The ALRC considered that assessment of damages for breaching the duty of good faith should be based on ordinary contractual principles. This would encompass the recovery of damages for losses suffered as a result of the breach of duty — but not punitive or exemplary damages.[105]

6.22 The Issues Paper included a request for submissions on whether the current interest rate in section 57 was appropriate. Further submissions were sought on whether the IC Act should expressly make available, in addition to the section 57 interest, compound interest and/or punitive or exemplary damages or damages in tort for consequential loss arising from unreasonably late payment.

6.23 In respect of the first issue, some submissions in favour of a rate rise for unreasonably withheld payments noted that it would encourage prompt payment by insurers. Some submissions opposed a rate rise, noting that the issue is not one of incentive — often payments are delayed for reasons beyond the control of the insurer. One submission included an observation that insurers do not generally charge interest on late premiums, but also noted that in this area there could be different considerations between commercial and mass market risks.

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103 *Hungerfords v Walker* (1989) 171 CLR 125.

104 Godfrey, K. 'The duty of utmost good faith — the great unknown of modern insurance law', (2002) 14 *Insurance Law Journal* 56 at 59.

105 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra at paragraph 328.

6.24 In respect of the compound interest issue, views in submissions differ on whether compound interest is currently available and, if the position were clarified, whether it should be ruled in or out. This question turns upon whether section 57 should operate as a complete code for interest in the event of unreasonably withheld payment. It is arguable that subsections 57(4) and (5), to the effect that section 57 prevails over all other laws, show that section 57 is supposed to amount to a code. However, a number of courts have found a distinction between, on the one hand, interest on unpaid monies (which is dealt with in section 57) and damages for the loss of the use of money, which may exceed the opportunity or borrowing costs.[106]

6.25 As regards the availability of exemplary/punitive damages or damages for consequential loss in tort, the balance of opinion in submissions was that there was no need for any specific provision.

6.26 Other suggestions were that:

- there should be a requirement that insurers notify insureds of their entitlement to interest on unreasonably withheld payments; and

- an increased rate could be made payable only in specified circumstances, for example, where there are consequential losses and dispute resolution bodies could be responsible for determining when the increased rate applies.

6.27 The Review Panel considers that there is a distinction to be made between the right to interest under section 57 that applies in cases of unreasonably late payment and the other forms of compensation that have been discussed. The section 57 interest entitlement would be likely to dissuade insurers denying a claim in bad faith or otherwise engaging in wrongful conduct, such as unreasonably refusing to accept a settlement offer.

6.28 The Review Panel therefore considers that section 57 is appropriate. The alternative of prescribing a certain number of days from the date a claim is made, for example, as the date from which interest is payable is not appropriate because of the wide variation in the types of policies, claims and circumstances. The 'unreasonable' formulation in section 57 allows those variations to be considered, including such matters as delay on the part of the insured.

6.29 As to the rate, the Review Panel considers that there is a case for an increase. The rate prescribed under regulation 32 of the Insurance Contracts Regulations is 3 per cent above the 10 year Treasury bond rate, which would

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106 Mann, P, *Annotated Insurance Contracts Act*, 3rd Ed, Law Book Company, 2001, at page 219.

not necessarily be sufficient to reimburse insureds for the cost of alternative funds if they needed to be obtained on an unsecured basis. In the view of the Review Panel, a rate slightly above the expected rate an insured would pay for alternative funds would act as the 'incentive' for insurers to process claims in a reasonable time frame. The Review Panel suggests that a figure of 5 per cent above the Treasury 10 year bond rate would be more appropriate than the current figure of 3 per cent.

6.30 The Review Panel does not agree with the suggestion that insurers should be required to notify insureds of their statutory rights to interest under section 57. The costs of making a mandatory disclosure to all insureds as part of the pre-contract disclosure, or requiring new mandatory notification to be sent to all persons lodging a claim, outweigh the benefits.

6.31 In relation to the issues of the availability of additional remedies (*Hungerford's* type damages, exemplary or punitive damages or damages for consequential loss in tort) against insurers regarding late payment, the Review Panel does not consider that a sufficient case has been made to either expressly make those remedies available, or expressly rule them out. Where there is, for example, consequential loss arising from the failure to pay a claim within a reasonable period, the use of section 13 by an insured in those circumstances may provide a suitable remedy in damages. In light of those considerations, the Review Panel does not make any recommendations concerning those issues.

Recommendation

6.2 The rate of interest prescribed under section 57 of the IC Act should be increased to 5 per cent above the 10 year Treasury bond yield.

CHAPTER 7: REMEDIES OF INSURER

7.1 Where there has been misrepresentation or non-disclosure by an insured, prior to a contract being entered into, the remedies available to an insurer are set out in Part IV of the IC Act. They are dependent upon whether the failure to disclose is fraudulent or not. The approach differs between general and life insurance. Part VII of the IC Act contains provisions restricting general insurers' rights to cancel policies.

BREACH OF THE DUTY OF DISCLOSURE BY THE INSURED — LIFE INSURANCE

7.2 Division 3 of Part IV of the IC Act provides remedies to an insurer where an insured has failed to disclose a matter to it or where the insured has made a misrepresentation or incorrect statement.[107] The key provisions are sections 28 and 29.

7.3 Section 28 of the IC Act provides the remedies to an insurer under a contract of general insurance where there has been non-disclosure or a misrepresentation by the insured. Where there has been fraud, the insurer is entitled to avoid the insurance contract. In the absence of fraud, subsection 28(3) of the IC Act allows the insurer to reduce its liability to the amount that would restore its position had no failure occurred.

7.4 Section 29 of the IC Act provides for the remedies available to an insurer under a contract of life insurance where there has been non-disclosure or misrepresentation by the insured. The term 'contract of life insurance' is defined in subsection 11(1) of the IC Act to mean 'a contract that constitutes a life policy within the meaning of the *Life Insurance Act 1995*'. A 'life policy' includes, *inter alia*, a contract of insurance that provides for the payment of money on the death of a person; a contract that constitutes an investment account contract and one that constitutes an investment-linked contract.[108]

7.5 The remedies provided by section 29 are as follows.

- Avoid the contract where there has been fraudulent non-disclosure or misrepresentation that does not relate to age.
- Avoid the contract where there has been innocent non-disclosure or misrepresentation that does not relate to age and the insurer would not

107 Section 33 of the IC Act.
108 Subsection 9(1) of the *Life Insurance Act 1995*.

have entered into the contract of insurance with the insured on any terms. However this can only occur within three years after the contract was entered into. If the insurer discovers the misrepresentation or the non-disclosure after three years since the contract was entered into the insurer has no remedy.

- Vary the contract on the basis of the formula set out in subsection 29(4) (which reflects the principle of proportionality) where the failure is innocent and does not relate to age. Again, this is dependent upon the insurer discovering the failure within three years.

- Vary the amount of the sum insured where the insured has misrepresented his or her age (see section 30 of the IC Act).

7.6 Division 3 of Part IV of the IC Act also provides a remedy where there has been non-disclosure or a misrepresentation by a member of a scheme[109] or by a retirement savings account (RSA) holder[110] or where there has been a misstatement as to age.[111]

The law before the IC Act

7.7 At common law if an insured breached its duty of disclosure obligations or made a misrepresentation, the insurer could avoid the contract.[112] This applied to both contracts of general and life insurance.

7.8 The position for life insurance was modified by the introduction of the *Life Insurance Act 1945*, with limitations being placed on the remedies available to an insurer where a misrepresentation had been made by an insured. These limitations being:

- the inability to avoid the policy because of a misrepresentation by the insured of his or her age;[113] and

- the inability to avoid the policy because of an incorrect written statement, unless the statement:

  - was fraudulently untrue; or

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109 Section 32 of the IC Act.
110 Section 32A of the IC Act. The term 'RSA' has the same meaning as in the *Retirement Savings Accounts Act 1997*.
111 Section 30 of the IC Act.
112 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, paragraph 3.5.
113 Section 83 of the *Life Insurance Act 1945*.

- was a statement that the insurer considered a material risk. However, in order to avoid the policy this statement must have been made within the period of three years immediately preceding the date on which the policy is sought to be avoided or the date of the death of the life insured, whichever is the earlier.[114]

7.9 In the second reading speech for the introduction of the Life Insurance Bill, the then Acting Prime Minister and Treasurer noted that it:

> 'Sets out certain minimum rights that a policy-owner shall have in relation to his policy contract.
>
> 'The provisions of the bill are not unduly harsh on the management of life insurance companies; indeed, I think it may be said that the better companies have already voluntarily given their policy-holders substantially all the rights conferred by the measure. However, the measure will introduce improvements into the practices of some other companies that have not been so liberal in the past.'[115]

The law under the IC Act

7.10 Section 29 of the IC Act provides the remedies available to an insurer under a contract of life insurance where an insured has failed to disclose a matter to it or where the insured has made a misrepresentation or incorrect statement.

7.11 The Explanatory Memorandum to the Insurance Contracts Bill 1984 explains the purpose of section 29.

> 'As the law stands, the provisions of the *Life Insurance Act 1945 (Cwlth)* apply only to written misstatements and not to oral misstatements or to the failure to disclose. There is no reason why such a distinction should be drawn and, consequently, the proposed law will treat them in the same way. Section 84 of the *Life Insurance Act 1945 (Cwlth)* also leaves open the question of the appropriate method of assessing damages for an innocent misrepresentation or non-disclosure. The formula adopted is based on the principle of proportionality which is already used in the insurance industry in relation to misstatements of age (section 83 of the

114 Section 84 of the *Life Insurance Act 1945*.
115 Australia, Parliament, 1945, *Parliamentary Debates Session 1945, Third Session of the Seventeenth Parliament*, Vol 182, at page 2147.

Life Insurance Act 1945 (Cwlth)). These reforms are consistent with those effected by clause 28 in relation to general insurance.'[116]

Changes to life insurance market

7.12 At the time of the ALRC's 1977 Issues Paper on Insurance Contracts and the following 1978 Discussion Paper and 1982 Report,[117] business that constituted life insurance comprised mainly whole of life insurance,[118] endowment insurance,[119] term life insurance[120] and rider benefits to each of the insurances.[121]

7.13 The Investment & Financial Services Association Ltd (IFSA) has advised[122] that although term life policies were common at the time of the ALRC review into insurance contracts, the major part of life companies' business at that time was endowment and whole of life policies.

7.14 The proportion of new business in 1977 which was term life was less than 15 per cent. Now, the proportion of new long term life insurance business

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116 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984 Explanatory Memorandum at page 47.

117 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra preceded by Australian Law Reform Commission 1977, *Insurance Contracts*, IP 2, Australian Law Reform Commission, Sydney and Australian Law Reform Commission 1978, *Insurance Contracts*, DP 7, Australian Law Reform Commission, Sydney.

118 'Under a whole of life policy, the sum insured is payable only on the death of the life insured … The insurer invests the investment component of the premium and the insured becomes entitled not only to the sum insured, but also (if, as is usually the case, the policy is one "participating in profits") to a share in the net profits (declared in the form of "bonuses") of the investment.': see Kelly D. and Ball, St L. 2001, *Kelly and Ball principles of insurance law* 2nd edn (loose leaf), Butterworths, Sydney at paragraph 13.0030.

119 'Under an endowment policy, the sum insured is payable on the life insured reaching a specified age (normally) on that person's death before reaching that age … The insurer invests the investment component of the premium and the insured becomes entitled not only to the sum insured, but also (if, as is usually the case, the policy is one "participating in profits") to a share in the net profits (declared in the form of "bonuses") of the investment.': see Kelly, D and Ball, St L. 2001 at paragraph 13.0030.

120 'Term insurance is insurance under which the sum insured is payable only on the death of the life insured during the term of the contract, which is usually of short duration.' See Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, paragraph 1.4.

121 Although a variety of rider benefits are available, providing benefits on total and permanent disablement, total and temporary disablement and additional rights to future insurance as well as waiver of premium, most rider benefits of any substance constituted a pre-payment of the policy sum insured, consistent with the 'bundled' nature of the contracts.

122 See submission by Investment & Financial Services Association Ltd dated 27 February 2004.

represented by term insurance including rider benefits, disability insurance and so on is 94 per cent.

7.15 In 1977 life insurance sales were dominated by sales of individual non-superannuation whole of life and endowment assurance products which equated to 80 per cent of the 458,000 policies sold in the year ending 30 June 1977.

7.16 The change in the type of product sold can be seen in the following table.[123]

Year ending 30 June	Whole of life and endowment	Term	Investment A/C and linked	Accident sickness and disability	Group life and credit life	Other
1972	95.3%	3.3%	_	1.4%	_	_
1974	92.6%	5.7%	_	0.2%	_	1.5%
1976	88.4%	9.0%	_	1.2%	_	1.4%
1977	80.0%	14.9%	_	3.7%	_	1.4%
1978	75.3%	19.0%	_	4.2%	_	1.5%
1982	40.7%	19.5%	23.2%	11.4%	4.2%	1.0%
Year						
1992	16.7%	19.6%	34.5%	23.7%	3.8%	1.7%
1994	8.4%	34.4%	16.8%	33.4%	4.6%	2.4%
1996	6.1%	36.4%	12.6%	36.6%	5.8%	2.4%

Concerns raised about section 29 of the IC Act

7.17 Some stakeholders have expressed the view that section 29 is no longer appropriate because of the changed nature of life insurance.[124]

7.18 Given the wider range of risks now underwritten by life insurers (such as trauma and income protection) and the fact that they are often in the same policy (that is bundled contracts), the range of remedies provided by section 29 is now said to be limited and, in some cases, inappropriate. For example, in relation to bundled contracts section 29 does not allow avoidance or correction of one cover without there being an effect on all the other covers.

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123 Table reproduced from the submission to this review by Investment & Financial Services Association Ltd dated 27 February 2004, referencing Life Insurance Commissioner, *1982 Annual Report* and Insurance and Superannuation Commission, *Quarterly Statistical Bulletin*, December 1997.

124 See, for example, submissions on the Issues Paper by MLC (undated supplementary submission); Australian Life Underwriting and Claims Association; Investment & Financial Services Association Limited dated 19 April 2004; and Phillips Fox dated 21 April 2004.

Comments received about subsection 29(3) of the IC Act

7.19 Subsection 29(3) of the IC Act provides 'if the insurer would not have been prepared to enter into a contract of life insurance with the insured on any terms if the duty of disclosure had been complied with or the misrepresentation had not been made, the insurer may, within 3 years after the contract was entered into, avoid the contract.'

7.20 The main concerns raised by stakeholders regarding subsection 29(3) of the IC Act centre around:

- the distinction between 'the contract' and 'a contract'; and
- the retention of the three year time period from section 84 of the *Life Insurance Act 1945* to subsection 29(3) of the IC Act.

7.21 In relation to the distinction between 'the contract' and 'a contract', IFSA state the problem as being that 'a life insurer's right to avoid the contract contained within section 29(3), is predicated on the fact that the insurer would not have been prepared to enter into "a contract" of life insurance with the insured on any terms.' The Queensland Court of Appeal in *Schaeffer v Royal & Sun Alliance Life Assurance Aust Ltd* recently held that 'for a right of avoidance under s29(3) to arise it must be shown that, on the insured's offer on the assumption that it had stated the true facts, the insurer would not have been prepared to enter into a contract on any terms; in other words, the insurer would have declined the risk.'[125]

7.22 This being so, IFSA and MLC both believe that subsection 29(3) 'effectively traps life insurers and "rewards" those insureds who fail to comply with their duty of disclosure or misstate material facts'.[126] This is because insurers will usually offer a contract of life insurance to a potential insured but it may be on modified terms. Therefore, subsection 29(3) will have limited effect. The Consumers' Federation of Australia have suggested that such a narrow interpretation of *Schaeffer's* case may not be correct as it renders the phrase 'on any terms' redundant. It states that:

> 'Whilst it is correct that section 29(3) uses the phrase "a contract" rather than "the contract" (as appears in section 29(2) and (4)), it also includes the phrase "on any terms". When read together, it appears that the effect of section 29(3) is that an insurer has a remedy if it would not have

125 *Schaeffer v Royal & Sun Alliance Life Assurance Aust Ltd* [2003] QCA 182; (2003) 12 ANZ Ins Cas 90-116 at [43] per Davies J.A. with whom McPherson J.A. and Cullinane J. concurred.

126 See submissions on the Issues Paper by MLC (undated submission on issues of importance to the life insurance industry at page 12) and Investment & Financial Services Association Limited dated 19 April 2004.

> offered the risk proposed on any terms and does not extend to any life insurance cover whatsoever. Unless the risk proposed for by the insured included an investment product or other life insurance products in a bundled contract, the insurer would not have to establish it would not have offered such other products to apply section 29(3) of the IC Act.'[127]

7.23 The second issue of concern raised by stakeholders about subsection 29(3) is the three year time period in which an insurer can avoid a contract. Life insurers say it is anachronistic and should be repealed. MLC state that:

> '… the rationale for the three-year rule is to protect consumers where the policy being avoided may have a surrender value. However, such policies are rare in today's market. The vast majority of policies impacted by section 29 do not have a surrender value.'[128]

7.24 Australian Life Underwriting and Claims Association (ALUCA) also believes that the three year time period is out of keeping with current practice. It states:

> 'This does not address current practice within the life insurance industry, or current medical knowledge. Not all illnesses result in death or disablement within 3 years, and in any case illnesses and medical conditions are not the only information relevant to the insurer's decision. Income, assets and other aspects of financial status are relevant to decisions on disability income (income protection) insurance where a monthly income replacement benefit is payable. Such information is also relevant for setting the limits for death, TPD and trauma cover.'[129]

7.25 IFSA also support the removal of the three year time period in section 29 but only for morbidity risks. It believes that the time period could be retained for all mortality risks whether underwritten in traditional products (that is, whole of life and endowment policies) or not.[130]

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127 See submission on the Proposals Paper by the Consumers' Federation of Australia dated June 2004.

128 See submission on the Issues Paper by MLC (undated submission on issues of importance to the life insurance industry at page 12).

129 ALUCA noted in its submission on the Issues Paper the reasoning behind the three year rule: 'appears to be that any relevant medical condition not disclosed is likely to result in death or disablement within three years, allowing the insurer to exercise its remedies. The three year limit may have been intended to prevent insurers from exercising remedies unfairly in respect of non-disclosure of old conditions that did not cause the death or sickness.'

130 See submission by Investment & Financial Services Association Limited dated 19 April 2004 at page 10.

7.26 However, the Consumers' Federation of Australia believes that the three year time period provides a reasonable outcome and that 'to simply repeal the three year time limit would upset the balance between the interests of insurers and insureds'.[131]

7.27 In relation to both these issues, the ALRC recommended that 'where a misrepresentation or breach of the duty of disclosure is disclosed within three years of the contract being entered into, the insurer should be entitled to reduce the amount payable under the contract of insurance in accordance with the principle of proportionality. An exemption should be made where the insurer would not have entered into the contract at all. In those cases, the only appropriate remedy is avoidance.'[132] Thus, the law as it currently stands is in keeping with the intention of the ALRC's report.

Comments received about subsection 29(4) of the IC Act

7.28 Subsection 29(4) provides that where an insurer has not avoided a contract of life insurance, it can, in certain circumstances vary the contract for the sum insured according to the formula provided.

7.29 The formula is said to be an inflexible remedy. For example, where an insured has an old knee injury and does not disclose this, the policy cannot be substituted under subsection 29(4); all that can occur under this subsection is that the amount of the sum insured can be varied.

Bundled contracts of insurance

7.30 As mentioned above, some stakeholders have suggested that there is an inability to obtain an appropriate remedy under section 29 of the IC Act where an insured has made a misrepresentation or failed its duty of disclosure obligations. Section 29 does not allow avoidance or correction of one cover without there being an effect on all the other covers. ALUCA suggests that 'it would be better for both insureds and insurers if specific provisions were made, in cases where the non-disclosure or misrepresentation affects one of the covers only and not just the others, to allow avoidance or correction of one cover, including adjustment of the premium if appropriate, without the other covers being affected'.[133]

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131 See submission on the Issues Paper by Consumers' Federation of Australia at page 27.
132 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 198.
133 See submission on the Issues Paper by Australian Life Underwriting and Claims Association at page 10.

Suggested possible solutions

7.31 Phillips Fox suggests that in relation to the three year period issue, 'a fairer balance would be achieved by introducing the concept of proportionality and removing the entitlement of the insurer to avoid a policy where non-fraudulent misrepresentation or non-disclosure has occurred. Instead, it should be provided for the insurer to be put into the position had such non-disclosure or misrepresentation not occurred, effectively adopting the remedy provided for in contracts of general insurance as per section 28(3)'.[134]

7.32 MLC and IFSA suggest the possible solution to the concerns about subsection 29(3) as follows:

- adopt a similar approach to section 28; or alternatively
- amend section 29 so that:
  - the three year rule is limited to policies that acquire a surrender value; and
  - more flexible remedies are made available that allow, where appropriate, insurers to:
    - : reduce the sum insured;
    - : vary a policy to include an exclusion and/or loading;
    - : sever parts of the contract (bundled contracts or multiple life insureds).

7.33 ALUCA submits that all issues concerning section 29 can be resolved if the remedies available to general insurers under section 28 were made available to life insurers. The exception to this would be the retention of the proportionality principle in subsection 29(4) (but not the three year time period) 'where the appropriate remedy is the reduction of the sum insured or monthly benefit.'

Conclusion

7.34 While section 29 of the IC Act is, in general, in keeping with the outcome suggested by the ALRC, the Review Panel acknowledge that in some situations its application is no longer in alignment with current practices. This can be seen by the different products sold by life insurance companies and the fact

134 See submission by Phillips Fox dated 21 April 2004.

that many policies provide different types of cover (for example, death cover, total and permanent disablement, trauma and income protection).

7.35 The Review Panel considers that for bundled contract of insurance, section 29 does not provide a fair outcome where an insured has either made a misrepresentation or breached its duty of disclosure obligations. The balancing of interests in this context is particularly difficult, but the Panel believes the concerns raised by stakeholders can be overcome by adopting the following approach.[135]

7.36 First, and as mentioned in Chapter 4 above, for the purposes of Part IV of the IC Act, life insurance contracts should be 'unbundled'. Thus, each cover will be treated as a separate policy for the purposes of Part IV of the IC Act.

7.37 Second, for the reasons discussed in paragraphs 7.21 and 7.22 above, the words 'a contract' in subsection 29(3) should be replaced by the words 'the contract'.

7.38 In relation to a 'contract' of life insurance, which includes parts of a contract of life insurance, that covers mortality or contains a surrender value, the law as it currently stands should continue to apply (subject to the proposal that subsection 29(3) be amended so that 'a contract' be replaced by the words 'the contract'). Importantly, for those contracts, the three year time period in which an insurer can avoid a contract should remain.

7.39 However, a 'contract' of life insurance, which includes parts of a contract of life insurance, that does *not* cover mortality or does *not* contain a surrender value, should be subject to an equivalent of section 28 of the IC Act, subject to any necessary modifications.[136] The result will be that for these contracts,

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135 *Cf* submission by the Consumers' Federation of Australia (CFA). It submits that 'the impetus for change to section 29(3) of the IC Act to unbundle life insurance contracts and to the wording of section 29(3) is based on the false premise that the remedies under section 29(3) are so narrow as to be ineffective.' See CFA's submission on the Proposals Paper, dated June 2004, at page 10.

136 MLC submits that this recommendation should be subject to the proportionality principle in subsection 29(4) being maintained within the reworked section 28 and the clarification of the phrase 'necessary modifications' (see MLC's submission on the Proposals Paper). The Review Panel believes these issues can be resolved during any implementation process. The Consumers' Federation of Australia submits that while the remedies for non-disclosure and misrepresentation of general insurance policies is relatively straight forward, the same cannot be said for life insurance. 'As such, decisions as to non-disclosure or misrepresentation by consumers of life insurance products are much more likely to be marginal and include subjective issues as to the knowledge and honesty of a life insured. To remove morbidity life insurance policies from the scope of section 29 of the IC Act, will significantly erode consumers' rights by removing the knowledge and honesty of an insured from the determination of an insurer's remedies for non-disclosure and

insurers may avoid the contract at any time in the event of fraud. Absent fraud, insurers may not avoid the contract; instead, the parties are put into the same position they would have been if the failure of disclosure had not occurred or the misleading representation not been made.

Recommendations

7.1 For the purposes of Part IV of the IC Act life insurance contracts should be 'unbundled'.

7.2 Subsection 29(3) should be amended so that the words 'a contract' are replaced by the words 'the contract'.

7.3 All 'contracts' of life insurance (including parts of a contract of life insurance) excepting those that cover mortality or contain a surrender value, should be subject to section 28 of the IC Act, subject to any necessary modifications.

Misstatement of age

7.40 Section 30 of the IC Act provides for the variation of the sum insured when there has been a failure to disclose the date of birth of one or more of the life insureds or where there has been a misrepresentation of age. It provides a formula to work out the amount of the variation.

7.41 The formula provides for interest at a prescribed rate of 11 per cent payable on overpayment of premium. Some suggest the prescribed rate should be the same as the prescribed rate for the purposes of section 57.[137]

7.42 The Review Panel believes that the interest rate prescribed for the purposes of section 30 should be the Treasury 10 year bond rate.

Recommendation

7.4 The interest rate prescribed for the purposes of section 30 should be the Treasury 10 year bond rate.

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misrepresentation in respect of many life insurance policies.' See submission by the Consumers' Federation of Australia dated June 2004.

137 See submissions on the Issues Paper by Australian Life Underwriting and Claims Association; Brendan Pentony dated 13 April 2004; MLC (undated supplementary submission); Phillips Fox dated 21 April 2004; *cf* submission by Investment & Financial Services Association Limited dated 19 April 2004.

7.43 IFSA believes that section 30 should be repealed. This is because '"new age products" do not necessarily allow the insurer the freedom to determine an outcome that is equitable to the insurer and insured … If it were to be retained, however, it should be limited to policies covering "mortality" risk as distinct from a morbidity risk'.

7.44 MLC have submitted that although section 30 is not deficient, it needs to be made relevant to today's insurance market.

> 'To accord with the intention of the section (that is, to place the parties in the position they would have been had the misstatement not occurred), MLC submits that section 30 be amended to allow insurers to change the expiration date of contracts where that date has been calculated with reference to the insured's (incorrectly stated) date of birth'.

7.45 The Review Panel believes on balance that no sufficient case has been made for changes to section 30, other than the change recommended by MLC.

Recommendation

7.5 Section 30 of the IC Act should be amended to allow insurers to change the expiration date of contracts where that date has been calculated with reference to the insured's (incorrectly stated) date of birth.

CANCELLATION OF A CONTRACT OF INSURANCE

7.46 Part VII of the IC Act relates to expiration, renewal and cancellation of insurance contracts.

7.47 Section 63 provides that an insurer is not able to cancel a contract of general insurance except in accordance with the provisions of the IC Act.

Cancellation of contracts of general insurance

7.48 Section 60 of the IC Act provides the circumstances in which an insurer can cancel a contract of general insurance:

- a breach of the duty of utmost good faith;
- a breach of the duty of disclosure;
- a misrepresentation;
- a breach of a provision of the contract; or

- a fraudulent claim under the contract, or under some other contract in effect at the same time.

7.49 The insurer can also cancel the contract by reason of an act or omission of the insured or some third party, if this is provided for in the contract, and the act or omission occurs after the contract has been entered into. The section refers to an act or omission of 'the insured or some other person'.

7.50 There is no section 60 equivalent for contracts of life insurance. Therefore, there is no provision in the IC Act that allows a life insurer to cancel a policy for any reason. Many life insurers have proceeded on the basis that they are entitled, under some circumstances, to cancel a contract under the common law.

7.51 It has been suggested that consideration should be given to extending section 60 to cover contracts of life insurance.[138] The Investment & Financial Services Association Ltd (IFSA) further suggested that:

> 'Due to the evolution of products since the ICA was originally drafted … it is IFSA's recommendation that the proposed amendments should only apply to morbidity benefits (that is, TPD, trauma and income protection) and not mortality benefits (that is, death cover) or bundled contracts (that is, whole of life or endowment policies)'.[139]

7.52 The question arises as to whether an amendment is warranted to give specific statutory rights of cancellation to life insurers, in line with those of general insurers.

7.53 There are two main concerns associated with extending the operation of section 60 of the IC Act, to all or even some life insurance products.

7.54 The Review Panel notes that section 210 of the *Life Insurance Act 1995* does not allow a forfeiture of the policy, for premium non-payment, in certain circumstances. If section 60 of the IC Act were amended to apply to life insurance, the Review Panel would be concerned about possible conflicts between paragraph 60(1)(d) and section 210 of the *Life Insurance Act 1995*. IFSA

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138 See submissions from the Investment & Financial Services Association Ltd dated 24 December 2003 at page 5 and dated 27 February 2004 at page 16; submission on the Issues Paper from Australian Life Underwriting and Claims Association (ALUCA) at page 12; and MLC dated 16 March 2004 and its supplementary submission on the Issues Paper at page 4.

139 Submission by the Investment & Financial Services Association Ltd dated 27 February 2004, at page 16.

suggested that this problem would not arise if the operation of section 60 was only extended in relation to morbidity benefits.[140]

7.55 However, it is also understood that life insurers can currently rely upon the common law and specific cancellation clauses in their policies to provide a similar outcome to that of section 60 of the IC Act. The Review Panel notes that the industry is concerned that these common law rights have yet to be tested by the High Court, however, the Review Panel questions the need to clarify in statute that which is already available to the life insurance industry.

7.56 On balance, the Review Panel is not convinced that section 60 of the IC Act requires amendment.

Cancellation procedure

7.57 Section 59 sets out the procedures to be followed by the insurer when exercising a right to cancel a contract of insurance. That is, the insurer must give notice in writing to the insured of the proposed cancellation. This does not apply where section 210 of the *Life Insurance Act 1995* applies.

7.58 The question arose as to whether the period of notice for cancellation should be amended.

7.59 Submissions on this issue ranged from suggesting that the current time frames were appropriate, to suggesting that timeframes were either too long or not long enough. In light of such disagreement, the Review Panel is not minded to suggest an amendment to the timeframes that were proposed by the ALRC.

140 See submission from the Investment & Financial Services Association Ltd dated 11 June 2004, at page 3.

CHAPTER 8: RESTRICTIONS ON INSURERS' CONTRACTUAL RIGHTS AND REMEDIES

8.1 Some provisions in the IC Act operate to curtail the rights and remedies insurers would otherwise have under contract. Issues have been raised about the provisions affecting the ability of insurers to:

- avoid a contract for fraud (section 31);
- exclude or limit liability due to another insurance contract (section 45);
- rely on exclusions regarding pre-existing defects, imperfections and pre-existing sickness or disability (sections 46 and 47); and
- terminate some renewable insurance contracts (section 58).

COURT'S ABILITY TO DISREGARD AVOIDANCE WHERE THERE HAS BEEN A 'LITTLE BIT OF FRAUD'

8.2 The ability of an insurer to avoid a contract of insurance for fraudulent misrepresentation by an insured or because there has been a fraudulent failure to comply with the duty of disclosure is subject to the court being able to order that the avoidance be disregarded in certain circumstances.[141] A court may disregard avoidance where it would be harsh and unfair not to do so and the insurer has not been prejudiced or any prejudice is minimal or insignificant.

8.3 There are long held views an insurer ought to be able to deny fraudulent claims. This was recognised by the ALRC when it said 'the Commission recommends that the insurer's right to refuse to pay claims on the basis of fraud should remain'. However, the ALRC went on to recommend that:

> '… in cases where the total loss of the insured's claim would be seriously disproportionate to the harm which the insured's conduct has or might have caused, a court should be entitled to order the insurer to pay to the insured an amount which is just and equitable in all the circumstances. In exercising its discretion, the court should have regard to all relevant factors, including the need to deter fraud.'[142]

This is the basis for section 31.

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141 Sections 31 and 56 of the IC Act.

142 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 243.

8.4 However, section 31 does not apply to innocent non-disclosure. In some situations an innocent breach of the disclosure obligations will entitle an insurer to reduce its liability to nil (through the operation of subsection 28(3)). This may occur, for example, if an insurer can establish that under its own underwriting guidelines it would not have written the risk at all had there been full disclosure.[143] Although some submissions suggested that this problem is illusory,[144] the Review Panel was informed in its meetings with the dispute resolution bodies, that there were cases where injustice had occurred.

8.5 The majority of submissions received following the release of the Issues Paper supported the retention of section 31.[145]

8.6 In relation to whether entities other then the courts should be able to apply section 31 of the IC Act (an issue which also arises with respect to section 56), views amongst the stakeholders differed. However, the Review Panel believes that the language of sections 31 and 56 should not be thought to exclude dispute resolution bodies from resolving disputes that are otherwise within their terms of reference; and applying the same principles as a court of law.

8.7 Dispute resolution bodies, such as the Insurance Enquiries and Complaints Limited, apparently sometimes already make decisions using sections 31 and 56.[146] This enables the community to obtain quick and inexpensive solutions to problems they may face in the insurance arena. Nevertheless, any argument that a dispute resolution body is not entitled to use section 31 (and section 56) of the IC Act should be removed.[147] Whether a dispute resolution body ultimately does apply sections 31 and 56 when making determinations, would depend upon its terms of reference. (The exception is

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143 *Lindsay v CIC Insurance Limited* (1989) 16 NSWLR 673; *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 193 CLR 603.

144 See submission by Phillips Fox dated 21 April 2004.

145 See submissions by the Law Council of Australia dated 27 April 2004; Insurance Council of Australia Limited dated April 2004; Australian Medical Association Limited dated 21 April 2004; Brendan Pentony dated 13 April 2004; Insurance Enquiries and Complaints Limited Panel dated March 2004; Phillips Fox dated 21 April 2004; Consumers' Federation of Australia; and the National Insurance Brokers Association; *cf* MLC's supplementary submission on the Issues Paper at page 5.

146 See for example, submission by Australian Associated Motor Insurers Limited dated 16 April 2004.

147 While support for this proposal received support from, amongst others, the Superannuation Complaints Tribunal and the Consumers' Federation of Australia (see their submissions on the Issues Paper dated 16 April 2004 and on the Proposals Paper dated June 2004 respectively) , it was not universal: see for example, the submission by MLC Limited (supplementary submission on the Issues Paper), the Insurance Council of Australia Limited dated June 2004, and the Investment & Financial Services Association Ltd dated 11 June 2004.

the Superannuation Complaints Tribunal, whose powers are statutory and whose statute may therefore need revision.)

8.8 Further, the Review Panel is of the view that section 31 of the IC Act should be expanded so that it applies where it is alleged there has been innocent non-disclosure or misrepresentation. Some submissions argued that this is not necessary because innocent non-disclosure or misrepresentation is already addressed by subsection 28(3) of the IC Act.[148] The Review Panel considers that although subsection 28(3) of the IC Act will achieve a just result in most cases, there may be cases where it does not.[149] We would only see section 31 being used by the courts or dispute resolution bodies, to disregard innocent non-disclosure or misrepresentation, in exceptional circumstances.

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148 'The purpose of section 31 is to ameliorate the effect of an insurer's avoidance for fraudulent non-disclosure or misrepresentation pursuant to section 28(3) where that remedy would be harsh and unjust. Innocent non-disclosure and misrepresentation is governed by section 28(3) of the Act. Avoidance is not an available remedy under section 28(3) – the insurer may only reduce its liability to pay a claim to the extent that it has been prejudiced. In those circumstances, there is no room for the operation of section 31.': submission by Phillips Fox dated 21 April 2004. See also submissions by the Insurance Council of Australia Limited dated April 2004; and Australian Associated Motor Insurers Limited dated 16 April 2004.
See also the submission from Catlin Underwriting Agencies Ltd, dated 9 June 2004, where it says subsection 28(3) 'is to apply in every case other than voidance. The remedy provided by s31 is not that it allows the insured what he would have received *if he had not committed the fraudulent misrepresentation*. It is to allow him what he would have received if he had not made the misrepresentation *fraudulently*. The proposal, (and indeed the discussion in the issues paper), appears to misunderstand this and in so doing overturns an essential principle of insurance.' The Review Panel believes that section 31 does overturn one of the common law principles of insurance law pertaining to fraud. The Explanatory Memorandum to the Insurance Contracts Bill 1984 (at page 50) states that the provision is required so that 'a just and equitable result between the parties [can be achieved] where avoidance of the insurance contract for fraud is out of proportion to the harm which the fraudulent conduct has caused.' And further the provision was in keeping with a number of Australian jurisdictions at that time that legislatively allowed 'courts to set aside a recision of a contract for misrepresentation in certain circumstances.' (Explanatory Memorandum at page 48).

149 Under subsection 28(3), it is possible to reduce the liability of an insurer to nil, or to a greatly reduced amount. An expanded section 31 would give the courts a power to override such a result. The Review Panel envisages this power would only be used in the unlikely event that subsection 28(3) produces an unjust outcome.

Recommendations

8.1 Sections 31 and 56 of the IC Act should be re-drafted so that they can be applied by alternative dispute resolution bodies.

8.2 Section 31 of the IC Act (including the limitation in subsection 31(2)) should be amended so it applies where it is alleged there has been innocent non-disclosure or misrepresentation.

EXPIRATION AND RENEWAL OF CONTRACTS

8.9 Section 58 of the IC Act provides that, prior to 'renewable insurance cover'[150] under a contract of general insurance expiring, an insurer is required to provide written notification to the insured stating when the cover is to expire and whether the insurer is prepared to negotiate to renew or extend the cover. If the insurer does not do this, and the insured has not obtained alternative insurance, the original cover is automatically extended until the insurer cancels the contract; a period equal to the original contract of insurance period expires; or the insured obtains alternative insurance.

8.10 Further, an insurer is not entitled to receive a premium for the statutorily extended period of cover, the exception being where the insured makes a claim. In such a situation the insurer is entitled to a pro-rata amount if the claim is 'not for the total loss of the property insured.'[151] If the claim is for the 'total loss of the property insured', the premium is an amount equal to the amount that would have been payable under the original contract of insurance.[152]

8.11 The reasoning for this was as follows:

> 'Where a contract is deemed to exist because the insurer has failed to comply with its obligations under sub-clause 58(2), it is inappropriate that it should be entitled to any premium. By the same token, it is inappropriate that the insured should be required to pay a premium for cover which he does not necessarily wish to continue in any event. However, should the insured choose to take advantage of the deemed

150 'Renewable insurance' is defined in subsection 58(1) of the IC Act to mean insurance cover that is either provided for a particular period of time or is of a kind that it is usual to renew.
151 Subsection 58(6) of the IC Act.
152 Subsection 58(5) of the IC Act.

> contract, then, in fairness to the insurer and other insureds, he should pay a premium for the period to the date of the claim.'[153]

8.12 One submission received stated that subsections 58(5) and (6) are unworkable. First, the meaning of 'total loss of the property insured' is uncertain. For example,

> 'Suppose the insurance was for a first loss of $1 million on property which was valued at $100 million, does the entire property have to be destroyed before subsection 5 will operate? Should it not rather be when the entire sum insured has been used up?'

8.13 It was also submitted that an insurer should be required to pay the full premium if there has been a loss. The Insurance Council of Australia Limited (ICA), however, considers that section 58 'as presently drafted strikes a fair balance between the interests of insurers and insureds in the premium. The ICA does not support the suggestion that section 58(6) should be repealed'.[154]

8.14 The Review Panel believes it is not equitable for an insured to pay only a pro-rata amount of the premium that was charged under the original contract of insurance where an insured makes a claim that is not for the total loss of the property insured during the extended period of the insurance policy. If the insured had renewed its contract of insurance with its insurer and later it made a claim, it does not receive any pro-rata refund at the end of the policy. And taken to its natural conclusion, if an insured makes no claim during the period of insurance, it does not receive at the end of the policy a refund of the premium paid. Accordingly, the Review Panel proposes that if a claim is made, the full premium is payable, irrespective of the size of the claim.

8.15 A concern raised by a stakeholder in the preliminary submissions prior to the release of the Issues Paper was that section 58 of the IC Act should be clarified so as to eliminate the possibility of perpetual renewal. Phillips Fox, however, doubts this, stating 'that this would be found to occur is unlikely'.[155]

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153 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984, Explanatory Memorandum at page 86. See also Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 264.

154 See submission by the Insurance Council of Australia Limited dated April 2004.

155 See submission by Phillips Fox dated 21 April 2004.
At paragraph 10.4.5 of its submission Phillips Fox states: 'This [i.e. subsection 58(3)] would tend to preclude a contract deemed to be in force from being considered "renewable insurance cover" for the purpose of subsection 58(1). There is no new cover under the section, rather the same cover is to apply for a further period. At the end of the further period the operation of section 58 would appear to be exhausted. Similarly, it is unlikely that parliament would have intended that a contract of insurance for a designated period would renew indefinitely until action by one of the parties. This would seem to surpass

8.16 The Review Panel agrees that the concern about perpetual renewal appears to be theoretical and therefore no change is needed.

8.17 Concern has also been raised about the clarity of the definition of 'renewable insurance cover,' under section 58.[156]

8.18 While the Review Panel notes these concerns, it does not propose suggesting a change to the existing definition of 'renewable insurance cover.' The Review Panel considers that attempts to clarify such a definition could lead to different ambiguities and problems.

8.19 Finally, the Hollard Insurance Company submitted that section 58 does not cater for monthly insurance policies (that is, policies that are renewable monthly as opposed to annual policies that are paid in monthly instalments).[157] This is because insurers must issue a notice of renewal at least 14 days prior to policy expiration and as such is not administratively practical for most monthly policies.

8.20 The Review Panel believes that the possible introduction of monthly insurance in the market place raises a number of other issues, for example, the duty of disclosure obligations and possible prudential requirements. All of these issues would need to be canvassed in more depth for monthly insurance policies to be viable. It is not merely a question of amending section 58 of the IC Act. The Review Panel does not consider there is sufficient demand to consider these issues as part of this review.

Recommendation

8.3 The IC Act should be amended so that if an insured makes a claim on an insurance policy extended by operation of section 58, it must pay a premium equal to the amount that was payable under the original contract of insurance, irrespective of the size of the claim.

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even the most generous interpretation of the intention of parliament to protect consumers from being unknowingly uninsured. Subsequently, an interpretation of the Act to provide perpetual renewal would be likely to be in conflict with the established principles of statutory interpretation – see Acts Interpretation Act 1901, section 15AA.'

156 Submission by the Insurance Council of Australia Limited (ICA), dated April 2004, at page 28.

157 See submission by The Hollard Insurance Company dated 19 April 2004.

LIMITING THE ABILITY TO EXCLUDE OR LIMIT LIABILITY BECAUSE OF ANOTHER CONTRACT OF INSURANCE

8.21 Under section 45 of the IC Act a provision in a contract of general insurance will generally be void if it limits or excludes the liability of the insurer because of some other contract of insurance. An exception is where the loss is covered by a contract of insurance that is specified in the first-mentioned contract.

8.22 Concern has been raised by stakeholders that the meaning of 'specified' in subsection 45(2) should be clarified because it is uncertain as to whether other insurance covers have to be precisely named.[158] The Law Council of Australia submits that the law needs to be clarified, 'in particular it is necessary to signify whether a reference in an excess of loss policy to the underlying insurance solely by reference to a class of insurance is sufficient to invoke section 45(2)'.[159]

8.23 The Review Panel considers a narrow view of subsection 45(2), as taken by Mason P in *HIH Casualty & General Insurance Ltd v Pluim Constructions Pty Ltd,*[160] is consistent with the policy intent.

8.24 Some submissions argued a wide approach to the subsection 45(2) exception is required because otherwise section 45 operates to discriminate against Australian insurers. The argument is that insurers not subject to the IC Act are able to include valid 'other insurance' clauses in their contracts, but Australian insurers cannot due to section 45 (unless they can fall within the subsection 45(2) exception).[161] The Review Panel considers that its proposal regarding clarifying the intended territorial application of the IC Act will address these concerns (see Chapter 1 above).

8.25 Accordingly, the Review Panel does not consider a change to section 45 is justified.

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158 See *HIH Casualty and General Insurance Ltd v Pluim Constructions Pty Ltd* [2000] NSWCA 281; (2000) 11 ANZ Ins Cas pp 61-477.

159 See submission by the Law Council of Australia dated 27 April 2004. See also submissions by Professional Indemnity Insurance Company Australia Pty Ltd dated 21 April 2004 and submission on the Issues Paper from Consumers' Federation of Australia; *cf* submissions on the Issues Paper from the Australian Medical Association of Australia Limited dated 21 April 2004, and National Insurance Brokers Association of Australia.

160 *HIH Casualty & General Insurance ltd v Pluim Constructions Pty Ltd* (2000) 11 ANZ Ins Cas 61-477 at paragraph 44.

161 See for example submissions by the Insurance Council of Australia Limited dated April 2004; Law Council of Australia dated 27 April 2004; Phillips Fox dated 21 April 2004; Australian Medical Association of Australia Limited dated 21 April 2004; and submission on the Issues Paper from Consumers' Federation of Australia.

PRE-EXISTING DEFECTS AND IMPERFECTIONS AND PRE-EXISTING SICKNESS OR DISABILITY

8.26 The IC Act provides that, in certain circumstances, where a person suffers loss that has occurred as a result of a pre-existing defect or imperfection or where an insured has a pre-existing illness or disability, the insurer cannot rely on the contract to limit or exclude their liability where the insured was not aware of, and a reasonable person could not be expected to have been aware of, that pre-existing state of affairs.

8.27 Section 46 of the IC Act provides that, where an insured makes a claim under a contract of insurance for the loss that has occurred as a result of a defect or imperfection of a thing, the insurer cannot rely on the contract to limit or exclude their liability in situations where the insured was not aware of, and a reasonable person could not be expected to have been aware of, the defect or imperfection. This protection for the insured does not, however, apply to classes of contracts specified in the regulations. These include construction risk contracts and certain contracts concerning the breakdown or malfunctioning of machinery.

8.28 Concern has been raised that section 46 is difficult to interpret, especially subsection 46(2). Subsection 46(2) provides, in part, that:

> '… the insurer may not rely on a provision included in the contract that has the effect of limiting or excluding the insurer's liability under the contract by way of reference to the condition, at a time before the contract was entered into, of the thing.'

8.29 Preliminary submissions received from stakeholders, prior to the release of the Issues Paper, suggested that section 46 should be redrafted to clearly articulate the policy intent. This view has received support from a number of stakeholders following the release of the Issues Paper. However, there is no consensus on what the intent should be.

8.30 In light of the divergence of views, the Review Panel does not propose any change to section 46 of the IC Act.

8.31 Section 47 of the IC Act provides that where a person takes out a contract of insurance and at the time of taking it out the insured was not aware of, and a reasonable person could not be expected to be aware of, the sickness or disability then the insurer may not rely on the a provision in the contract that limits or excludes its liability.

8.32 One concern about section 47 was that it does not contemplate the application of waiting periods before cover is provided for some trauma

conditions.[162] The Australian Life Underwriting and Claims Association (ALUCA) explained the mischief, saying:

> '… it is anomalous that a waiting period would exclude illness occurring after entry into the contract (but diagnosed during the waiting period) while section 47 would prevent the waiting period clause from operating to exclude conditions that arose prior to entry into the contract.'

8.33 The New South Wales Court of Appeal in *Asteron Life Limited v Zeiderman* recently held that subsection 47(2) of the IC Act mitigates 'the effect of certain contractual provisions where liability is sought to be avoided "by reference to" a sickness or disability to which the insured was subject at the time before the contract was entered into'. In that case it was held that the contract in question had 'the effect of limiting the relevant liability not by reference to (or because of or on the basis of) pre-contractual pathology but by reference to post contractual diagnosis irrespective of pre-contractual pathology, that is, irrespective of whether the insured was subject to the particular sickness or disability at a time before the parties entered into the contract'.[163]

8.34 In light of this judgment the concern raised about waiting periods appears now to be theoretical and the Review Panel believes that no change to the law is warranted.[164]

8.35 Further concern has been raised that the meaning of 'aware of' is uncertain. Does it mean the insured must be aware of the precise medical diagnosis or whether it is sufficient that the insured be aware of the existence of a sickness or disability likely to give rise to a claim on a policy? The Insurance Council of Australia Limited recommend that section 47 be amended to clarify that it will not protect the claimant who knew they were suffering symptoms of a sickness/disability at the time the contract was entered into when the claimant, or a reasonable person in the circumstances could foresee that the symptoms would lead to a claim on the policy for that sickness/disability'.

8.36 The Review Panel considers that the meaning of 'aware of' can be determined on a case by case basis and some flexibility in the law in this regard is desirable and that no amendment to the terms of section 47 is required.

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162 See submission on the Issues Paper by Australian Life Underwriting and Claims Association at page 11.

163 *Asteron Life Limited v Zeiderman* [2004] NSWCA 47 (5 March 2004) at [53] per Bergin J.

164 See submissions by Investment & Financial Services Association limited dated 19 April 2004; MLC's supplementary submission on the Issues Paper.

CHAPTER 9: INNOCENT CO-INSUREDS

9.1 Some stakeholders have expressed concerns about outcomes in cases where a party who has a joint insurance contract with a co-insured is denied a claim because of a wilful act or other breach by their co-insured.

9.2 At common law, a joint insurance policy means the co-insureds are indemnified in respect of a joint loss. Such a policy is different from a composite insurance policy, which is a single contract that embodies insurance in favour of more than one insured, whose interests are different. Under a composite contract each insured can have a separate and distinct claim. Whether a contract of insurance is joint or composite is not always obvious on its face. It is determined by reference to the intentions of the parties as ascertained from the policy terms and surrounding circumstances.[165] The IC Act does not distinguish between insureds under joint and composite policies.

9.3 In the case of spouses holding joint tenancy in a dwelling it is usual to be covered under a joint contract of insurance. There have been a number of cases involving wilful acts (for example, arson by one of the parties) which have led courts to consider whether such a policy is joint or composite. Under the 'traditional' approach to joint insurance of jointly owned property, the wrongdoing of one co-insured will preclude a claim by the other and no express wording in the policy to that effect is required for that to be the result. A rationale for such an approach is that all parties elected to treat the interests of the co-insureds as one under the contract, so it follows that an act or omission by one of them should affect both. To allow a claim in relation to jointly held property to succeed would allow the party in default to indirectly benefit.[166]

9.4 Some decisions in other jurisdictions have taken a different approach to the question of joint or composite insurance in such cases. For example, in *Maulder v National Insurance Co of New Zealand Ltd*,[167] a case involving a husband deliberately destroying a house by fire, the court noted that the 'traditional' approach which focused on the nature of the property interests at the time the insurance contract was entered into failed to take into account the reality of modern spousal relationships and the fact that they can alter rapidly. The court expressed the view that insurers should be taken to know that the

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165 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney at paragraph 3.147.

166 An example of a court applying the traditional approach is found in *MMI General Insurance v Baktoo* [2000] NSWCA 70.

167 [1993] 2 NZLR 351, discussed in Sutton, K. 1999 *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney at paragraph 3.151.

categorisation of property as 'joint' in the context of a spousal relationship is meaningless, and if the insurer wished to prevent an innocent party from recovering for loss due to breach by a co-insured, the policy would need to have clear language included to that effect. The court found that the insurance policy was a composite one and each insured had cover for their respective interests in the property. This type of approach to innocent co-insured cases has been coined a 'socially realistic' approach, as opposed to the traditional approach.[168]

9.5 The issue of an innocent co-insured being disadvantaged also arises in the context of misrepresentation or non-disclosure by a co-insured. In these situations, sections 21 and 28 of the IC Act are likely to come into play. In *Advance (N.S.W.) Insurance Agencies Pty. Limited v Matthews*[169] the High Court found that, where there is more than one insured party, the duty of disclosure under the section 21 of the IC Act extends to all of them, and similarly the references to 'the person who became the insured' in section 28 also means each of the co-insured. Accordingly, a fraudulent non-disclosure or misrepresentation by one of the co-insureds under section 28 will allow the insurer to avoid the contract, even though another co-insured had no knowledge of the breach. The court rejected the argument that adopting this construction would lead to injustice for the innocent co-insured. Rather, the court noted that it would be inherently unjust to allow a guilty party to compel performance by the insurer. The court also found that whether the contract is joint or composite is irrelevant in this context, noting that even in a composite contract, some obligations are joint.[170]

9.6 Circumstances involving innocent co-insureds raise some complex issues, including some involving social policy. However, for purposes including the scoping of further work, the Issues Paper included an invitation to comment on:

- whether the IC Act should expressly refer to joint and composite policies and, if so, whether contracts involving more than one insured should be required to nominate which form they take;
- whether there should be mandatory disclosure in respect of the risks of entering a contract with co-insureds; and
- any other measures that should be taken into account in relation to co-insureds.

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168 See *Holmes v GRE Insurance Ltd* [1988] Tas R 147.
169 (1989) 166 CLR 606.
170 (1989) 166 CLR 606 at 619.

9.7 A number of submissions were made on these issues. There was not significant comment on the notions of joint and composite insurance, except to note that where there is more than one person covered by life insurance, it is always a joint policy and for practical reasons would be likely to remain so. There was some support for mandating more disclosure about the risks associated with co-insurance but it was noted that further work would be required on what the form of the disclosure should take.

9.8 As to other suggestions, there was some support for a discretion on the part of the court (similar to the discretion where minor fraud is involved) to offer a means of providing justice in those cases. However, others opposed such a measure on the grounds that it is unrealistic to expect an insurance policy to deliver social justice. There was a view that it should be the policy, as negotiated with the insurer, that determines liability and to impose liability through legislation could have a significant impact on premiums in some policy classes because of the difficulty involved in adequately pricing the risk of a deliberate act on the part of one of the insured parties. The Review Panel notes that comparable arguments could be applicable in relation to the court's power to disregard avoidance under existing section 31.

9.9 Following the release of the Proposals Paper the Women's Legal Service Victoria suggested that:

> '… at a minimum, an overriding discretion on the part of the court to ensure justice is provided in cases where an innocent co-insured seeks to make a claim after deliberate act by the other insured. However, we wonder whether greater clarity could be achieved, by also introducing a legislative provision to the effect that, upon separation, joint insurance policies are deemed to be composite policies. In our view, this would need to be additional to the court's discretion, rather than in substitution for it, to ensure that insureds parties who had not yet separated or could not prove separation could also be protected where justice so dictated '.[171]

9.10 The Review Panel believes that there is merit in the suggestion of a court discretion to deal with cases of innocent co-insureds. However, it accepts the argument that to introduce such a discretion may affect the insurance risk and the cost and availability of insurance. To determine whether the effect would be significant, and whether the benefits would outweigh the costs, would ideally involve analysis of data concerning claims by innocent

171 See submission by the Women's Legal Service Victoria dated 16 June 2004.

co-insureds that are, or could be, denied on the grounds of some default on the part of a 'guilty' co-insured. No such data is currently available.[172]

9.11 The issue of innocent co-insureds raises complex interactions of legal, economic and social policy considerations. Denial of claims by innocent co-insureds will be a recurring source of criticism of insurers and the insurance industry generally unless it is demonstrated that no change to the current position is justified. Although it may take some time to compile sufficient relevant data for analysis, the Review Panel believes that it is in the interests of both insurers and insureds for this to occur. The Review Panel encourages industry peak bodies to assist in organising collection of the data to inform future review of this issue in a suitable forum.[173]

172 The Insurance Council of Australia Limited (ICA) advised that it is 'presently discussing with APRA the need for publication of underwriting data collected at a unit record level, that does not compromise the commercially sensitive nature of some such data.' See the ICA submission dated June 2004.

173 Both the Law Council of Australia and the Consumers' Federation of Australia suggested that the issue of innocent co-insureds should be referred to the Australian Law Reform Commission (see submissions on the Issues Paper).

CHAPTER 10: THIRD PARTY BENEFICIARIES

10.1 There are a number of issues regarding persons who are not party to an insurance contract, but are beneficiaries of the insurance cover provided in it (third party beneficiaries).

GENERAL ACCESS TO THE IC ACT

10.2 The Consumers' Federation of Australia believes that third party beneficiaries should have the same access to the IC Act as an insured, as well as access to dispute resolution bodies such as Insurance Enquiries & Complaints Limited.[174]

10.3 Others, however, submit that a third party should be able to access some but not all provisions of the IC Act. For example, Phillips Fox submitted that where an insurer has an obligation to inform an insured of some matter under sections 22, 35, 37, 39 and 44, for example, 'the insurer's obligations should be treated as discharged if the notice is given to the insured without it being given to any third party beneficiaries. On the other hand, where the IC Act requires the insured to give a notice, for example notice of facts that might give rise to a claim pursuant to section 40(3), it is submitted that third party beneficiaries should be treated as though they were insured for the purposes of sections 65, 66 and 67' (which deal with subrogation).[175]

10.4 Extending the IC Act to third party beneficiaries has received support, see for example, the High Court in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd;*[176] Mahoney JA in *C E Heath Casualty & General Insurance Ltd v Grey* in relation to the obligation of good faith;[177] and Bryson J in *Sayseng v Kellogg Superannuation P/L* where his Honour held that 'a person other than a contracting party to the policy may have standing to challenge the effectiveness of an opinion formed by an insurer'.[178]

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174 See submission on the Issues Paper by Consumers' Federation of Australia.
175 Submission on the Issues Paper from Phillips Fox dated 21 April 2004 at page 26.
176 (1988) 165 CLR 107, applied in *Tanevski v Trenwick International Limited* (2004) 13 ANZ Ins Cas 61-587.
177 *CE Heath Casualty & General Insurance ltd v Grey* (1993) 32 NSWLR 25.
178 *Sayseng v Kellogg Superannuation P/L* [2003] NSWSC 945 (13 November 2003) at paragraph 79.

10.5 The Review Panel agrees with the view that third party beneficiaries should have access to the IC Act to the following extent:

- the same rights and obligations as an insured for the purposes of subrogation;
- the duty of utmost good faith (but not pre-contractually);[179] and
- where the IC Act allows the insured to give notice, for example, pursuant to subsection 40(3) or section 74.

10.6 Further, third party beneficiaries should have recourse to dispute resolution bodies. It is not necessary for most purposes to amend the IC Act to achieve this. This is because it can be implemented by other means, for example, through a code.[180] The exception may be the possible need to amend the *Superannuation (Resolution of Complaints) Act 1993* so as to allow third parties access to the Superannuation Complaints Tribunal).

Recommendation

10.1 Third party beneficiaries should have access to the following provisions of the IC Act:

- the same rights and obligations as an insured for the purposes of subrogation;
- the duty of utmost good faith (but not pre-contractually); and
- where the IC Act allows the insured to give notice, for example, pursuant to subsection 40(3) or section 74.

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179 In its submission on the Proposals Paper, the National Insurance Brokers Association of Australia (NIBA) submitted that the duty of utmost good faith should be limited to the management of claims. It was concerned that the duty might be intended to cover pre-contractual matters, most especially non-disclosure. The Review Panel believes that in these circumstances the duty of utmost good faith should commence once the contract takes effect.
In relation to the question of whether section 13 of the IC Act should apply to third parties, many of the submissions on the Issues Paper answered it in the positive... NIBA considered that 'the application of section 13 to post contractual matters is already contemplated by s48 and could usefully be made explicit. It is impractical to seek to apply it to pre-contractual matters including, in particular, the duty of disclosure'. The Insurance Council of Australia stated that 'since there is no contract between the third party and the insurer, the duty of utmost good faith must be expressed as a statutory duty rather than an implied contractual duty' (see ICA submission on the Issues Paper at page 36).

180 For example the Insurance Council of Australia Limited state in their June 2004 submission that 'recourse to dispute resolution bodies is not provided by the IC Act. The dispute resolution scheme for insureds involves systems of internal dispute resolution and external dispute resolution (for example through Insurance Enquiries and Complaints Limited)'.

GENERAL INSURANCE AND THIRD PARTY BENEFICIARIES

10.7 Pursuant to section 48 of the IC Act, a person who is not a party to a contract of general insurance, but who is specified as being covered by the policy, has the right to recover from the insurer an amount for loss suffered. Subsection 48(2) provides, *inter alia*, that such a person has the same obligations to the insurer as if they were the insured,[181] and pursuant to subsection 48(3) 'the insurer has the same defences to an action under this section as the insurer would have in an action by the insured'.

10.8 There is a divergence of judicial interpretation as to the meaning of subsection 48(3) and this is causing concern for some stakeholders.[182]

> 'The competing views are that the words "the same defences" in the subsection mean (a) that the identical defences available against the assured can be used against the third party; or (b) that defences similar in kind to that which can be used against the assured are available against the third party, provided that they have arisen out of the conduct of the third party and not out of the conduct of the assured.'[183]

10.9 In other words, under one view the non-party claimants are not tainted by the actions of the insured while under the other view they are. It has been suggested that the obligations of third party beneficiaries need to be clarified.

10.10 Further, the courts have also distinguished between pre-contractual breaches and post contractual breaches in interpreting section 48. Giles J. in *Commonwealth Bank of Australia v Baltica General Insurance Co Limited* held that an insurer can rely on non-disclosure by the insured as a defence to a non-party's claim.[184]

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181 However, the duty of disclosure obligations under section 21 of the IC Act do not apply to third party beneficiaries as they are not a party to the contract, see *Carden v CE Heath Casualty and General Insurance Ltd* (1992) 32 NSWLR 25.

182 See for example, *VL Credits Pty Ltd v Switzerland General Insurance Co Ltd* [1990] VR 938; *CE Heath Casualty & General Insurance Limited v Grey* (1993) 32 NSWLR 25; *Commonwealth Bank of Australia v Baltica General Insurance Co Ltd* (1992) 28 NSWLR 579; *Barroora Pty Ltd v Provincial Insurance (Australia) Limited* (1992) 26 NSWLR 170; *General Motors Acceptance Corporation Australia v RACQ Insurance Ltd* (2003) 12 ANZ Ins Cas 61-574.

183 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, page 113. See also Fotheringham, Michael, 'The insurance contract — time for reform of section 48' (2000) 11 *Insurance Law Journal* 127.

184 (1992) 28 NSWLR 579.

10.11 The Explanatory Memorandum to the Insurance Contracts Bill 1984 does not resolve this point merely saying '… the insurer has the same defences as if that person were the insured.'[185]

10.12 Muir J in *General Motors Acceptance Corporation Australia v RACQ Insurance Limited* held that the right of a third party to recover under a contract of insurance is 'in accordance with the contract'.[186] This being so, Phillips Fox submits that:

> '… it is for the drafter of the insurance policy to make it clear in the policy what those rights are and in particular what is the position of the third party beneficiary when there has been a breach by the insured and what is the position of the third party beneficiary when there has been a breach by the third party beneficiary by himself or herself. Any clarification should reinforce this interpretation.
>
> We submit that there should be a provision that in the absence of a provision to the contrary there should be a presumption that a wilful act or breach by the insured shall prejudice the rights of an innocent third party beneficiary. This will emphasise the difference between being a co-insured and being a third party beneficiary.'[187]

10.13 The Review Panel considers that a third party should be in no better position than the insured. It would be odd if a third party could be in a better position than the insured when making a claim given that the insurer has contracted on the basis of the insured's disclosure and the terms of the insurance contract entered into with the insured. If the insurer has genuine grounds for relief for non-disclosure, for misrepresentation or a breach of the insurance contract, its rights should not be reduced because the claim under the policy is being made by a third party, unless there is specific recognition of this in the contract.

10.14 Another question raised in the Issues Paper was whether 'persons' referred to in section 48 should be limited to existing beneficiaries at the time the contract was entered into. Submissions received on this issue said that section 48 should not be limited as to do so would severely limit the ability of new third party beneficiaries to bring an action directly against an insurer. And there are few avenues open to such beneficiaries, for example under agency or trust law, or in limited cases under State legislation such as

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185 Australia, Parliament, 1984, House of Representatives, Insurance Contracts Bill 1984, Explanatory Memorandum at page 71.

186 *General Motors Acceptance Corporation Australia v RACQ Insurance Ltd* (2003) 12 ANZ Ins Cas 61-574 at [25].

187 See submission by Phillips Fox dated 21 April 2004.

section 55 of the *Property Law Act 1974* (Qld) (which is about contracts for the benefit of third parties).

10.15 Further, it was submitted that to limit section 48 to existing beneficiaries at the time the contract was entered into would 'undermine the efficacy of many forms of policy. For example, when contract work insurance is taken out either by a principal or by a head contractor, it is usually not known who the subcontractors will be. It is important that it be made clear at the outset that those will be entitled to the benefits of section 48'.[188] Further, this would cause hardship where the class was closed off.[189]

10.16 The Review Panel agree with these comments but also agree with the view that this issue can be resolved by ensuring that a contract of insurance is drawn sufficiently widely so that it is not limited to existing beneficiaries at the time the contract is entered into.[190]

Recommendation

10.2 Subsection 48(3) of the IC Act should be clarified so that it is clear that a third party beneficiary is in no better position than the actual insured, that is, insurers should be able to raise the conduct of the insured (whether pre or post contract) in defence to a claim brought by a third party beneficiary.

LIFE INSURANCE AND THIRD PARTY BENEFICIARIES

10.17 Section 48A of the IC Act is very similar to section 48 except that it applies to contracts of life insurance rather than contracts of general insurance and the wording used is a little different. However, there are differences, for example, section 48A is not as wide as section 48. This is because section 48A refers to third parties that are 'specified in the contract' whereas section 48 refers to persons who are 'not a party to the contract.'[191]

10.18 Under section 48A of the IC Act the third party has the right to any money that 'becomes payable.' Concern was raised in the preliminary submissions prior to the release of the Issues Paper that, if the insurer decides

188 See submission by Phillips Fox dated 21 April 2004.
189 See submission by Insurance Enquiries and Complaints Limited Panel dated 21 April 2004.
190 See submissions on the Issues Paper from the Insurance Council of Australia Limited dated April 2004, and from the National Insurance Brokers Association of Australia.
191 See submission by the Consumers' Federation of Australia dated June 2004.

not to pay a benefit, there is no statutory right available to the third party to recover the proceeds payable in accordance with the contract.[192]

10.19 Submissions received following the release of the Issues Paper have supported the view that third parties should have a right to proceed directly against the insurer and that it should not be the case that due to technicalities in the law the third party must obtain an order that the policy owner enforce the payment on their behalf.[193]

10.20 The late Professor Sutton believed that a beneficiary 'has a direct right of action against the insurer to enforce her or his entitlement under the contract, for the money is said to be payable even though the beneficiary is not a party to the contract, but there is no specific reference to this right of action as there was in the former s48(2)'.[194]

10.21 The Investment & Financial Services Association Limited (IFSA) further submits that section 48A of the IC Act should be expanded so that a life insured can be nominated as a third party beneficiary. This 'would be consistent with section 48 and give clients maximum flexibility to nominate third party beneficiaries without restriction of it having to be someone other than the life insured'.[195] Currently section 48A excludes the life insured from being a beneficiary. IFSA also argues that it would be preferable for the nominated beneficiary to be able to give a legally binding discharge on the payment of the policy proceeds. Thus, the life insurer would be entitled to pay the proceeds of a life policy to a beneficiary direct as it has become legally entitled to the benefit and can discharge the policy.

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192 This was said to be because the life insured must bring an action against the policy owner seeking an order that the policy owner enforces the payment of the policy proceeds on behalf of the insured. A life insured might then be deprived of access to external dispute resolution schemes on the basis that the dispute is not with the member of the scheme (that is, the insurer) but with the owner of the policy. In practice, however, it has been said that the real issue is with the insurer not the policy owner and it may be that the technicalities of the right to bring an action to enforce the contract directly against the insurer are not considered in any great depth: see preliminary submission by Banking and Financial Services Ombudsman Limited, dated 5 February 2004.

193 See submissions by Phillips Fox dated 21 April 2004; and the Law Council of Australia dated 27 April 2004.

194 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, page 125. Section 48A of the IC Act was added to the IC Act by the *Life Insurance (Consequential Amendment) Act 1995* (No 5 of 1995) replacing subsections 48(4) and (5) (whose operation was narrower). See also submission by Investment & Financial Services Association Limited, dated 19 April 2004.

195 See submission by Investment & Financial Services Association Limited dated 19 April 2004.

10.22 The Review Panel accepts these propositions and agrees that a third party who is entitled under a life insurance policy can bring such an action,[196] and that section 48A of the IC Act should be expanded so that the life insured can be nominated as a third party beneficiary and any third party beneficiary is able to provide a valid discharge to the insurer.

Recommendation

10.3 Section 48A of the IC Act should be amended so that:

- it is clear that a third party can bring an action against an insurer without the intervention of the policy owner;
- the life insured can be nominated as a third party beneficiary; and
- a third party beneficiary can provide a valid discharge to the insurer.

RIGHTS OF THIRD PARTY BENEFICIARIES TO RECOVER AGAINST AN INSURER

10.23 Under section 51 of the IC Act, a third party to a contract of insurance has the right to recover against an insurer where the insured has died or cannot, after reasonable enquiry, be found.

10.24 A number of submissions concerning different aspects of section 51 were received from stakeholders. In relation to where the insured has died or cannot be found, the following views were put.

- Section 51 should be expanded to give rights against an insurer under a claims made policy when the claim is made after the insured has died or cannot be found.[197]
- Section 51 'needs to be extended to cover the case where the insured is alive and can be found but where the third party cannot recover under execution of a judgment obtained against the insured, that is, when execution is

196 In its June 2004 submission on the Proposals Paper, the Consumers' Federation of Australia argued that section 48A of the IC Act should be amended so that it would extend to beneficiaries under policies like group life. Recommendation 10.3 could read: 'section 48A of the IC Act should be amended so that it a third party specified or referred to in the contract, whether by name or otherwise, can bring an action against an insurer without the intervention of the policy owner.'

197 See submission by Phillips Fox dated 21 April 2004.

returned with a nulla bona endorsement.[198] In support of that, the insured should be required by the statute to provide details of relevant policies held'.[199]

- Section 51 should be expanded so that it applies when a section 48 party is liable and cannot after reasonable inquiry be found. Currently, section 51 only refers to the right to recover against an insurer when it is the insured who is liable in damages to a third party. It does not give a remedy when the liability is that of a person entitled to the benefit of the policy by application of section 48 of the IC Act.[200]

- Section 51 does not need expanding so that its remedies are available to claimants in other situations. This is because section 51 'reflects similar provisions in the area of third party motor vehicle insurance legislation across the States and Territories. Payment by the insurer to the third party discharges its liability under the contract as well as the insured's liability to the third party.' And further, with the enactment of section 601AG of the of the *Corporations Act 2001* the rights of third parties has been sufficiently extended where the insured is a company.[201] Section 601AG provides that in certain circumstances a person may recover from the insurer of a company that is deregistered an amount that was payable to the company under the insurance contract.[202]

10.25 It has also been suggested that section 51 of the IC Act should expressly override section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) and its State and Territory equivalents.[203] Section 6 concerns insurance and provides for:

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198 A nulla bona endorsement literally means "no goods" and refers to the return made by the sheriff when he has not found any goods of a defendant in the jurisdiction from which a judgment could be satisfied.

199 See submission on the Issues Paper by The Hon Dr D. Derrington QC.

200 See submission by Phillips Fox dated 21 April 2004. relying on *Ripper v Gattenby* (2002) 10 Tas R 435; (2002) 12 ANZ Ins Cas 61-532. See also Sutton, K. 'Section 51 of the Insurance Contracts Act' (2002) 30 *Australia Business Law Review* 453.

201 See submission by the Insurance Council of Australia Limited dated April 2004.

202 It has also been argued that section 601AG of the *Corporations Act 2001* should be incorporated into section 51 of the IC Act. See for example, Drummond, S. 'Direct claims against liability insurers – section 601AG and ideas for further reform' (1999) 10 *Insurance Law Journal* 186. However, the Review Panel believes that this issue is beyond the scope of its terms of reference, it being a Corporations Act issue.

203 The object of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) is to, amongst other things, make certain provisions in relation to actions of tort and in relation to rights against third parties and to make certain provisions in relation to changes upon insurance moneys payable as indemnity for liability to pay damages or compensation. See Drummond, S.W. and P Mann, 'Abolish section 6' (1997) *Insurance Law Journal* 76.

- funds payable under indemnity policies to be subject to a statutory charge; and

- third party claimants to enforce the charge directly against insurers.

The section includes special provisions dealing with insolvent companies and there are carve outs for compulsory insurance schemes.

10.26 The Review Panel notes that rules in section 51 of the IC Act, section 46 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) and its State and Territory equivalents, sections 562 and 601AG of the *Corporations Act 2001* and section 117 of the *Bankruptcy Act 1966* all deal with similar issues in different contexts and they may, in some cases, overlap with each other.

10.27 The Review Panel considers the interaction of section 51 of the IC Act and the related provisions should be revised and any necessary amendments made to ensure consistent operation. Further, it should address situations in which:

- the insured under a liability policy is alive and can be found but where the third party cannot recover under execution of a judgment obtained against the insured, that is, when execution is returned with a nulla bona endorsement; and

- a section 48 party (that is, a person who is not the insured but is specified or referred to in the contract as being covered under section 48 of the IC Act) liable and cannot after reasonable inquiry be found.

10.28 The Review Panel does not propose that section 51 is expanded to give rights against an insurer under a claims made policy when the claim is made after the insured has died or cannot be found. This is because it already applies to liability insurance and thus claims made policies.

Recommendation

10.4 Section 51 of the IC Act should be revised to ensure its interaction with related provisions in other legislation results in consistent operation. The following situations should be addressed:

- the insured is alive and can be found but the third party cannot recover under execution of a judgment obtained against the insured, that is, when execution is returned with a nulla bona endorsement; and
- a section 48 party is liable and cannot after reasonable inquiry be found.

NON-DISCLOSURE OR MISREPRESENTATION BY MEMBERS OF GROUP SCHEMES

10.29 Section 32 of the IC Act extends the remedies available to an insurer under Division 3 of Part IV to situations where there has been a failure to comply with the duty of disclosure or where there has been a misrepresentation to an insurer under a blanket superannuation contract in respect of a proposed member of the relevant superannuation or retirement scheme.

10.30 Paragraph 32(b) is designed to overcome the difficulty that group contracts are usually entered into before the member joins them, so remedies that deal with non-disclosure and misrepresentation before the contract is entered into, such as subsection 29(1), would not operate in the usual way. Paragraph 32(b) addresses that problem by providing that the disclosure and misrepresentation provisions in such cases operate as if the contract had been entered into when the member joins the scheme.

10.31 Comment has been made that it is unclear how section 32 applies to non-disclosure and misrepresentation that occurs after the person has joined the superannuation scheme but before cover is effected on their life. It has been suggested that the operation of paragraph 32(b), which deems the insurance contract to come into effect when the member joins the scheme, might have the outcome that no disclosure or misrepresentation made after joining the scheme could be relied upon because the remedies under subsection 29(1) only apply to statements made 'before the contract is entered into'. It has been suggested that the remedies for non-disclosure and misrepresentation should be available regardless of whether a person is a member of the scheme when they apply for the cover. In submissions on the Issues Paper there was some support, and no opposition, in relation to this proposal.

10.32 It has also been suggested that section 32 should be extended to encompass non-superannuation group scheme arrangements, such as employer and industry schemes. A number of submissions noted there has been a growth in the Australian market of non-superannuation group scheme products which had not been in contemplation when the IC Act was devised. Most stakeholders submitted that there does not appear to be a logical reason to treat non-superannuation group schemes differently from superannuation group schemes in this respect.

Recommendations

10.5 Section 32 of the IC Act should be amended so that it is clear that remedies for non-disclosure and misrepresentation remain available in relation to a misrepresentation or non-disclosure that occurs between the time an insured becomes a member of the scheme and applies for cover.

10.6 Section 32 of the IC Act should apply to non-superannuation group life schemes.

CHAPTER 11: MISCELLANEOUS ISSUES

11.1 Miscellaneous issues that have been raised include how the IC Act operates in relation to:

- interim cover and contracts of life insurance;
- subrogation; and
- underwriting decisions based on genetic information, including family medical history.

INTERIM COVER AND CONTRACTS OF LIFE INSURANCE

11.2 Section 38 of the IC Act is concerned with interim contracts of insurance. Subsection 38(1) prevents an insurer making cover under an interim insurance contract dependent upon later completion of a satisfactory proposal.

11.3 Subsection 38(2) deals with the expiry of interim contracts. An interim contract of insurance does not expire until the earliest of the following times:

- the time when insurance cover commences under another contract of insurance, being insurance cover that is intended to replace the insurance cover provided by the interim cover;
- the time when the interim contract is cancelled; or
- the time the insured withdraws the proposal.[204]

11.4 If the time taken to finalise a contract of insurance is greater than the length of time prescribed in the interim cover, the interim cover continues until one of the abovementioned conditions is satisfied. Section 38 of the IC Act therefore provides the insured with cover that extends beyond the date mentioned in the cover note.

11.5 In relation to general insurance, the only method of avoiding the risk of a claim under this extended statutory cover is to cancel the contract in accordance with section 59 of the IC Act.

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204 Subsection 38(2) of the IC Act.

11.6 In its report on insurance contracts, the ALRC rejected an argument that there should be an immediate right to cancel an interim contract of insurance in some circumstances, for example, fraud.[205] Indeed it recommended that:

> 'Where an insured has lodged a proposal form for insurance, any interim cover taken out in respect of that insurance should remain in effect until either cover commences under another contract of insurance which is intended to replace the interim contract or the insurer cancels the contract of insurance, whichever is the earlier.' [206]

11.7 Phillips Fox submitted that the law should be amended so that interim cover expires on the date mentioned in the interim cover note itself. This is because a cancellation 'is in effect a black mark against a person which must be disclosed when applying to another insurer. This seems inappropriate when the cancellation is of an interim contract'.[207]

11.8 Further, the Investment & Financial Services Association Ltd suggested that, due to the nature of life insurance, life insurers should not be required to comply with the cancellation provisions in order to no longer be liable on an interim contract of insurance.

> 'While it might be reasonable to require the insurer to confirm that interim cover has ceased, it is unreasonable and inappropriate to require the insurer to provide the 20 business days notice specified in section 59 of the Act. Such a notice period performs no substantive purpose, given the objective of the interim cover (to provide limited cover while an application is being underwritten) and belies the short term nature of the cover in any event. It is also a consequence outside the concern which the

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205 The Insurance Council of Australia submitted to the ALRC that, *inter alia*, where for example, arson had been committed by the insured 'it would be intolerable in these circumstances to suggest that the insurer should remain on risk for say another seven days after notifying the client that the proposal is unacceptable'. The ALRC rejected this argument because 'it is important to ensure that rules designed or used to protect insurers from liabilities arising from fraud do not provide them with powers which may also be used against insured in cases where no question of fraud arises. An insurer which suspects arson should be required to prove it in a court of law. It should not be entitled, on suspicion of arson, to cancel without notice to the insured. It has other means of protecting itself against such a risk during a prescribed period of notice, including contact with the police': Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 209.

206 ALRC 20, paragraph 209.

207 See submission by Phillips Fox dated 21 April 2004.

> Australian Law Reform Commission originally sought to address when proposing the introduction of section 38.'[208]

11.9 Neither the ALRC's recommended draft provision dealing with this issue, nor section 38 of the IC Act, differentiated between interim contracts of general insurance and interim contracts of life insurance. The Explanatory Memorandum to the Insurance Contracts Bill 1984 stated that the inclusion of expiration provisions in subsection 38(2) was to provide an equitable outcome for both the insurer and the insured:

> 'A cover note is invariably in force for a limited time. Where the insured has lodged a proposal form with the insurer but the insurer has not considered it at the time the cover note expires, the insured is left without protection. Usually the cover note provides that the insurer may cancel upon giving notice to the insured and, should it do so after rejecting the proposal, the insured is again left without protection and no opportunity to arrange alternative cover. A more equitable balance of the insurer's and insured's rights will be achieved by clause 38.'[209]

11.10 Given the reasoning behind section 38 of the IC Act as provided by the Explanatory Memorandum and ALRC Report 20, the Review Panel considers that no change should be made to the expiration requirements of interim contract of insurance that are found in subsection 38(2) of the IC Act.

11.11 Another issue raised in the Issues Paper is whether there should be an amendment to section 9A of the *Life Insurance Act 1995* to bring interim covers for continuous disability policies within that definition.

11.12 Currently, for interim covers for continuous disability policies to be considered life insurance, permission must be sought from APRA. This is because interim covers for continuous disability policies are not life policies within the meaning of section 9 of the *Life Insurance Act 1995* (as they do not fall within the definition of a continuous disability policy in section 9A of that Act (generally because they are of less than three years' duration)).

11.13 While a number of submissions have been received about this issue, the Review Panel have been advised that the question of the need for an amendment to the *Life Insurance Act 1995* has been referred for inclusion in a review of that Act. While a case had been advanced for this amendment, in the

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208 See submission to this review by Investment & Financial Services Association Ltd dated 19 April 2004.

209 Australia, Parliament 1984, House of Representatives, Insurance Contracts Bill 1984, Explanatory Memorandum, at page 58.

short-term, the difficulties related to the operation of the section are able to be overcome by administrative means.

SUBROGATION

11.14 In the case of indemnity insurance, unless excluded by the terms of the policy, there is a right for an insurer to act in the insured's name in relation to any rights the insured has against third parties in respect of a loss. For example, if an insurer pays out a claim for accident damage under a motor vehicle insurance policy, the insurer will be permitted to seek, in the name of the insured, damages from third parties who contributed to causing the accident.

Application of recovered monies

11.15 In a case of subrogation, the insurer acts in the name of the insured to recover loss from a third party. When this occurs, the question arises: who should receive the benefit of the proceeds of the claim — the insurer or the insured? A key aspect of the doctrine of subrogation in the context of indemnity insurance is that the insured party should not make a profit from the loss and should account to the insurer for any profit that is made.[210]

11.16 Section 67 of the IC Act deals with the application of funds recovered through subrogation. It provides that (subject to a contrary provision in the contract)[211] where an insurer recovers monies through subrogation, the insured is entitled to an amount that cannot, when added to the amount paid by the insurer in relation to the loss, exceed the amount of the loss.[212] For example, if there is a loss of $10,000 and the insurer has paid the insured $5,000 under the policy, then if the insurer later recovers $8,000 from a third party, the insured is only entitled to a maximum of $5,000 from the recovered funds. This outcome leaves the insured fully compensated, with the insurer bearing a loss of $2,000.

11.17 Under the draft Insurance Contracts Bill prepared by the ALRC (upon which the IC Act was based),[213] the rule about the insured never recovering more than their loss was the only rule regarding the maximum recovery by an

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210 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney, paragraph 16.1.

211 The issue of the extent to which a contract can vary the provision is discussed further below.

212 Paragraph 67(2)(a) of the IC Act.

213 Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra at page 273.

insured from recovered monies. However, in the Insurance Contracts Bill as introduced, a further rule was included to the effect that the insured cannot recover more than the difference between the amount recovered and the amount paid by the insurer in respect of the loss. So, in a case where the loss is $10,000, the insurer has paid $5,000 (perhaps because of a cap on the liability included in the policy) and later recovers $8,000 from a third party, the insured would only be allowed to recover $3,000 from the recovered funds. This outcome leaves the insurer in a 'break even' position (ignoring the costs of the action) and the insured bearing a loss of $2,000. The rationale for the additional rule (appearing as paragraph 67(2)(a)) was not explained in the Explanatory Memorandum to the Bill.

11.18 Under one interpretation of subsection 67(2) of the IC Act, the rules apply so the most the insured can recover is the lesser of what is allowed for in paragraphs 67(2)(a) and 67(2)(b).[214] However, under a contrary interpretation, the insured will be entitled to the greater of what the two rules allow.

11.19 Whichever interpretation is correct, the rules are subject to any contrary agreement made by the parties after the loss has occurred (subsection 67(3)) and, under subsection 67(4), costs incurred in recovering the monies are to be deducted from monies recovered before remitting any proceeds to the insured.

11.20 It has been suggested that the additional rule (in paragraph 67(2)(a)) should be removed. This would mean that monies recovered under subrogation are applied first toward any uninsured 'top layer', consistent with the common law principle that where insurance is arranged in layers, losses should be borne from the 'ground up' and recoveries applied from the 'top down'. Insurers would still be able to recoup costs of running the subrogated action under subsection 67(4), so no unfairness to insurers would result.

11.21 A contrary suggestion is that, rather than removing the rule in paragraph 67(2)(a), the section should be redrafted to make it very clear that the insured is only entitled to the lesser of the amounts determined under paragraphs 67(2)(a) and (b). On this view, the rule in paragraph 67(2)(a) is necessary to provide an incentive for insurers to pursue actions under subrogation. In some cases the absence of the rule would mean the insurer would only recover their costs under section 67(4), with all benefits of the recovery flowing to the insured. If insurers do not have sufficient incentive to pursue subrogated actions the costs of insurance are likely to increase — the beneficiaries of the change being the unpursued third parties.

11.22 Three further criticisms of section 67 of the IC Act have been raised.

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214 Sutton, K. 1999, *Insurance Law in Australia*, 3rd edn, LBC Information Services, Sydney at paragraph 16.63.

11.23 First, there is uncertainty about the extent to which it is possible to make binding agreements in the insurance contract about how funds recovered by subrogation are to be divided as between the insurer and the insured. Subsection 67(2) clearly contemplates that the insurance contract might place higher limits on the amount an insured might recover. However, when read together with subsection 67(3)[215] there is, arguably, an implication that any agreement (whether in the insurance contract or otherwise) that would result in an insured's entitlement being less than the amounts set out in section 67(3) is of no effect unless it is made after the loss occurred. This interpretation could be justified on the basis that subsection 67(2) is supposed to protect insureds from 'signing away' their rights to subrogation proceeds under the provision before they are conscious of what is at stake. An alternative interpretation is that subsection 67(2) merely provides 'default rules', which are subject to contrary provision in the insurance contract. On that view, section 67(2) permits any kind of arrangement regarding distribution of recovered monies to be included in the insurance contract, but that agreement and the rules in subsection 67(1) and (2) may be varied by a subsequent agreement made after the loss occurred.

11.24 Second, it does not provide for any interest component to be added to the maximum amount that can be recovered. Since recovery can sometimes take many years, the maximum that insureds should be entitled to recover should include interest for that period, as well as the original loss.

11.25 Finally, section 67 is drafted on the assumption that recovered funds are paid to the insurer when, in practice, they are usually payable to the insured as creditor and only directed to the insurer at the insured's direction. It has been suggested that the section should be redrafted so that it does not assume the monies are recovered by the insurer. However, in a case where monies recovered under subrogation are received by an insured, the insurer might be expected to extract its share of the proceeds pursuant to the terms of the policy or a subsequent agreement under subsection 67(3) of the IC Act.

11.26 The Issues Paper contained an invitation to comment on the operation of section 67. In particular, comments were sought on:

- whether the rule in paragraph 67(2)(a) of the IC Act should be removed, or whether it should made clear that the it is the lesser amount of the two rules in paragraphs 67(2)(a) and (b) to which an insured is entitled;

- whether pre-loss agreements regarding application of monies recovered by subrogation that provide lesser rights to the insured that those in

215 Subsection 67(3) provides that the rules in subsection 67(1) and 67(2) may be overridden by agreement made after the loss occurred.

subsection 67(2) be permitted and, if so, whether section 67 should be redrafted to clarify that is the outcome;

- whether section 67 should provide for insureds to receive amounts representing interest out of monies recovered by subrogation; and

- whether section 67 of the IC Act should be redrafted to remove the assumption that monies recovered under subrogation are always recovered by insurers (as opposed to insureds).

11.27 One submission suggested that subrogation should be determined exclusively by agreement between the parties, and section 67 was unnecessary. However, the balance of the opinions in submissions was generally in favour of more clarity in the operation of section 67.

11.28 In its submission, the Australian Law Reform Commission (ALRC) drew attention to the sections of its report into the *Marine Insurance Act 1909* dealing with subrogation. The ALRC set out the following statements of principle that should apply in relation to the order or priority in which the recovered money should be distributed, subject to any agreement between the parties in the contract.[216]

- 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 should be reimbursed, or share the reimbursement pro rata if there is insufficient recovered money to reimburse both in full.

- Second, there are three possibilities 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 insurance contract. The insured is then entitled to any further amount that may be required so that it ultimately recovers from the insurer under the insurance contract 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 promptly under the policy in accordance with its terms and the insurer's obligation to pay promptly, subject to any contrary agreement between the parties.

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216 Australian Law Reform Commission 2001, *Review of the Marine Insurance Act 1909,* ALRC 91, Australian Law Reform Commission, Sydney, paragraph [12.17].

(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.

(c) If the action is funded jointly by both insurer and insured, they are entitled to the same amounts as those referred to in (a) and (b) above, pro rata if there are insufficient funds to reimburse them in full.

- Third, any excess or windfall recovery is then distributed to both parties in the same proportions as they contributed to the administrative and legal costs of the recovery action. Thus the party (or parties) shouldering the cost and risk of the recovery action for the benefit of all concerned receives 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 as the insured would have been entitled to these losses as damages from the third party as a matter of principle, whether or not there was any insurance in place.

- Finally, any separate or identifiable component in respect of interest should be paid to the parties in such proportions as fairly reflects the amounts that they have each recovered and the periods of time for which they have each lost the use of their money.

11.29 The Review Panel considers that the approach recommended by the ALRC would provide suitable solutions to the criticisms and queries about the operation of section 67 of the IC Act raised in the Issues Paper. The Review Panel agrees with the ALRC's comment that there seems to be no reason in principle why there should be divergence between the IC Act and the *Marine Insurance Act 1909* in relation to subrogation rights.[217]

11.30 Accordingly, the Review Panel recommends that section 67 of the IC Act be amended in line with the ALRC's equivalent recommendation regarding the *Marine Insurance Act 1909*.[218]

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217 ALRC 91, paragraph [12.17].

218 ALRC 91, recommendation 32. *Cf* Submission by the Insurance Council of Australia Limited (ICA), dated June 2004. In its submission the ICA state that 'The key proposal to change the MI Act, now proposed by the Review Panel, was that the distribution of moneys should be determined by reference to who funded to recovery. ICA believes that this is not a proper and principled basis for revisiting the subrogation provisions. Such a basis for distribution doers not take into account of many complexities of subrogation (none of

Recommendation

11.1 Section 67 of the IC Act should be brought into harmony, in due course, with the outcome of the review of the *Marine Insurance Act 1909* on the same subject.

Subrogation and third party beneficiaries

11.31 Subsection 48(2) of the IC Act provides that persons not party to the insurance contract but to whom the insurance under an insurance contract extends have, in relation to a claim by such persons, the same obligations to the insurer as they would have if they were an insured.[219]

11.32 It has been suggested that the provisions regarding subrogation in Part VIII of the IC Act should also apply to claims made by third party beneficiaries who are not 'insured' for the purposes of those sections.

11.33 The Issues Paper contained an invitation to comment on whether the subrogation rules should apply to claims relating to third party beneficiaries and, if so, whether any legislative changes are required, having regard to the terms of subsection 48(2). That subsection provides that third party beneficiaries with claims against insurers have the same obligations to the insurer that the insured would have had, and may discharge those obligations in relation to the loss.

11.34 No submissions opposed the proposal that the subrogation provisions should apply to third party beneficiaries and one submission supported a legislative clarification to ensure this was the case because subsection 48(2) may not already achieve this result.

Recommendations

11.2 The IC Act should be amended to clarify that the provisions regarding subrogation in Part VIII apply to claims made by third party beneficiaries who are not 'insured' for the purposes of those provisions.

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which appear to have been discussed by the ALRC) including the basis on which any over-recovery is made and there may be doubt as to whether or not there is an over-recovery or not because of the difficulties associated with determining the full quantum of the loss.'

219 Paragraph 48(2)(a) of the IC Act.

REASONS FOR UNFAVOURABLE UNDERWRITING DECISIONS — PROTECTION OF HUMAN GENETIC INFORMATION

11.35 Section 75 of the IC Act imposes a duty on insurers, upon request of a person who has been denied insurance, written reasons for the adverse decision.

11.36 A joint report by the Australian Law Reform Commission and the Australian Health Ethics Committee of the National Health and Medical Research Council recommended an amendment to section 75 to 'clarify the nature of the obligation of an insurer to provide written reasons for an unfavourable underwriting decision upon the request of an applicant. Where such a decision is based on genetic information, including family medical history, the insurer should be required to give reasons that are clear and meaningful and that explain the actuarial, statistical or other basis for the decision'.[220]

11.37 The Review Panel notes that the Government's response to this recommendation is being progressed separately to this review.

220 Australian Law Reform Commission 2003, *Essentially Yours: Protection of Human Genetic Information in Australia,* ALRC 96, Australian Law Reform Commission, Sydney, recommendation 27-5.

ABBREVIATIONS

ALRC	Australian Law Reform Commission
ALUCA	Australian Life Underwriting and Claims Association
AAMI	Australian Associated Motor Insurers Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Corporations Act	*Corporations Act 2001*
DOFIs	direct offshore foreign insurers
DMFs	discretionary mutual funds
FSRA	*Financial Services Reform Act 2001*
ICA	Insurance Council of Australia Limited
IC Act	*Insurance Contracts Act 1984*
IFSA	Investment & Financial Services Association Ltd
MLC	MLC Limited
NIBA	National Insurance Brokers Association of Australia
PDS	product disclosure statements
RSA	retirement savings account

SUBMISSIONS

Australian Associated Motor Insurers Limited

Australian Law Reform Commission

Australian Life Underwriting and Claims Association

Australian Medical Association Limited

Australian Securities & Investments Commission (confidential)

Banking and Financial Services Ombudsman Limited

Catlin Underwriting Agencies Limited

Consumers' Federation of Australia

Derrington QC, The Hon Dr Desmond

Drummond, Mr Stanley

Financial Industry Complaints Service - Panel

FM Global, FM Insurance Company Ltd

Hollard Insurance Company

Insurance Enquiries and Complaints Limited – Panel

Insurance Council of Australia Limited

Investment & Financial Services Association Ltd

Law Council of Australia Limited

Legal Aid Commission of New South Wales

London underwriters

MLC Limited

Motor Trades Association of Australia

National Insurance Brokers Association of Australia

Pentony, Mr Brendan

Phillips Fox

Professional Indemnity Insurance Company Australia Pty Ltd

RACQ Insurance Limited (confidential)

Radford, Mr Mark

Reinhardt, Mr Greg

Superannuation Complaints Tribunal

Vero Insurance Limited

Women's Legal Service Victoria

Copies of written submissions are available at the Review website, http://icareview.treasury.gov.au.

MEETINGS WITH STAKEHOLDERS

Date and Place	Organisation / Attendee
Tuesday 3 February 2004 (Melbourne)	Financial Industry Complaints Service Banking and Financial Services Ombudsman Insurance Enquiries and Complaints Limited – Panel Superannuation Complaints Tribunal
Tuesday 3 February 2004 (Melbourne)	Consumers' Federation of Australia
Wednesday 4 February 2004 (Sydney)	Insurance Council of Australia Limited
Wednesday 4 February 2004 (Sydney)	Australian Life Underwriting & Claims Association Insurance Council of Australia Limited Investment & Financial Services Association Ltd
Wednesday 4 February 2004 (Sydney)	Australian Competition & Consumer Commission Australian Prudential Regulation Authority Australian Securities and Investments Commission
Wednesday 4 February 2004 (Sydney)	Legal Aid Commission of New South Wales Australian Consumers Association
Monday 23 February 2004 (Sydney)	Law Council of Australia Limited

Date and Place	**Organisation / Attendee**
Monday 23 February 2004 (Sydney)	Phillips Fox
Wednesday 25 February 2004 (Sydney)	Australian Life Underwriting and Claims Association Investment & Financial Services Association Ltd
Wednesday 25 February 2004 (Sydney)	Insurance Council of Australia Limited
Tuesday 23 March 2004 (Melbourne)	Australian Associated Motor Insurers Limited
Monday 29 March 2004 (Canberra)	Mr Brendan Pentony
Monday 29 March 2004 (Canberra)	Law Council of Australia Limited
Wednesday 31 March 2004 (Melbourne)	Financial Industry Complaints Service Insurance Enquiries and Complaints Limited – Panel Superannuation Complaints Tribunal
Wednesday 31 March 2004 (Melbourne)	Consumers' Federation of Australia
Thursday 1 April 2004 (Sydney)	Insurance Council of Australia Limited
Friday 2 April 2004 (Sydney)	Australian Life Underwriting and Claims Association Investment & Financial Services Association Ltd

Date and Place	**Organisation / Attendee**
Tuesday 6 April 2004 (Sydney)	Australian Competition & Consumer Commission Australian Prudential Regulation Authority Australian Securities and Investments Commission
Tuesday 6 April 2004 (Sydney)	National Insurance Brokers Association of Australia
Wednesday 7 April 2004 (Brisbane)	Consumers' Federation of Australia
Wednesday 3 June 2004 (Sydney)	Australian Underwriting and Claims Association Investment & Financial Services Association Ltd
Wednesday 3 June 2004 (Sydney)	National Insurance Brokers Association of Australia
Wednesday 3 June 2004 (Sydney)	Law Council of Australia Limited
Thursday 10 June 2004 (telephone hook-up)	Consumers' Federation of Australia
Tuesday 15 June 2004 (Sydney)	Insurance Council of Australia Limited