NATIONAL INSURANCE BROKERS ASSOCIATION

RESPONSE RE SECTION 54

No need for proposed section 54A

Before considering the proposed amendments, NIBA notes the following matters:

(a) section 54 of the *Insurance Contracts Act* has been part of the insurance landscape in Australia for 20 years. Over that extended period general market conditions have varied widely, from extreme over supply of capacity with softening rates to under capacity with hardening rates. Capacity from overseas markets has always been a feature of the domestic market, depending upon the state of the global market cycle.

(b) section 54 by and large operates to strike a fair balance between insurer and insured, by essentially only allowing an insurer recourse where prejudice is suffered: in other words, the insurer remains protected if it suffers prejudice.

(c) accordingly, any reform of Section 54, so as to assist insurers, is one called for to assist in circumstances where in an individual case the insurer is unable to establish that it has in fact suffered prejudice.

(d) the Exposure Draft attempts to address a perceived unfairness to insurers from the application of section 54 to an omission by an insured to make notification under a "deeming" clause. As mentioned above, this "unfairness" arises where the insurer must be otherwise unable to establish that it has in fact suffered prejudice by "late" notification under such a clause.

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(e) in considering that "unfairness", NIBA notes that:

i) the so called unfairness to insurers by virtue of the decision in *FAI General Insurance Company Limited v. Australian Hospital Care Pty. Limited* needs to be weighed against the use by some insurers (to secure competitive advantage) of "continuous cover" clauses in their claims made wordings. Specifically, a case was made that permitting the decision to govern the operation of section 54 would result in an unacceptable uncertainty to insurers in terms of calculating IBNR for policies, discouraging participation in the Australian market.

The effect of continuous cover clauses is to accept claims and circumstances under a current policy when they ought to have been the subject of notification under an expiring wording. The clear competitive advantage of such clauses is that they encourage a continuity of business for the incumbent expiring insurer.

In providing cover on this basis, the incumbent effectively forgives a breach of the duty of disclosure by the insured at the commencement of the renewed policy period and therefore accepts an IBNR factor in the calculation of premium for the current policy.

The commercial acceptability of this risk to insurers (for competitive reasons) is difficult to follow if, at the same time, it is commercially unacceptable to properly attribute a circumstance/claim to an earlier period (with the ability to adjust subsequent premiums) as is achieved through an application of section 54 to "deeming" clauses.

ii) second, the insurers seeking relief from perceived "unfairness" are already in a position to protect themselves by private means: by the removal of "deeming" clauses from claims made policies issued by them. In NIBA's recent experience, all major domestic insurers offering claims made cover in the Australian market have removed "deeming" clauses from their standard policy wordings.

That private choice has proven to be an effective mechanism to remove the perceived "unfair" application of section 54, having regard to the recent decision in *Gosford City Council v. GIO General Limited* (2003) 54 NSWLR 542, where section 54 was found not available to relieve an insured from failing to notify circumstances under section 40(3) where a policy without a "deeming" clause was the subject of consideration.

In NIBA's view, if an insurer exercises a personal freedom to include a "deeming" clause in its standard wording, knowing of the potential impact of section 54 in light of the decision in *FAI General Insurance Company Limited v. Australian Hospital Care Pty. Limited* (2001) 204 CLR 641, it would be differentiating its product from other market participants, and may secure competitive advantages in doing so.

The proposed legislative amendment would remove that potential competitive freedom.

iii) third, it is not surprising that a dynamic market was able to react in a more timely manner than is likely to be achieved by legislative process. In fact, any parliamentary debate of the proposed amendment by the inclusion of section 54A is, on one view, a matter largely of historical interest.

As NIBA perceives it, the proposed amendment to Section 54 will simply remove a potential competitive differentiator between insurers, to the detriment to all insured. Any perceived unfairness in terms of IBNR is inconsistent with the use of continuous cover clauses and the operation of the *Australian Hospital Care Case* has already been negated by market action.

For the reasons identified above, NIBA does not recognise any need for amendment of the *Insurance Contracts Act* by the proposed inclusion of a new Section 54A as is contained in the Exposure Draft, and sees such an amendment as reducing competitive freedom in the marketplace.

Proposed amendments to section 40

NIBA recognises that as a result of the market-wide removal of "deeming" clauses from claims made policies, section 40(3) of the *Insurance Contracts Act* has taken on an increasing importance in balancing the rights and obligations of insurer and insured. The balance of this submission concerns the proposed amendments to section 40.

Proposed Sub-Section (2A)

There are three aspects of this proposed sub-section that require further consideration:

(a) the timeframe for notification. If the period identified is that selected, it is likely that there will need to be a second mail-out to insureds in addition to that required in the renewal process. NIBA recommends that the timeframe reflect that in section 58 i.e. that notice be provided no later than 14 days before the current policy expires.

(b) NIBA is not in favour of the adoption of a criminal sanction. NIBA believes that the approach taken in other parts of the Act on a benefit and burden basis (see, for example, Section 22(1) and (3)) ought to apply here. In this case, a defaulting insurer ought to be precluded from relying upon a late notification of circumstance as a basis for non-application of the expiring cover.

(c) third, NIBA recommends that a standard form notice be included in the regulations to reflect the final form of section 40(3), whatever that may be.

Proposed Sub-Section (2B)

NIBA is not in favour of paragraph (b), on the basis that it creates an unnecessary layer of administration for insurers. It seems that the insurer is placed in the unenviable position of either making inquiry as to the facts identified in (2B)(b) or, alternatively, being engaged in the (2A) process.

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Proposed Sub-Section (3)

In NIBA's experience, there has been a significant problem that has arisen in the market as to the meaning of "facts" for the purposes of a valid section 40(3) notification. NIBA's experience is that because of the narrow construction given by some insurers to what constitutes a "fact" for the purposes of notification, arid debates often result between broker and insurer, and potentially unsatisfactory gaps in cover, arising from an insured's section 21 obligation, may arise unless cover is renewed with the incumbent expiring insurer. This situation, including its potential uncompetitive effect of tying the insured to the expiring insurer, ought to be overcome.

NIBA recommends that Section 40(3)(a) and (b) refer not to just "facts" but to "facts, matters and/or circumstances". Each of those expressions are familiar to brokers and insurers alike. The inclusion of such words will greatly reduce debate and provide a higher level of protection against gaps in cover where an insured may choose to engage in a competitive renewal process.

The timing obligation upon the insured has become a matter of much greater focus than it was when "deeming" clauses proliferated standard wording.

In NIBA's experience there are two matters of significance for insureds in the notification process:

(a) first, facts, matters and/or circumstances may only come to the attention of an insured close to the expiration of cover. A short extension of time along the lines presently included in the Exposure Draft is justifiable, having regard to the lack of prejudice suffered by an insurer for the minor extension in time (evidenced by the existence of extended notification clauses) when compared to the hugely prejudicial effect upon an insured if the notification is not received in time.

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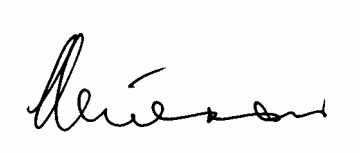
(b) second, there is often uncertainty on the part of insureds as to whether a relevant qualifying "fact" or "fact, matter and/or circumstance" exists that requires notification. Often further investigation is required. There ought not necessarily be prejudice suffered by an insured if further investigation to determine the appropriateness of notification takes longer than the notification period identified. NIBA recommends that an extended notification period be provided for (up to 12 months after expiry) upon the insured being able to provide a full and satisfactory explanation to the insurer for the delay in notification. NIBA notes that such a process of extension of time upon the provision of a full and satisfactory explanation has proven to be an effective mechanism in other forms of legislation, such as the *NSW Motor Accidents Act*.

The reference to requiring notification as soon as "reasonably practicable" ought to be limited to the extended periods for notification (i.e. after expiry). Inclusion of a reasonable practicability requirement during the currency of cover introduces a new and unnecessarily burdensome hurdle for insureds, which does not appear to result in sufficient benefit to insurers. Such a requirement potentially limits the benefit of the current section 40(3), and, if implemented, is likely to result in further disputation and uncertainty.

Yours sincerely



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