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financial services law alert

Insurance Contracts Act

On Monday 12 February 2007 the Federal Government released the long awaited draft bill to amend the *Insurance Contracts Act 1984* (Cth) following a lengthy review process. The draft bill and associated material can be found at: <http://icareview.treasury.gov.au>. The Government has asked for submissions by 23 March 2007.

Many of the proposed amendments apply to insurance contracts generally, while others are specific to life or general insurance.

Proposed amendments – Life and General

Duty of good faith

The duty of utmost good faith has been retained but it is proposed that a breach of the duty now be considered a breach of the Act. The proposed amendments amongst other things would allow ASIC to take action against an insurer for breach of the duty of good faith and potentially other remedies.

Duty of disclosure

Section 21(1)(b) contains a test which includes both subjective and objective elements. The objective limb of the test requires consideration of what a reasonable person would think in the circumstances. The exposure draft proposes to introduce additional criteria in relation to the application of that objective test. They include factors such as the nature and extent of the insurance cover, the class of persons to whom that cover is provided, and the circumstances in which the cover is entered into, including the nature and extent of any questions asked by the insurer.

There is an equivalent test in section 26(2) regarding the determination of statements that constitute misrepresentations. Curiously, this test has not been remodelled in line with the test in section 21(1)(b).

Extending the disclosure requirements for eligible contracts of insurers

The proposed amendments to section 21A extend the disclosure requirements that apply to all 'eligible contracts' (which include

motor vehicle, home contents and travel insurance) to include renewals, variations and reinstatements. The amendments prevent insurers from relying on "catch-all" questions in proposals for eligible contracts of insurance.

To date, it has been generally understood that section 21A does not apply to life insurance contracts and it was hoped that the proposed legislation would make this position clear. Unfortunately, this is still to be addressed.

Insurer's duty to inform of duty of disclosure

Under the proposed amendments to section 22 which alter the insurer's duty to inform the insured of the duty of disclosure, the insurer must now explain that the duty of disclosure obligation applies until the proposed contract is entered into. If there is a two month delay before the acceptance of the offer or a counter-offer for cover, the insurer has to provide the insured with a further reminder of the duty of disclosure.

Power of Court to modify insurer's remedy for non-disclosure or misrepresentation

Section 31 allows a court to modify action taken by the insurer in cases of fraudulent non-disclosure or misrepresentation, where the court considers the result is harsh and unfair for the claimant. This will be extended to cases of non-fraudulent non-disclosure or misrepresentation where the liability of the insurer would otherwise be significantly reduced. Section 31 will also be amended to reflect the extended rights to be given to life insurers in cases of non-disclosure or misrepresentation (noted below).

Notification of certain provisions

The notification obligations regarding "prescribed contracts" such as car and home insurance (section 35) and in relation to

unusual terms (section 37) have been brought into line with the obligations under the Corporations Act i.e. to be “clear, concise and effective”. In relation to life insurance, this will primarily impact contracts that are “consumer credit insurance”.

Application of the Act: contracts with foreign insurers

The proposed amendments to section 8 of the Act provide that the Act will apply to all contracts of insurance entered into with persons who are domiciled in Australia, irrespective of where the risk is located, as well as to contracts that cover the risk of loss or damage occurring in an Australian State or Territory.

Further amendments that affect Life Insurers

Duty of disclosure

The duty of disclosure currently lies with the applicant for a policy, or in the case of a change in cover which is already in place, the owner of the policy. Where that person is not the person whose life is insured, the duty of disclosure does not extend to the life insured. It is now proposed to correct this anomaly by extending the duty of disclosure to the life insured, with a consequential obligation on the insurer to explain this duty to the life insured (sections 22 and 31A).

Cover on death or cover with a surrender value

The remedies available to life insurers in the event of non-disclosure or misrepresentation are limited and currently set out in section 29. While it is proposed to substantially retain section 29, that section will be limited to life insurance contracts which have the primary purpose of providing a benefit on death, or which have a surrender value. Other types of life insurance contracts are dealt with under a new section 28A (see below).

An important change, however, is proposed to sub-section 29(3). In the case of actionable innocent non-disclosure or misrepresentation, an insurer can currently only avoid the policy if it would not have been prepared to enter “a contract” on any terms with the insured if it was aware of the details not disclosed or misrepresented. It is proposed to change the reference to “a contract” to “the contract”, meaning that the insurer can potentially avoid the policy if it would not have entered that particular contract, as opposed to the current standard of any life insurance contract.

Contracts without death cover or surrender value

A new section 28A has been inserted to cover other types of life insurance contracts not covered under section 29 (such as disability income, total and permanent disablement and trauma).

This new section provides a more flexible remedy in the case of actionable innocent non-disclosure or misrepresentation by allowing the insurer a right to adjust the amount of its liability in line with the amount of cover that would have been available had the misrepresentation or non-disclosure not occurred. (This right

is similar to that available to general insurance companies under section 28).

Significantly, unlike section 29, there is no 3 year time limit proposed where the misrepresentation or non-disclosure is innocent.

Bundled life insurance contracts

Life insurance contracts that combine more than one type of cover will be “unbundled” under section 27A for the purpose of applying the relevant remedies for non-disclosure and misrepresentation under sections 28A and 29.

Expiration date

A new sub-section 30(3A) has been included to allow insurers to adjust the expiration date of a life insurance contract where the date had been calculated by reference to the insured’s incorrectly stated date of birth.

Third party beneficiaries

Amendments are proposed to section 48A, which gives rights to third party beneficiaries. The adjustments that have been proposed are technical and will be considered in more detail in future publications.

Group life insurance

Group life insurance policies are not adequately dealt with under the current Act (which assumes all group insurance is affected under superannuation schemes). A new definition extends to group contracts of all types.

It is also proposed that, in the event of non-disclosure or misrepresentation in an application for cover of an individual life under a group policy, the insurer will have the same remedies available to it as it would have if the cover was provided under an individual contract (section 32).

Further amendments that affect General Insurers

Claims made and claims made and notified policies

Section 54 will now exclude claims made and notified policies as defined in a new section 40.

Section 40(3) will provide that if an insured or third party beneficiary becomes aware of facts that might give rise to a claim and gives notice in writing of those facts as soon as is reasonably practicable, but no later than 28 days after the insurance cover expires, then the insurer is not relieved from liability only because the claim is made after the policy has expired.

The insurer has to inform the insured clearly at least 14 days before the expiry of the policy of the effect of the insured failing to give notice of circumstances within 28 days after expiry. Importantly, under the new proposed section 54A, if the policy

is one to which section 40 applies, then a failure by the insured to give notice to the insurer of circumstances during the policy period or within 28 days after expiry is carved out of section 54, so that an insurer can refuse to pay the claim.

Implementation of the amendments

It is envisioned that these changes will not take place all at once. Some changes will be implemented following a transition period after Royal Assent while other changes apply from that time. The changes generally apply to contracts "entered into" after commencement of the relevant provision. This means that the amendments will apply to renewals, variations, extensions and reinstatements entered into after that date and Treasury has sought comment on whether this will cause difficulties. The proposed introduction of additional criteria to the objective test in the duty of disclosure, however, applies to insurance contracts whenever issued.

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