

# Section 29 of the *Insurance Contracts Act 1984* : The new regime

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# Life Insurance - the duty of disclosure

- s 21 imposes on an insured a **duty to disclose to the insurer**, before the contract of insurance is entered to, every matter that is known to the insured that:
  - The insured knows to be a matter relevant to the insurer's decision whether to accept risk and the terms of that acceptance
  - A reasonable person could be expected to know to be a relevant matter, considering the nature and extent of the cover, and the class of persons who would usually seek that kind of cover
- There are **exclusions** such as for common knowledge, matters that diminish risk and other matters an insurer ought to know
- s 31A imposes similar duties in relation to a contract of life insurance under which a person (other than the insured) would become a life insured

# Life Insurance - failure to disclose and misrepresentation

- s 29 **applies** where the insured, under a life insurance contract:
  - Failed to comply with the duty of disclosure; or
  - Made a misrepresentation to the insurer before the contract was entered into
- s 29 **does not apply** where:
  - The insurer would have entered the contract regardless of the insured's failure to comply

# Avoiding a policy: The 3 year rule

- s 29(2) if the failure/misrepresentation was undertaken **fraudulently**, then the insurer may avoid the contract (ie **at any time**)
- s 29(3) if the insured was **not** fraudulent, the insurer may avoid the contract **within three years after the contract was entered**

# Varying sum insured

- If the insurer has not avoided the contract for **non-disclosure/misrepresentation** the insurer may vary the contract by substituting for the sum insured (including any bonuses), a sum that is not less than the sum

$$S \times P / Q$$

- Where
  - S is the number of dollars that is equal to the sum insured (including bonuses)
  - P is the number of dollars that is equal to the premium that has, or to the sum of the premiums that have, become payable under the contract
  - Q is the number of dollars that is equal to the premium, or to the sum of the premiums, that the insurer would have been likely to have charged if the duty of disclosure had been complied with or the misrepresentation had not been made
- NB This applies differently in a contract with a surrender value, or a contract that provides insurance cover in respect of the death of a life insured

# The changes - varying the policy

- The relevant amendments took effect on 28 June 2014 and apply to policies incepting after that date or to certain variations in a previously incepting policy occurring after that date (increase in sum insured, additional levels of cover, non-automatic variations)
- s 29(6)

"If the insurer has not avoided the contract or has not varied the contract under subsection (4), the insurer may, by notice in writing given to the insured, vary the contract in such a way as to place the insurer in the **position (subject to subsection (7))** in which the insurer would have been if the duty of disclosure had been complied with or the misrepresentation had not been made."
- NB this right is not available if the policy has a surrender value or insures death (ie unbundling as most policies will have a death component)

# Unbundling

- s 27A
  - This section has been introduced to "unbundle" combined life policies (eg life and TPD cover) when applying the relevant remedies of non-disclosure and misrepresentation
  - In the case of s 29, this would mean that one product would be "unbundled" into its various parts if an insurer sought to vary a particular part of the contract due to non-disclosure or misrepresentation

# Similarities to general insurance

- s 29(6) has some similarity to s 28(3) for general insurance

"If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection (2) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made."

- This is a new concept and not entirely analogous with previous procedure
- However, the life insurance remedy is to **vary the contract** while the general insurance remedy is only to **reduce liability** under the contract



# The insurer's position when varying under s 29(6)

- s 29(7)

"The position of the insurer under a contract (the relevant contract) that is varied under subsection (6) **must not be inconsistent** with the position in which other reasonable and prudent insurers would have been if:

(a) they had entered into similar contracts of life insurance to the relevant contract; and

(b) there had been no failure to comply with the duty of disclosure, and no misrepresentation, by the insureds under the similar contracts before they were entered into."

- s 29(8) - "similar" means provides insurance cover that is the same or similar to the kind of insurance cover provided and was entered into at or close to the time the contract in question was entered into
- There is no similar provision for general insurance although industry practice may obliquely arise because the underwriter can be cross-examined on the reasonableness of the reduction in liability

# Reasons for the change

- The relevant Minister gave the following rationale for the changes in his speech during the Second Reading of the Bill:
  - "This bill, the Insurance Contracts Amendment Bill 2013, is yet another example of how the Gillard government is improving the insurance market in Australia. The law governing contracts of insurance has a direct influence on the effectiveness and efficiency of the insurance market."
  - To remove impediments to the use of electronic communication of statutory notices and documents
  - Make the duty of disclosure easier for consumer understanding and compliance
  - Make the **remedies in respect of life insurance contracts more flexible and more suitable to modern life insurance products**

# Practical matters: Gate 1

- The insurer has to firstly show what **it** would have done had the correct disclosure been made. The insurer bears the onus of proving this cf:

- *Montclare v MetLife Insurance Ltd and Anor* (2015): Court upheld MetLife's avoidance of a life insurance contract following the suicide of a claimant who failed to disclose a background of mental illness

MetLife was unable to call on the underwriter who assessed the application but called a senior underwriter that worked on the same team. That underwriter stated that the same cover would not have been offered had MetLife known the insured's full history

- *Hitchens v Zurich Australia* (2015): Court upheld Zurich's avoidance of an income and TPD policy after the claimant failed to disclose various medical conditions

The original underwriter was present and discussed their usual practice in assessing an application. They showed that if they had known the insured's full medical history, they would not have entered the contract

# Gate 1

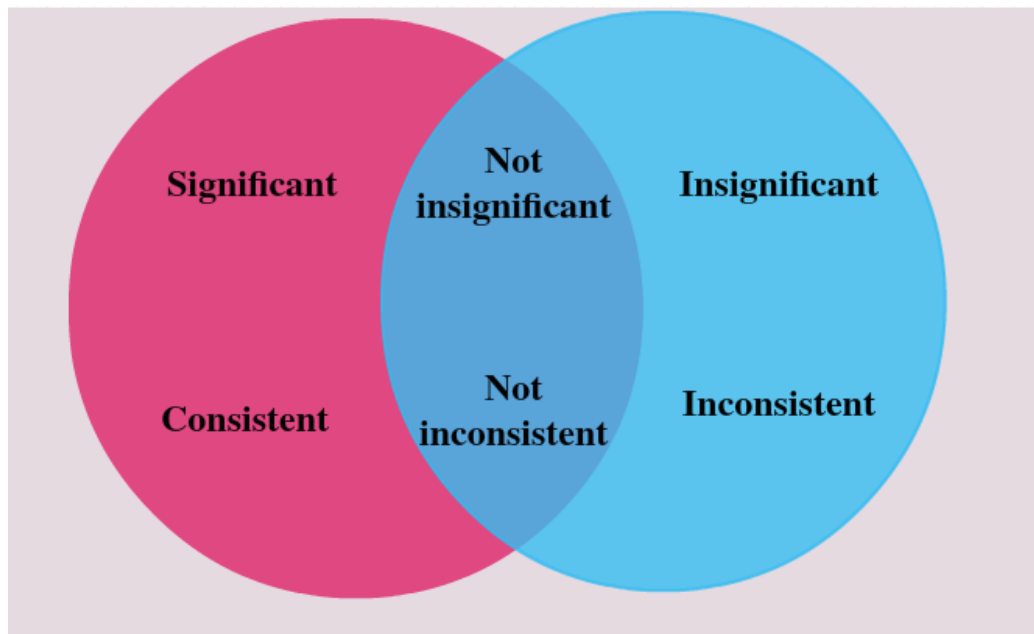
- In *McCabe v Sun Alliance Life Assurance Australia Ltd* (2003) the Court accepted that s 29(3) applied to a final decision but also seemed to agree that further enquiries would have meant that the insurer was refusing to insure on the terms
- Similarly in *Schaffer v Royal & Sun Alliance Life Assurance* (2003) it was held that an insurer must show that at some point it would have declined the application for insurance. It was not enough to show that further investigations would have been carried out or that a decision would have been deferred
- While there are degrees of uncertainty, if an insurer becomes aware of facts that reveal that the insured had not complied with disclosure, but needs time to obtain further information before determining what its attitude to acceptance of the risk would have been, it is entitled to bring the results of those consequent inquiries to bear in that exercise

# Gate 1: Witnesses


- Who are the witnesses required to show what would in fact have occurred?
  - Underwriter
  - Own reinsurers (on fac and equivalent ie only if reinsurer was involved on the original application)
- The evidence must relate to the time of inception - this could be an issue given the time frames envisaged by the new regime and the passage of time on subtle issues
- Insurers will need to consider rigorous document retention - internal guidelines, underwriting manuals, material to document the underwriting process

## Gate 2: Other insurers

- The insurer must also show that what it would have done is **not inconsistent** with what other reasonable and prudent insurers would have done.
- "Not inconsistent" does **not** necessarily mean consistent - cf tort law where a risk does not have to be significant to be "not insignificant".



## Gate 2: Witnesses



- The Explanatory Memorandum to the bill discusses how an insurer would establish that its actions are not inconsistent with other prudent and reasonable insurers
  - Generally, a view from one or more third parties is needed
  - These third parties may include, but are not limited to, underwriters and reinsurers (provided they would agree to conduct the exercise which is unlikely)
  - Underwriters generally have a good understanding of the development of life insurance in the market place
  - As underwriters are cited specifically in the Explanatory Memorandum, they will likely have a key role in the determination of a prudent and reasonable insurer
  - An insurer's own reinsurers or related parties are unlikely to be sufficiently independent
  - Risk that other reinsurers could not be considered independent as a cedant is a potential client of the reinsurer
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## Witnesses: Gate 2

- It is not entirely clear what the practical steps are for an underwriter to consider whether the insurer's actions are not inconsistent with a reasonable and prudent insurer:
  - Merely opines on the Gate 1 evidence
  - Assesses the Gate 1 procedure and the outcome that the procedure brought about
  - Compares the Gate 1 final outcome with other comparable products in the market
- s 29(8) provides a test of "similarity". "Similar" does not mean the "same". This poses some difficulty however as comparing products with various terms and conditions can be problematic, as seen in *Stevens v Colonial Mutual Life Assurance Society Ltd v CFP* [2012] where policies had to be compared in a misleading and deceptive conduct case
- It is not another retro-opinion (ie not the Gate 1 exercise) but an opinion on industry practice





## Gate 2

- What needs to be shown: Gate 2 experts
    1. Working as an underwriter as at or close to the Commencement Date of the Policy
    2. Work included underwriting [IP, Trauma, TPD] policies similar to the Policy in question
    3. Relevant experience including the length of time working as an underwriter, nature of industry experience, scope of experience underwriting [IP, Trauma, TPD] policies
    4. Identify "similar" contracts of life insurance at or close to the Commencement Date of the Policy using s29(8)
    5. What would you have done had the disclosure been made before the policy was entered into?
    6. Is the Proposed Variation not inconsistent with that?
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## Witnesses: Gate 2

- In any of those three scenarios, there are commercial confidentiality concerns, as any sensitive underwriting manuals or procedures may be released to a third party underwriter for assessment
- As a result, it may be in insurer's commercial interests to use underwriters who are not competitors (are they appropriately qualified? are there any?) or are retired
- Insurers will need to locate a pool of independent experts
- The expert must opine of the industry practice as at the inception date, which could be many years prior once time passes

# Key points

1. An insurer can avoid for fraudulent non-disclosure or representation at any time
  2. In the first three years of a life insurance contract, an insurer can avoid the contract where there is an innocent failure to disclose or misrepresentation
  3. Throughout the policy, an insurer can apply the SxP/Q formula for non-disclosure
  4. Throughout the policy, if an insured has failed to disclose or made a misrepresentation, an insurer may vary a contract so that it is in the position in which it would have been, had the correct disclosure been made
  5. That position must be not inconsistent with that of another reasonable and prudent insurer
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# Key points

6. Underwriters have a key role in determining the actions of a reasonable and prudent insurer
7. Insurers will need to develop a pool of Gate 2 experts quickly
8. Should insurers consider forming an industry working group?
9. Will this lead to a more flexible non-disclosure regime in light of the growing complexity and variety of life insurance products in the market?
10. When will ASIC take over "handling insurance claims" (Report 498)?
11. Impact of the Code
12. Will s 28 be amended?

