



Insurance Contracts Amendment Bill 2010 and Unfair Contracts

The Insurance Contracts Amendment Bill 2010 (**Bill**) was tabled in Parliament on 17 March 2010. The long awaited Bill arose out of recommendations made by the Federal Government Review Panel commissioned in 2003.

The Bill makes substantive changes to the *Insurance Contracts Act* 1984 (Cth) (**ICA**), including the following:

- a failure to comply with the duty of utmost good faith will be a breach of the ICA;
- allowing of the use of electronic communications for statutory notices and documents required under the ICA;
- simplification of the duty of disclosure requirements for consumers;
- greater flexibility and introduction of relevant remedies in respect of life insurance contracts;
- clarification of rights and obligations of third party beneficiaries; and
- guidance on the distribution of money recovered under subrogation.

This update summarises the key changes arising from the Bill and further anticipated changes with respect to unfair contracts.

Overview

Whilst the Bill introduces a number of key changes to the ICA, particularly with respect to disclosure obligations and the rights of third party beneficiaries, the changes are less comprehensive than the amendments proposed in the exposure draft of the legislation released in 2007. The Bill does not address the unfair contracts carve out under section 15 of the ICA. The Trade Practices Amendment (Australian Consumer Law) Bill 2009 which will commence on 1 July 2010, subject to receiving Royal Assent, introduces an unfair contracts regime and additional enforcement remedies, but does **not** incorporate changes that relate to insurance contracts. This update discusses the Unfair Terms in Insurance Contracts Options Paper, which was introduced to parliament on the same day as the Bill.

The proposed amendments

Schedule 1: Scope and application of the ICA

The Bill contains amendments relating to the scope and application of the ICA.

Duty of utmost good faith

The failure by a party to a contract of insurance to comply with the duty of utmost good faith will now be a breach under the ICA. The amendment will allow the Australian Securities and Investment Commission (**ASIC**) to:

- commence or continue representative action on behalf of an insured against an insurer under the ICA; and
- access various remedies under the *Corporations Act* 2001 in relation to Australian financial services licence holders. These remedies include a banning order under section 920A of the *Corporations Act*, suspension or cancellation of the insurer's financial services licence, the imposition of conditions on the licence or the acceptance of an enforceable undertaking.

Third Party Beneficiaries

The Bill extends the duty of utmost good faith to third party beneficiaries. This duty commences only after the contract of insurance has been entered into.

Exempt and bundled contracts

Workers' compensation policies will remain exempt from the ICA. This exemption extends to any part of a policy that also provides employers' common law liability cover.

The Bill provides that other bundled contracts are to be notionally 'unbundled' so that a contract of insurance that includes cover that would otherwise be exempt from the ICA, as well as cover that falls within the ICA, will be treated as two separate 'unbundled' contracts for the purpose of the ICA. If there are more than two types of cover bundled within the subject contract, more than two notional contracts will be developed for the purpose of unbundling.

Irrespective of whether there is one or more kinds of exempt covers, the result of applying the unbundling process will be that only those contractual terms that relate to the exempt cover will be exempt from the operation of the ICA.

Schedule 2: Electronic communication

Schedule 2 and the amendments to the *Electronic Transactions Act 1999* and *Electronic Transactions Regulations 2000* will allow notices or other documents or information under the ICA to be provided in electronic format. This amendment will take effect on a day to be fixed by Proclamation to allow co-ordination of the commencement with the proposed amendment to the *Electronic Transactions Act 1999*.

Schedule 3: Powers of ASIC

ASIC will be responsible for the general administration of the ICA and accordingly ASIC will be vested with a number of specific powers to support this role, including powers to obtain documents.

A new section 11F will be inserted into the ICA providing ASIC with the power to intervene in matters arising under the ICA and matters arising under Part 3 of the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003*.

Schedule 4: Disclosure and Representations

These amendments will take effect 18 months after the date of Royal Assent to allow insurers an opportunity to amend their business practices in response to the new rules.

Insured's duty of disclosure

Currently, an insured's disclosure obligations are determined by reference to a mixed subjective/objective test (section 21 of the ICA). To clarify the interpretation of the test, the Bill introduces a non-exclusive factor (the nature and extent of the insurance cover to be provided under the relevant contract) to the objective element of the test. The Courts may have regard to this factor when determining what a reasonable person in the circumstances could be expected to know when considering matters relevant to the insurer's decision to enter into the contract.

Eligible contracts of insurance

Under section 21A of the ICA, it is currently permissible for an insurer to ask 'catch all' questions for eligible contracts. Eligible contracts of insurance are prescribed by regulations made under the ICA and include cover commonly sought by individual consumers such as motor vehicle cover. The Bill amends section 21A (and section 21B) to:

- remove the ability of insurers to ask 'catch all' questions in relation to eligible contracts; and
- apply enhanced rules for the duty of disclosure on original inception and renewal of an eligible contract.

The new section 21A will provide that an insurer is required to ask the insured one or more specific questions that are relevant to the insured's decision to accept the risk on the original inception for eligible insurance contracts.

Insurers' duty to inform of duty of disclosure

An insurer is to notify the insured, before the contract of insurance is entered into, that the duty of disclosure obligations continue until the time the policy is actually entered into.

Schedule 5: Remedies of insurers - Life insurance contracts

These amendments are designed to make the remedies available under contracts of life insurance more flexible and tailored than those currently available. The amendments will provide, inter alia, that:

- insurance contracts that bundle different types of protection can be 'unbundled' and relevant remedies applied to each 'unbundled' contract;
- in the event that a life insured's date of birth is misstated and the contract of life insurance was calculated by reference to the incorrect date of birth, the insurer may vary the contract by changing its expiration date to the date that would have been calculated if the insurer had been provided with the correct date of birth; and
- the provisions relating to the cancellation of general insurance contracts will be extended to life insurance contracts.

Schedule 6: Third parties

The Bill contains a series of amendments that alter the rights and obligations of third parties under the ICA. These include:

- a revised definition of third party beneficiary to 'a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends';
- rights in respect of the request for information from insurers by third parties beneficiaries; and
- an amendment to section 67 of the ICA to clarify the approach to be adopted for the distribution of moneys recovered from a third party under a right of subrogation.

Unfair contracts

The Bill does **not** seek to address the unfair contracts current carve out under section 15 of the ICA. The Minister for Financial Services, Superannuation and Corporate Law has released an Options Paper seeking comments on options to address unfair terms included in insurance contracts (**Options Paper**).

The Options Paper

To achieve the overall objective of preventing consumers (including third party beneficiaries) of insurance contracts suffering loss due to terms in unfair contracts, five potential options for legislative amendment (or no amendment) have been identified in the Options Paper for consultation in with stakeholders. These options are:

- maintain the status quo, with unfair and harsh terms in insurance contracts being addressed through the operation of section 14 of the ICA (as expected to be modified by the Bill);
- Option A: Permit the unfair contract terms provisions of the *ASIC Act 2001* to apply to insurance contracts. This would involve changes to section 15 of the ICA to permit the unfair terms provisions in the *ASIC Act* to operate in addition to and alongside the ICA remedies.
- Option B: Extend ICA remedies to include unfair terms provisions. Under this option, further amendments to the ICA would be required to incorporate remedies relating to unfair insurance contract terms consistent with the unfair contract provisions in the *ASIC Act*. Section 15 of the ICA would be maintained under this option.
- Option C: Enhancing existing ICA remedies. This would involve the modification of existing remedies in the ICA, particularly section 14 (beyond the changes already proposed in the Bill) to improve their effectiveness in preventing the use of unfair contract terms in standard insurance contracts with consumers. Under this option, section 15 of the ICA would be maintained.

- Option D: Encourage industry self-regulation to better prevent the use of unfair terms by insurers. This option would involve insurers addressing the use of unfair terms through self-regulatory means, for example, by the addition of a section dealing with this issue in the General Insurance Code of Practice. This option would also involve the maintenance of section 15 of the ICA.

Submissions responding to the Options Paper closed on 30 April 2010. There will likely be additional amendments to the ICA following the completion of the consultative process.

Moving forward

The changes to the ICA, contained in the Bill, will apply to contracts of insurance entered into after the commencement of the relevant amendment. The Bill has received a second reading in the House of Representatives and it is anticipated that it will be passed in the very near future.

Whilst the unfair contract terms have not been included in the Bill, in anticipation of further amendments occurring in this space, it would be prudent for stakeholders to make preparatory arrangements for these expected further amendments.

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