



Précis Paper

ICA Reform: The re-design of remedies for pre-contractual misrepresentation

A discussion about the recent amendments and changes to the *Insurance Contracts Act 1984* (Cth) and in particular the changes to the remedies that an insurer has in relation to pre-contractual misrepresentations and non-disclosures.

Discussion Includes

- Background
- Changes to life insurance
- Relevant failure
- Reasonable Care
- Practical implications of the changes
- Other categories of insurance

ICA Reform: The re-design of remedies for pre-contractual misrepresentation

In this edition of BenchTV, Diren Fernando Partner (Partner, HWL Ebsworth Lawyers, Sydney) and Elizabeth Esber (Barrister, Edmund Barton Chambers, Sydney) discuss the recent amendments and changes to the *Insurance Contracts Act* 1984 (Cth) and in particular the changes to the remedies that an insurer has in relation to pre-contractual misrepresentations and non-disclosures.

Background

1. The *Financial Sector Reform (Hayne Royal Commission Response)* Bill 2020 (Cth) implemented changes to the *Insurance Contracts Act* 1984 (Cth). These changes apply to both life insurance and general insurance.
2. The particular changes and reforms are in relation to recommendations 4.5 and 4.6 of the Hayne Financial Services Royal Commission. Recommendation 4.5 was that the *Insurance Contracts Act* be amended for consumer insurance contracts to replace the duty of disclosure in section 21 of the *Insurance Contracts Act* with a duty to take reasonable care not to make a misrepresentation to the insurer. This will be a new provision under section 20B of the *Insurance Contracts Act*.
3. Recommendation 4.6 is in relation to section 29(3) of the *Insurance Contracts Act* being amended so that an insurer may only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if it can show that it would not have entered into a contract on any terms. This is a reversion back to the pre-2013 amendment regime.
4. Those recommendations were made with an objective of addressing a perceived asymmetry between insurers and consumers with respect to the duty of disclosure and the finding by the commission that the previous regime, allowing life insurers avoiding cover for innocent non-disclosure misrepresentation was unfairly weighted against the consumer.

Changes to life insurance

5. Back in 2013, when the *Insurance Contract Act* was amended, there was a change to the remedy under section 29(3) of the *Insurance Contracts Act* which governs an insurer's right to avoid a policy for non-fraudulent misrepresentation or non-disclosure.
6. Prior to 2013, an insurer could only avoid for non-fraudulent matters if it could show that, but for the misrepresentation or non-disclosure it would not have entered into a contract with the insured on any terms.

7. In 2013 this requirement was removed so that an insurer was entitled to avoid for innocent misrepresentation or non-disclosure, as long as it could show that it would not have offered the same contract. Under this provision an insurer could for instance, avoid a policy entirely even if the only impact of the misrepresentation had been that it would otherwise have charged a bit more premium.
8. One of the changes in the 2020 financial reform bill has been to revert section 29(3) to its prior state. That change came into effect on 1 January, 2021 and will apply to contracts which were entered into after that date, or contracts which have been actively varied after that date so as to increase the sum insured or add a new kind of cover.
9. What insurers will need to be careful of is applying the correct version of 29(3) in respect of contracts entered into between 2013 and 1 January, 2021.
10. From the consumer's perspective, limiting the circumstances in which an insurer can avoid cover for innocent non-disclosure or misrepresentation acts as a safe guard in terms of product purchase.
11. From the perspective of the insurer, in circumstances of innocent non-disclosure, if the evidence is that cover would have been offered but on different terms, there might not be any right to avoid cover in that circumstance. However, an insurer may still have an entitlement to another remedy under section 29 of the *Insurance Contracts Act*. In particular, it may be able to rely on subsections 6-8, to vary the contract to place it in the position in which it would have been, had that non-disclosure or misrepresentation not been made.

Relevant Failure

12. The nature of the specific failure that has to occur, in order for an insurer to access any remedy, has been subject to some substantial amendment both for life insurance and for general insurance. The new legislation now establishes essentially a new category of insurance contracts within the *Insurance Contracts Act* called Consumer Insurance Contracts.
13. These are either policies that are obtained wholly or predominantly for the personal, domestic or household purposes of the insured or otherwise a policy in relation to which the insurer states, before entry into the contract that the policy will be a consumer insurance contract.
14. Having established this new category of insurance contracts, the legislation goes on to create a regime that applies to those policies alone - and the first step is to jettison the old duty of disclosure under Section 21 that won't apply at all to consumer insurance contracts.
15. Secondly, the insurer's right to act on the fact of a misrepresentation will be removed. The insurers will not be able to obtain any remedies simply because a misrepresentation has occurred, instead, the insured under a consumer insurance contract will be subject to a duty to take reasonable care not to make a misrepresentation. Only a breach of this new duty will give rise to any remedy in favour of the insurer.

16. This means that a misrepresentation will not be actionable at all unless the insurer can show that the misrepresentation was the result of a failure to take reasonable care not to make it. This will apply to all the remedies in section 28 for general insurance or section 29 for life insurance, and will apply to contracts which come into existence from 5 October 2021 or which are actively varied after this date to increase the sum insured or to add a new kind of cover.

Reasonable Care

17. Reasonable care is not a defined term in the Act. Section 20B states that the insured has a duty to take reasonable care not to make a misrepresentation to the insurer.
18. There are a number of sub paragraphs in Section 20B which on the face of it, might appear to provide some assistance as to what constitutes a breach, but they don't go that far and the duty to take reasonable care is not as specifically guided by the statute in the same way that the duty of care is guided by section 5B of the *Civil Liability Act 2002* (NSW). Thus, reasonable care under the *Insurance Contracts Act* remains quite an amorphous concept.
19. Section 20B(2) provides that whether an insured has taken reasonable care not to make a misrepresentation, is ultimately going to be determined with regard to all of the relevant circumstances.
20. There is no limitation to the range of matters that might be considered. Section 20B(3) provides a list of matters which might be taken into consideration in determining whether an insured has taken reasonable care. The determination must also take into account any characteristics or circumstances of the insured of which the insurer was aware, or ought reasonably to have been aware, under section 20B(4).
21. Section 20B(6) provides that if a misrepresentation is made fraudulently, it will be taken to be a misrepresentation made in breach of the duty to take reasonable care.

Practical implications of the changes

22. The first implication of the changes everyone needs to recognize that the duty of disclosure will not apply to these consumer insurance contracts
23. As a result, insurers will need to be increasingly specific in the questions that they ask.
24. If a clear and specific question has not been asked, then the insurer may find it difficult to argue that the insured has failed to take reasonable care. This new duty will make it particularly easy for an insured to argue that its obligations were not breached where the question asked was nebulous or broad. A failure to accurately respond to an open-ended or general question would be easier for an insured to explain away.
25. The other impact will be at the assessment stage. Insurers need to ensure that their claims teams have a thorough understanding of the changes that are being implemented as it will be at the claims level that the consideration of the avoidance or variation typically takes

place. Assessors will need to be conscious of the different versions of the legislation, and to consider which version applies in relation to the policy at hand.

26. Insurers need to become accustomed to not only ascertaining whether a misrepresentation has taken place, but also placing themselves in the position of the consumer to consider whether reasonable care was taken not to make the misrepresentation.

Other categories of insurance

27. Two further categories of insurance that may warrant further mention are over the phone insurance and group life insurance particularly in relation to whether it can be a consumer insurance contract.
28. In regard to over-the-phone insurance, the fact that an application is taken over the phone would be a relevant factor to consider in whether the duty to take reasonable care has been breached or not.
29. Group life insurance poses some interesting questions in relation to consumer insurance contracts. On the face of the new legislation, unless the policy is for the personal purposes of the insured, then it is not automatically a consumer insurance contract.
30. Under a group life contract, the insured is the trustee - even if you take into effect the operation of section 32. The contract would not be for the trustee's personal purposes; and so, absent a declaration by the insurer, this would not seem to be a consumer insurance contract.
31. However, the expectation in the Explanatory Memorandum to the financial reform bill seems to be that the new duty *would* apply to life insureds under group life insurance contracts. How all of that operates may be explored at some stage by the courts.

BIOGRAPHY

Diren Fernando

Partner, HWL Ebsworth Lawyers, Sydney

Diren has extensive experience providing legal services to general and life insurers. He assists clients with pre- and post-litigation claims disputes; advises in relation to policy design and wording; counsels about the impact of statutory change; and provides guidance about general business and claims handling practices. His expertise covers the range of products across the life insurance industry; as well as coverage and claims disputes arising under professional indemnity policies, typically covering financial advisers, builders and engineers.

Elizabeth Esber

Barrister, Edmund Barton Chambers, Sydney

Elizabeth was admitted to practice as a solicitor in 2012. Prior to being called to the Bar, Elizabeth acted for a number of prominent life insurers and fund trustees in disputed life insurance claims commenced in the Supreme Court and District Court of NSW, QLD and WA. Elizabeth has provided complex advice work across the financial services space in relation to litigation, the Insurance Contracts Act 1984 and complaints made to the Financial Ombudsman Service and the Superannuation Complaints Tribunal (now the Australian Financial Complaints Authority (AFCA)).

REFERENCES

Legislation

Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (Cth)

Insurance Contracts Act 1984 (Cth)

Civil Liability Act 2002 (NSW)