



Précis Paper

The Changing Landscape of Life Insurance

A discussion of life insurance focusing upon the impact of the 2013 amendments to the *Insurance Contracts Act 1984* (Cth).

Discussion Includes

- The changing nature of life insurance
- Misrepresentation and non-disclosure
- Remedies for misrepresentation and non-disclosure
- Section 31A of the *Insurance Contracts Act 1984* (Cth)
- Structure of life Insurance
- Duty of the utmost good faith
- Additional powers given to ASIC
- Key takeaways

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Video Title

In this edition of BenchTV, Peter Mann (Barrister – Ground Floor Wentworth Chambers, Sydney) and Stanley Drummond (Partner – Thomson Geer, Sydney) discuss life insurance and the impact of the *Insurance Contracts Amendment Act 2013 (No. 75, 2013) (Cth)* focusing primarily upon the impact of sections 29 and 14A of the *Insurance Contracts Act 1984 (Cth)*, and the increased powers of ASIC under the *Insurance Contracts Act 1984 (Cth)*.

The changing nature of life insurance

1. The following will consider Part IV of the *Insurance Contracts Act 1984 (Cth)* which concerns the duty of disclosure and the duty to not misrepresent, and the difficulties this changed landscape presents to life insurers at the moment. It is a present difficulty because of the changes brought about by the *Insurance Contracts Amendment Act 2013 (No. 75, 2013) (Cth)* and the need to determine whether an alleged misrepresentation or non-disclosure is subject to Part IV before or after the change. There is a difference in treatment.
2. The duty of utmost good faith is also considered. The case of *Carter v Boehm* (1766) 3 Burr 1905 is recognised as the first case in which the duty of 'the utmost good faith' was first raised and therefore originated. In this case, Lord Mansfield set out the duty of good faith and some disclosure principles. The judgement is still relevant in today's society as some of the disclosure principles have now seen their way through to ss 21(2) of the *Insurance Contracts Act 1984 (Cth)*.
3. Life insurance has changed radically over the past 30 years since the inception of the *Insurance Contracts Act 1984 (Cth)* (the Act). This Act was created after a detailed report from the Australian Law Reform Commission, *Insurance Contracts* (Report no. 20, 1982). The *Insurance Contracts Act 1984 (Cth)* did not really cater for the present mix of life insurance and the growth of superannuation based life policies. A few key concepts were not dealt with sufficiently in the Act, so it was necessary for changes to be implemented. This was done by way of the *Insurance Contracts Amendment Act 2013 (No. 75, 2013) (Cth)*. The various provisions that were amended by the 2013 Act had a staggered introduction over a two and a half year period starting on the date the Act gained royal assent on 28 June 2013. This staggered introduction means that it is necessary to take care in assessing the potential application of the amendments to any particular matter. Of course, this need to take care will diminish over time as more and more life policies are entered into or varied after the staggered introduction of the changes.

Misrepresentation and non-disclosure

4. Section 21 of the *Insurance Contracts Act 1984* (Cth) refers to the insured's duty of disclosure, and this section did have some amendments made by way of the *Insurance Contracts Amendment Act 2013* (No. 75, 2013) (Cth). In explaining one of the tests in ss 21(1)(b) of the Act, which is an objective test, some extrinsic factors were added to this particular subsection to give guidance to the operation of that subsection. The easiest way of looking at s 21 of the Act is to consider the requirements in proving that there has been a non-disclosure as a series of gates.
5. The first part of s 21 of the Act requires the insured to have knowledge of the matter that is said to have not been disclosed. The insured can only disclose what is "known". The insured not only has to have knowledge of the matter allegedly not disclosed, but the insured also either subjectively must know that particular matter was relevant to the decision making of the insurer about whether or not to enter into the policy, and if so, on what terms. Alternatively a reasonable person in the circumstances could be expected to know that the matter allegedly not disclosed was relevant to the insurer's decision making. This disclosure regime contained within the Act has replaced the old common law regime. The common law regime was different in a number of respects. It was based on a prudent insurer test and did not require the subjective and objective tests in s 21(1)(a) and (b) of the Act. Accordingly, the *Insurance Contracts Act 1984* (Cth) took a different direction. The subjective and objective tests also apply to the duty not to misrepresent and can be found within ss 26(2) of the Act.
6. In terms of proving that the insured either knew, or a reasonable person ought to have known, that the matter was relevant to the decision making of the insurer as to whether to enter into the policy, and if so, on what terms, it is observed that arguably this question is much easier to answer if the insurer has asked questions in a proposal or application for insurance in respect of the particular subject matter. Without relevant questions, a court may well ask how an insured or reasonable person respectively knew or could be expected to have known the relevance to the insurer's decision making. In situations where questions have been asked, it is more difficult for an applicant for life insurance to assert that she or he either did not know or a reasonable person could not be expected to have known that the matter was a relevant matter to disclose to the life insurer.
7. The process of answering questions in a proposal or application requires true statements in response. The duty not to misrepresent is therefore about providing information that is correct, whereas non-disclosure is about the failure to provide information. There will be situations where there is both a misrepresentation and a non-disclosure. In fact, every misrepresentation is also a failure to disclose the true facts. In other words, in cases where there has been a misrepresentation, there will always be a breach of the duty of disclosure. But not all breaches of the duty of disclosure involve a misrepresentation. A question may not have been posed by a life insurer. In terms of clearly pleading pre-contractual defences,

it is preferable in order of pleading for life insurers to plead misrepresentation before they plead non-disclosure.

8. Is fraud easier for a life insurer to prove in relation to a fraudulent misrepresentation, as opposed to a fraudulent non-disclosure? It is always difficult to establish fraud. It is a serious allegation to raise and therefore insurers are hesitant about raising fraud as a defence. The standard of establishing fraud is a very high standard as set out by the decision in *Briginshaw v Briginshaw* (1938) 60 CLR 336 and is reflected in the various State Evidence Acts.
9. The classic formulation of fraudulent misrepresentation comes from the decision of Lord Herschell in *Derry v Peek* (1889) LR 14 App Cas 337, UKHL 1. In summary, this case provided that fraudulent misrepresentation requires an intention to deceive or a reckless disregard for the truth. In *Prepaid Services v Atradius (No 2)* [2014] NSWSC 21, his Honour Meagher JA referred to the second limb of reckless disregard as "conscious indifference".

Remedies for misrepresentation and non-disclosure

10. Of all the amendments made to the Act by the *Insurance Contracts Amendment Act 2013* (no. 75, 2013) (Cth), it is likely that the changes made to s 29 of the Act are going to cause the most difficulty for life insurers. The amendments to s 29 commenced on 28 June 2014. The difficulty being paying close regard to whether a life contract or variation pre-dates or post-dates the amendments. Section 29 of the Act confers remedies on a life insurer for misrepresentation and remedies for non-disclosure.
11. The first gate in ss 29(1) of the Act provides, amongst other things, that an insurer must prove that it would not have entered into the contract of life insurance, or entered into the contract on the same terms, had the misrepresentation not been made, or had full disclosure been made. This subsection is effectively unchanged from pre *Insurance Contracts Amendment Act 2013* (No. 75, 2013) (Cth).
12. Subsection 29(2) of the Act provides life insurers with a remedy of avoidance if the misrepresentation or non-disclosure is fraudulent. The recent decision in *AIA Australia Ltd v Richards* (No. 3) [2017] FCA 1069 clarified the difference between avoidance and cancellation of a contract of insurance. In this case, an insurer was seeking recovery of amounts paid out to a fraudulent claimant who represented that they could never work again, but the claimant was actually residing in Latvia and Sweden, and was performing Botox therapy and other medical procedures. This case confirmed that avoidance is avoidance ab initio, meaning it is as if the contract never existed. It is retrospective, whereas cancellation is prospective, meaning cancellation only takes place from that point forward.

13. Avoidance means to treat the whole contract as having never existed. Cancellation is approached prospectively, as mentioned above. If an insured lodges a fraudulent claim, then the insurer does not have to pay that claim and may cancel the policy to avoid paying any future claim. However, for any past claims that have been lodged previously and legitimately, cancellation does not affect the insured's right to claim.
14. The decision in *Alexander Raymond Walton v The Colonial Mutual Life Assurance Society Ltd* [2004] NSWSC 616 confused the understanding of avoidance and cancellation, but Allsop J in *AIA Australia Ltd v Richards (No3)* [2017] FCA 1069 confirmed that avoidance means avoidance ab initio, and cancellation means cancellation prospectively. Section 59A of the Act, which did not exist prior to the 2013 amendments, specifies the grounds of cancellation of a contract of life insurance.
15. At common law if a policy was avoided because of an innocent misrepresentation or non-disclosure then the premium paid for the policy had to be repaid. In the case of a fraudulent misrepresentation or fraudulent non-disclosure, the question as to whether the premium has to be refunded was answered in the decision in *Chapman v Fraser* (1793) Park 456, which provided that the insurer does not have to refund the premium where there has been fraudulent conduct. The rationale for this rule is that the Court will not assist a person who has perpetrated a fraud. There is nothing in the general law or under the *Insurance Contracts Act 1984* (Cth) that requires the insurer who has been a victim of fraud to refund the premium. Generally, if it is a strong fraud case, many insurers would not pay back the premium, but if it was a case of innocent misrepresentation or innocent non-disclosure, the insurer would pay back the premium to the insured.
16. Prior to the 2013 amendments to the Act, ss 29(3) of the Act allowed avoidance of a contract of life insurance for innocent conduct within 3 years after the contract had first incepted. It referred to 'a' contract of life insurance, rather than 'the' contract of life insurance. Under the old formulation of s 29 of the Act, the life insurer has to demonstrate that it wouldn't have entered into "a" contract on any terms. However, post-amendment this is no longer a requirement. There is an alignment of sorts between ss 29(1) and ss 29(3) .
17. However, as above, this new formation applies only to contracts of life insurance entered into, renewed or relevantly varied after June 28, 2014. This means that life insurers, at the moment, have to look at the timeline very closely. It is important for life insurers to record their policy development correctly because they may have a policy that predates the changes in one respect, but post-dates the change in another respect. In these circumstances, s 27A of the Act may apply as this section now permits the life insurer to unbundle a contract of life insurance as if the various components were separate contracts of life insurance, and treat them separately.

18. Post-amendment if a life insurer has not avoided a contract of life insurance for fraudulent misrepresentation or fraudulent non-disclosure under ss 29(2) of the Act, is outside the 3 year period for ss 29(3), and is not seeking variation according to an additional premium that may be payable under ss 29(4) and (5) of the Act, it may still be able to look to ss 29(6) and ss 29(7).
19. Subsections 29(6) and (7) allow an insurer to vary the contract of insurance to put them into a position they would have been in if the misrepresentation or non-disclosure had not been made, but only if particular criteria are met. The criteria involve things such as being outside the three year period for innocent misrepresentation or an innocent non-disclosure, giving notice under ss 29(6) of the *Insurance Contracts Act 1984* (Cth), and seeking a variation that a reasonable or prudent insurer would have affected in the circumstances. The onus of establishing a variation falls on the life insurer. One difficulty that may arise in this respect is that life insurers may hold some of the information that would have to be disclosed if they were to give evidence in support of a proposition by another life insurer, but some of that information may be confidential. A reinsurer, on the other hand, may be able to give evidence as to the nature of the variation in terms of what a life insurer would have done had the disclosure been made, or had the misrepresentation not been made.

S 31A of the *Insurance Contracts Act 1984* (Cth)

20. Section 31A of the *Insurance Contracts Act 1984* (Cth) imposes a duty of disclosure on a life insured. This was one of the gaps in the *Insurance Contracts Act 1984* (Cth) in its original form that was filled by the 2013 amendments. As a digression it is interesting to note that the case of *FAI General Insurance Company Ltd v Australian Hospital Care Pty Ltd* [2001] HCA 38 led to the beginning of the reform process which culminated in the 2013 amendments. The reformation of the *Insurance Contracts Act 1984* (Cth) was one of the longest reform processes, as it was roughly 10 years from when the Cameron-Milne report (2004) was commissioned, initially to review s 54 following Australian Hospital Care and a review of the rest of the Act. .
21. During the reform process one of the gaps that was identified was where the Act treated a misrepresentation by a life insured as a misrepresentation by the insured. There was no equivalent provision in relation to non-disclosures by the life insured. This gap was filled by the insertion of s 31A of the *Insurance Contracts Act 1984* (Cth).

Structure of Life Insurance

22. In terms of the structure of a life insurance contract, the parties to the contract are the insurer and the contracting insured, who is also known as the policy owner within the *Life Insurance*

Act 1995 (Cth). The person who is the life that is insured is called the life insured. The life insured may or may not be the contracting insured, or they may be a different person. There may also be a third party beneficiary who exists in circumstances when the benefit is payable to a person other than the insured or life insured. As a result of the reform process, the position of the three different parties is much clearer.

Duty of the utmost good faith

23. Section 13 of the *Insurance Contracts Act 1984* (Cth) inserts the duty of the utmost good faith into the contract of insurance as an implied contractual term. Before this provision the duty was something that sat outside of the contract of life insurance. Prior to s 13, under the common law there was no remedy in damages for a breach of the duty to act in good faith, as it was not considered a term of the contract. Because under s 13 breach of the duty of utmost good is a contractual breach, it sounds in contractual damages.
24. After the 2013 amendments, the new ss 13(3) and (4) of the Act provide for a post contractual duty of utmost good faith in the hands of third party beneficiaries. Before the amendments to s 13 of the Act, there were some cases under the common law that suggested there was a duty of utmost good faith owed between the insurer and the third party beneficiary, but now that has been resolved by the amendments to s 13 of the Act.
25. Section 14 of the Act prevents a party to the contract of insurance from relying on the provision of the contract, when to do so would be a failure to act with the utmost good faith. For example, this section typically can prevent an insurer from relying upon an exclusion clause. Arguably the changes to s 13 flow through to s 14 of the Act so that a third party beneficiary can now invoke s 14 to prevent an insurer from relying on a provision of a contract of life insurance when that reliance would amount to a breach of the duty of utmost good faith. Section 14 of the Act is an underutilized provision.
26. One reason s 14 of the Act is so important is that it presents a straight forward remedy, an inability to rely on a provision of a contract of life insurance. Otherwise there are limitations on the remedies under s 13 for a breach of the utmost good faith. The remedy under s 13 is one based on contractual damages and there needs to be a causative link. For an insured the damages may be no more than the amount payable under the contract of life insurance.

Additional powers given to ASIC

27. The Australian Securities and Investments Commission (ASIC) can bring representative actions under s 55A of the *Insurance Contracts Act 1984* (Cth).

28. In the case of *Max Hams and 1 Ors v CGU Insurance Limited* [2002] NSWSC 273, ASIC sought to intervene and did successfully intervene. At the time of this case, prior to the 2013 amendments, ASIC required leave to intervene, but now post 2013 amendments, ASIC no longer requires leave to intervene, it can intervene in any relevant proceedings.
29. Under s 14A of the Act, ASIC now has specific powers in respect of certain breaches of the duty of the utmost good faith. Significant breaches, can lead to ASIC invoking its powers under the *Corporations Act 2001* (Cth) in terms of the licence of the insurer.

Key Takeaways

30. There are 3 main points to take away from this discussion:
- The changes to insurer's remedies for misrepresentations and non-disclosures under s 29 of the *Insurance Contracts Act 1984* (Cth) are advantageous to life insurers, but have brought added complexities. One of these complexities is that we now have to consider whether a contract of life insurance has incepted or has been renewed or varied after 28 June, 2014 when considering misrepresentations and non-disclosures. There may even be bundled contracts of life insurance that have covers that are treated differently under s 29 when unbundled under s 27A of the Act.
 - Section 14 of the Act is underutilized. If there is reliance upon a particular provision of a contract of life insurance and that reliance is in breach of the duty of utmost good faith then s 14 of the *Insurance Contracts Act 1984* (Cth) will provide a remedy. Arguably since the 2013 amendments the s 14 remedy is open to third party beneficiaries.
 - ASIC have enhanced powers under the *Insurance Contracts Act 1984* (Cth) in relation to representative actions and Australian financial services licensing. ASIC may become more active in this area, particularly given that there are so many Australians that have their insurance through superannuation funds.

BIOGRAPHY

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Peter Mann is a Barrister at Ground Floor Wentworth Chambers in Sydney. He is a recognised insurance and insurance law expert. Peter is an author of major insurance publications including *Mann's Annotated Insurance Contracts Act*, published by Thomson Reuters. He is an Adjunct Lecturer of the Faculty of Law at the University of Sydney, and teaches 'Insurance Law and Risk' at undergraduate level. Peter was the recipient of the prestigious AILA Annual Law Prize in 2012.

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He is a prolific author on insurance, superannuation and other financial services topics. He is a co-author of Thomson Reuters' *Wickens The Law of Life Insurance in Australia*. Articles by Stanley frequently appear in the LexisNexis *Insurance Law Journal*, *Insurance Law Bulletin* and *Superannuation Law Bulletin*. He is a member of the Editorial Boards of the *Insurance Law Bulletin* and *Superannuation Law Bulletin*. Stanley has a strong interest in the history of insurance law. He is an active member of the Australian Insurance Law Association and takes a leading role in arranging AILA events on life insurance topics, including the Annual Life Insurance Law Review.

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