HWL EBSWORTH
LAWYERS

Royal Commission Final Report Summary - Key Recommendations Affecting Life Insurance

Life Insurance

Pre-contractual disclosure and representations

A. Recommendation 4.5 – Duty to take reasonable care not to make a misrepresentation to an insurer

Part IV of the Insurance Contracts Act should be amended, for consumer insurance contracts, to replace the duty of disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer (and to make any necessary consequential amendments to the remedial provisions contained in Division 3).

- Commissioner Hayne's recommendation took into consideration the TAL case study regarding difficulties of placing a duty on consumers seeking insurance to disclose to their potential insurer, before the contract of insurance is entered into, information about the matters specified by section 21 of the Insurance Contracts Act.

- The view taken by Hayne was that *"the duty of disclosure presently contained in section 21 of the Act does not recognise the breadth and depth of the gap between what a consumer knows and what an insurer knows. That is, the duty fails to recognise the extent of the information asymmetry between a consumer and an insurer. And that gap is not closed by referring to what 'a reasonable person in the circumstances could be expected to know to be a matter so relevant'".*

- Commissioner Hayne referred to UK Law Commission and the Scottish Law Commission as well as submissions by entities for and against a move toward a duty to take reasonable care not to make a misrepresentation to an insurer. Hayne was in favour of the change on the basis that *"the essence of insurance that risk is spread between the holders of insurance. If the consequence of this change is that pricing may rise, the benefits of having more persons with effective insurance outweigh the detriments of increased pricing."*

- A duty to take reasonable care not to make a misrepresentation to an insurer places the burden on an insurer to elicit the information that it needs in order to assess whether it will insure a risk and at what price. The duty does not require an individual to surmise, or guess, what information might be important to an insurer.

- Breach of the duty of an insured not to misrepresent will engage the provisions of Division 3 of Part IV of the Act (sections 27A–33). Some consequential amendments to those provisions will be needed to recognise that there will no longer be a duty, in some cases, to make disclosures, only a duty not to misrepresent.

B. Recommendation 4.6 – Avoidance of life insurance contracts

Section 29(3) of the Insurance Contracts Act should be 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.

- A comparison was made to the pre 2013 amendments to section 29 (3).
- Given that a number of changes to section 29 were effected by the amending Act, the shift in the standard for avoidance may not be immediately apparent. However, the submissions to the Commission showed that the amendment has been understood, at least by some, as expanding the circumstances in which an insurer could avoid a contract of life insurance, so that a life insurer can now avoid a contract of life insurance if it can show that it would not have entered into *the same* contract of life insurance.
- Commissioner Hayne considered that the amendment results in an 'avoidance' regime that is unfairly weighted in favour of insurers. A number of entities recognised that the effect of the 2013 amendments was to tilt the balance in favour of insurers.
- Commissioner Hayne recommend that the position that existed prior to the amendment of section 29(3) be restored, 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.

Unfair contract terms

C. Recommendation 4.7 – Application of unfair contract terms provisions to insurance contracts

The unfair contract terms provisions now set out in the ASIC Act should apply to insurance contracts regulated by the Insurance Contracts Act. The provisions should be amended to provide a definition of the 'main subject matter' of an insurance contract as the terms of the contract that describe what is being insured.

The duty of utmost good faith contained in section 13 of the Insurance Contracts Act should operate independently of the unfair contract terms provisions.

- UCT regime to be located in the ASIC act.
- The considerations that render a UCT regime appropriate for other contracts for financial products and services apply equally to insurance contracts.
- Four key issues regarding policy design were considered:
    - Location of the UCT regime: ASIC Act.
    - The framing of the "main subject matter" of a contract: Commissioner Hayne preferred a narrower definition, as he considered "*the purpose of extending the UCT regime to insurance contracts would be undermined if the broader definition endorsed by industry were adopted."*
    - Interaction of UCT regime and Section 13 *ICA* duty: they are to operate independently.

- Transition period: Commissioner Hayne said it was desirable that there be no delay.

Claims handling

D. Recommendation 4.8 – Removal of claims handling exemption

The handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of 'financial service'.

- Referred to the handling and settlement of insurance claims being carved out from the definition of 'financial service' by regulation 7.1.33 of the Corporations Regulations.

- Noted that some of the general obligations set out in section 912A of the *Corporations Act* including in particular the obligation to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly did not govern the ways in which insurers:

  - make a decision about a claim, including investigating claims and interpreting policy provisions;
  - conduct negotiations in respect of settlement amounts;
  - prepare estimates of loss or damage, or likely repair costs; and
  - make recommendations about mitigation of loss.

- Commissioner Hayne noted (by reference to the case studies examined in the sixth round of hearings, particularly those of CommInsure and TAL regarding life insurance claims), that ASIC is limited in the regulatory interventions it can take due to the claims handling exemption.

- Commissioner Hayne recommended that the *Corporations Regulations* be amended, so that the handling or settlement of insurance claims, or potential insurance claims, is no longer excluded from the definition of 'financial service'.

Status of industry codes

E. Recommendation 4.9 – Enforceable code provisions

As referred to in Recommendation 1.15, the law should be amended to provide for enforceable provisions of industry codes and for the establishment and imposition of mandatory industry codes.

In respect of the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice, the Financial Services Council, the Insurance Council of Australia and ASIC should take all necessary steps, by 30 June 2021, to have the provisions of those codes that govern the terms of the contract made or to be made between the insurer and the policyholder designated as 'enforceable code provisions'.

- Considered it important that some provisions of industry codes be picked up and applied as law, so that breaches of those provisions will constitute a breach of the law.

- Referenced the Life Insurance Code of Practice (including that the next iteration of the Code was released for public consultation) and that the Insurance in Superannuation Voluntary Code of Practice was introduced on 1 July 2018.

- Recommended that in respect of the three insurance codes, the FSC, the ICA and ASIC take all necessary steps, by 30 June 2021, to have the provisions of those codes that govern the terms of the contract made or to be made between the insurer and the policyholder designated as 'enforceable code provisions'.

- The industry should continue to be given the option to seek general ASIC approval of its codes.

F. Recommendation 4.10 – Extension of the sanctions power

The Financial Services Council and the Insurance Council of Australia should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice to empower (as the case requires) the Life Code Compliance Committee or the Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code.

- Found that the Code Governance Committee had never exercised its powers to impose sanctions in response to those breaches, nor had the equivalent power been exercised by the Life Code Compliance Committee since 1 July 2017.

- The evidence indicated that the power to impose sanctions had not been exercised because the Committees could only impose sanctions where an insurer had failed to *correct* a Code breach. Sanctions could not be imposed in response to a breach of the Code, in and of itself.

- Recommended that FSC and the ICA should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice to empower (as the case requires) the Life Code Compliance Committee or the Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code. When considering whether to impose sanctions following a breach, the Committees should continue to be guided by the matters referred to in section 13.14 of the General Insurance Code of Practice and section 13.13 of the Life Insurance Code of Practice.

Group life policies

G. Recommendation 4.13 – Universal terms review

Treasury, in consultation with industry, should determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.

- In many cases, default members will not have made any active choice about the fund they have joined or considered the insurance offered through that product. Often a member will join the default fund chosen by their employer.

- Members are not always able to identify how key terms, definitions and exclusions will affect their coverage under their policy.

- ASIC Report 591 noted the difficulties that consumers face when comparing definitions in policies such as the definition of total and permanent disability. ASIC considered there was scope for improvement in this regard, including by the use of standardised definitions in policies.

- The adoption of standardised terms should be carefully considered, and the consequences of change identified, before they are implemented.

- Commissioner Hayne recommend that Treasury, in consultation with industry, determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.

H. Recommendation 4.14 – Additional scrutiny for related party engagements

APRA should amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, to obtain and provide to APRA within a fixed time, independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements.

- Commissioner Hayne expressed concerns about the conflicts that arise where related parties are engaged. Those concerns have equal force in the context of group life insurance.

- Entities that elect to integrate their businesses do so, overwhelmingly, for their own reasons (i.e. AMP and AMP Life). The entity's motivation will usually be to increase market share, to increase revenue, to increase profit, to place commercial pressure on its competitors, or some combination of those factors.

- The need for assurance of the appropriateness of the arrangements is all the stronger in circumstances where, as with the introduction of MySuper and the requirements for default superannuation, a policy decision has been made that is, by design, protective of the interests of members.

- Commissioner Hayne suggested that "*RSE licensees who engage related parties as insurers should be required to demonstrate to APRA how they are meeting the expectations of SPS 250"*, and that, among other things*, "at a minimum, that certification should be obtained before any policy of insurance is entered into and each time any policy is renewed".*

I. Recommendation 4.15 – Status attribution to be fair and reasonable

APRA should amend Prudential Standard SPS 250 to require RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.

- This section dealt with superannuation members' status classification i.e. ceasing to work with an employer; smoker classification or occupational type classifications, having an impact on rates charged to certain members in various categories ascribed by the Funds.

- Commissioner Hayne noted that *"ASIC's work shows, default members are vulnerable. There is, therefore, merit in providing some further protection"*.

- Trustees must be required to make proper arrangements about the premiums that will be charged to default members. That can be achieved by APRA amending SPS 250 to require that any status attributed to default members (such as 'blue-collar', 'smoker', or other status affecting the premium to be charged for insurance) is fair and reasonable. Ordinarily that would require consideration of whether the status attributed is statistically appropriate.