2019 ALUCA TurksLegal Scholarship
2nd Runner-Up Paper

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"To disclose or not to disclose: that is the question!"

"There are worse things in life than death. Have you ever spent an evening with an insurance salesman?" – Woody Allen

The insurance industry has an image problem. Reform aimed at modernizing the law and restoring consumer confidence is overdue. Abolishing the duty of disclosure is not a new idea. The UK did it in 2012, and New Zealand is considering doing the same. Will the duty of disclosure be missed in Australia? Not for long.

Following the Royal Commission into Misconduct in the *Banking, Superannuation and Financial Services Industry,* Commissioner Hayne recommended the duty of disclosure be replaced by a **duty to take reasonable care not to make a misrepresentation to an insurer**. The Australian Government has agreed to make this change.

It has been widely acknowledged there is an imbalance of knowledge about what ought to be disclosed to an insurer.[1] The changes would seek to move the onus of identifying what needs to be disclosed clearly to the insurer who has the expert knowledge of insurance risks and actuarial data to support their underwriting. The changes would discourage insurers from taking a passive approach to underwriting by removing the ability to avoid a contract due to non-disclosure.

The Current Position

Section 21 of the *Insurance Contracts Act 1984* (Cth), sets out that the insured must disclose circumstances that a reasonable person would know to be relevant to an insurer's assessment. Currently an insurer can avoid a contract within the first 3 years due to almost any non-disclosure or misrepresentation. (The government has now agreed to make policy avoidance possible only if the insurer proves it would have declined the application.)

There has already been significant reform in Australia. The first *Insurance Contracts Act 1984* (Cth) adopted recommendations by the Australian Law Reform Commission's Insurance Contracts report.[2] The common law duty of disclosure remained but its reach was limited by requiring insurers to make the duty of disclosure clear, and to waive the duty of disclosure if they don't follow up missed or incomplete questions. Further reform gave rise to the *Insurance Contracts Amendment Act 2013* (Cth). If the underwriting process has taken more than 2 months, a duty of disclosure reminder is required.[3] It also extended the duty of disclosure to insured members under a Group life policy.

General insurance has already seen a shift in judgments from the NSW Court of Appeal to put the onus on the insurer to ask specific questions, and to have the knowledge to know what is relevant to ask.[4] In *Marketform v Amashaw*[5] iendorsing the approach taken in the *Stealth Enterprises v Calliden* case[6], it was determined that *Amashaw* did not need to disclose it knew about pollution beneath its service station (for a liability policy that covered pollution) because, although the general duty of disclosure was brought to the insured's attention, no specific questions were asked about pollution on the proposal form.[7] Both judgments noted the insurer specialized in cover for specific industries and should have known what to ask.

Observations from abroad

The UK amended their insurance law in 2012 after 106 years of the *Marine Insurance Act 1906* (UK). In 1906 the law was designed to protect insurers. Its review was on the parliamentary agenda for over 50 years, and it was completed after 10 years of work by the UK and Scottish Law Commissions. The *Consumer Insurance (Disclosure and Representations) Act 2012* (UK) replaced the duty of disclosure with a duty for the consumer to take reasonable care not to make a misrepresentation, a position adopted by Commissioner Hayne. Of the 39 insurers and insurance representatives who responded to the Law Commissions' consultation questions, only 4 argued against statutory reform.[8] There has been no life insurance case law to test the reform yet. However, UK Ombudsman online case studies (for general insurance) all found in favour of the insurer mostly because the insured had not taken care in answering underwriting questions.[9]

New Zealand law requires an insured to disclose circumstances that a reasonable insurer would regard as material to its decision to accept the risk.[10] In May 1998 the New Zealand Law Commission published a paper called 'Some Insurance Law Problems' with the duty of disclosure listed as the most contentious issue. Limiting the duty of disclosure and requiring clear and specific questions were listed as

possible solutions to the noted disadvantage of the consumer.[11] It took 20 years for this paper to be re-examined and submissions were taken last year for re-consideration. The New Zealand government currently has five separate projects running to modernise insurance law.[12]

Consequences

> ***"If they wanted to know, why didn't they ask?"***

Insurers will now have to ensure they ask all the necessary questions relevant to a risk with clear and unambiguous language. The consumer will have to answer those questions honestly and reasonably. That should not be a fundamental change. The reality is that in practice insurers only expect consumers to answer questions asked and yet they are still able to respond to market pressures to shorten forms and simplify the underwriting process.

When abolishing the duty of disclosure was first considered in Australia in 2013, it was rejected because of the belief that long forms with complex and specific questions would be required and would be impractical.[13] There was equally strong opposition from insurers this time around.[14] Similar arguments were made in the UK. The concern that a highly conservative and risk-averse culture would result was not realised in the UK and nor is it likely to be in Australia.

Like the Lloyd's Market Association in the UK, the *Australian Prudential Regulation Authority* (*APRA*) noted pricing would likely be affected by reform, but Commissioner Hayne wasn't swayed.[15]

> *"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."*
>
> \- Commissioner Hayne

Any changes to the underwriting process would not be insurmountable. Even with a strict duty of disclosure the life insurance underwriting process is robust. Underwriting guidelines are comprehensive and regularly reviewed (with technical teams dedicated to them), and underwriting standards are frequently audited both internally and by reinsurers. Change will come from the way proposal forms are formulated.

The use of short forms for limited cover, and intuitive electronic applications have already gone some way to help give the underwriter enough information to accurately assess the risk while offering a more positive customer experience. There is still significant variation amongst insurers about how they word health-related questions, and whether subjective or self-limiting language is used. Potential for improvement exists which may be propelled forward by legislative reform.

Insurers should be mindful about continuing to give consumers opportunity to update or amend their disclosures up until cover inception. The insurer prompting these opportunities will likely be a consideration when the courts consider the reasonableness test in future.

The Reasonableness Test

Until the standard of 'reasonable care' has been defined by the Australian courts there may be a period of some uncertainty for the insurer and the insured alike. During that period both parties could be drawn into litigation in order to establish where they stand. The proposed change would capture a deliberate misrepresentation and a negligent misrepresentation but not an innocent misrepresentation. It is these distinctions that mean it is not just the fact of a misrepresentation that would need to be established but also the quality of the misrepresentation and that is what might create a period of potential uncertainty (for both parties). It will take time before the change will be regarded as better than the status quo, but once the new case law is settled, that point will be reached.

The UK decided the test for "reasonableness" should be objective, looking at what you would expect from a reasonable consumer.[16] The UK Ombudsman thought this did not provide sufficient protection for people without financial capability, who they described as "honest but dim".[17] An argument that did not convince the Law Commissions.

Not every statute has stood up to its intention once tested with actual disputes by the courts. Group life insurance has been a casualty of this as evidenced by the case of *Sharma v LGSS*[18]. Section 21 of the *Insurance Contracts Act 1984* (Cth) did not apply to people who obtained cover under a Group contract prior to 2013 because the duty to disclose was on the policy owner, which in Group insurance is not the life insured. A recent Australian Financial Complaints Authority (AFCA) determination affirmed this principle and went further by stating no remedy could be sought by the new insurer because representations were made to the previous insurer.[19] This will have far reaching implications for the Group life sector where the transfer of funds to new insurers is commonplace. This is a good example of rules-based regulation that isn't congruous with established industry principles, and of the importance of review and reform.

General Questions

The Australian Government acknowledged the duty of disclosure is important for insurers to appropriately price and underwrite risks, but felt the current law fails to protect consumers who inadvertently fail to disclose a circumstance because insurers failed to ask the right questions.[20]

Catch-all, general or open-ended questions are unlikely to invoke the duty of disclosure via the back door because insurers cannot seek remedy if incomplete answers are given. In the UK insurers are allowed to ask general questions but in doing so, run the risk of receiving vague answers.[21] UK consumer groups felt general questions acted like a trap and acknowledged people are not always careful answering such questions.[22]

It is unlikely a general question would be of use for remedy without the duty of disclosure. One of the reasons for replacing the duty was to encourage the insurer to ask more specific and clear questions that all consumers can understand. They are still useful for underwriting, as they are sometimes used at the start of proposal forms for the sole purpose of prompting a consumer to start thinking about what they need to disclose. It is yet to be seen whether the reform will be enacted in a way to either restrict or limit the scope of such questions.

Utmost Good Faith

Uberrima Fides
Noun: utmost good faith (*literally, "most abundant faith"*)
Origin: Latin

The duty of utmost good faith, established by the landmark case of *Carter v Boehm*[23], has also come under scrutiny. There has been little consensus on its use and scope.

In the UK it was mainly to protect the insurer and damages for an insurer breaching this duty have never been awarded.

In the USA it is used to protect consumers who can seek punitive damages in most states.

In New Zealand the case of *Young v Tower*[24] established that it was a reciprocal duty and Tower had to pay damages.

In South Africa the judgment in *Mutual & Federal v Oudtshoorn*[25] affirmed that an insurance contract is one of good faith, but it rejected the premise that there are degrees of good faith. A further South African ruling in *Jerrier v Outsurance*[26] noted that what is required to be disclosed at time of application needs to be clear and unambiguous, and if there is any doubt the insurance contract will be interpreted in favour of the insured.

In the *Insurance Contracts Amendment Act 2013* (Cth), failure to comply with the duty of utmost good faith would be a breach of the Act. However, in the Queensland Supreme Court judgment in *Matton Developments v CGU Insurance*[27] the court asserted that the intention of the amendment is to provide regulatory sanctions for a contravention of the duty and to allow the Australian Securities and Investments Commission (ASIC) to provide assistance to affected insured in seeking contractual remedies, but does not give rise to a statutory duty.[28]

The courts may disagree on the scope and use of the duty of utmost good faith but it is clear it will not be a duty of disclosure by another name.

Summary

"Insurance is no longer the province of a mercantile class. It is a universal product."

\- ***Commissioner Hayne***

There is a perception of systemic unfairness in the insurance industry. Despite the fact the industry pays over $8 billion in claims each year,[29] an April 2016 PwC survey found that while 78% of Australians view life insurance as important, only 42% believe their life insurer will pay a potential claim. Several high profile reputational scandals have only widened the gap between insurers and consumers when it comes to trust.[30]

Insurers are historically slow to change since their business relies on stability and risk aversion[31], but change is happening as evidenced by court judgements. Although insurers raised concern with replacing the duty of disclosure, the courts were already starting to move in the direction intended by the reform. Once the courts start heading in a direction it is best to legislate for clarity.

The insurer-insured relationship is one in which trust and confidence need to be strong. The role of the insurer in this relationship is never more important than when an insured or their family is under stress and vulnerable. Yes, the duty of disclosure will be missed by insurers for a time, but the opportunity to protect the consumer and protect the reputation of the industry makes this a reform deserving of support. The goal is a worthy one – restore confidence in the industry.

"To thine insurer be true and thou canst not then be false to any man."

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