Did you know?

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Insurance Contracts Act changes 28 June 2014

This week's *Did you know?* article looks at upcoming changes to the Insurance Contracts Act 1984 (ICA) (the Act) that impact on life insurance.

The third tranche of changes introduced by the Insurance Contracts Amendment Act 2013 commence from 28 June 2014. Earlier amendments effective from 28 June 2013 and 28 December 2013 included making a breach of the fundamental insurance principle of acting with "utmost good faith" a breach of financial services law, providing clarity on the options (and remedies available to the insurer) in the claims assessment process to "unbundle" policies based on benefit type, lives insured and underwritten/non-underwritten elements of the contract, and remedies available to the insurer for non-disclosure and misrepresentation, including misstatement of age by the policy owner/life insured (insureds). Other changes included new powers for ASIC to intervene and be represented in proceedings in relation to a matter under the Act, and formalising electronic communication as a valid method of communicating a notice or other document where the Act requires this to be "in writing".

Three significant ICA changes affecting life insurance take effect on 29 June 2014. They are:

1. Remedies available to insurers for non-disclosure and misrepresentation by insureds
2. Clarifying and extending the rights of third party beneficiaries under policies of life insurance
3. Non-disclosure or misrepresentation by members of group life insurance schemes

Remedies for non-disclosure and misrepresentation by insureds

Sections 29 and 30 of the ICA provide remedies for life insurers in relation to misstatements, misrepresentations and non-disclosures. If there is a misstatement about the date of birth of the life insured, section 30 provides for a remedy for the insurer, based on the principle of proportionality, to vary the sum insured or adjust/refund premiums. The remedies in section 29 deal with pre-contractual misrepresentations and non-disclosure about relevant matters other than age/date of birth. In summary:

- the only remedies for fraudulent non-disclosure or misrepresentation are either avoidance of the contract or, rarely, variance of the sum insured within 3 years of policy issue;
- the only remedies for innocent non-disclosure or misrepresentation discovered within 3 years are either:
  - a variation of the sum insured according to the statutory formula; or
  - if the insurer would not have been prepared to enter into a contract of life insurance *on any terms,* it may avoid the contract;
- there is no remedy for innocent non-disclosure or misrepresentation discovered after 3 years.

It was deemed that the current remedies for life insurers in section 29 of the ICA are not well-suited to non-traditional life insurance policies (e.g. income protection or total and permanent disability (TPD)).

Under the ICA amendments effective 29 June 2014, all life insurance contracts will continue to be subject to the remedies in section 29 of the ICA. Life insurance contracts that combine more than one type of cover e.g. death and TPD, are "unbundled" for the purpose of applying the relevant remedies for non-disclosure or misrepresentation. However, an insurer will now be able to avoid a life insurance contract on the basis of innocent or fraudulent non-disclosure or misrepresentation if it would not have entered that particular contract. This is significant as currently for innocent non-disclosure or misrepresentation, the insurer must show that it would not have entered into a contract of life insurance on any terms. The 3-year limitation on avoiding for innocent non-disclosure or misrepresentation continues to apply.

If the insurer does not avoid the contract or has not varied the contract in accordance with the statutory formula, the insurer may vary the contract to place the insurer in a position that the insurer would have been in if the duty of disclosure had been complied with or the misrepresentation had not been made. In varying the contract, the insurer must have regard to the position in which other reasonable and prudent insurers that had entered into similar contracts of life insurance would have been, at the time the relevant contract was entered into. This new remedy does not apply to death cover or cover with a surrender value.

Third party beneficiaries

The concept of a third party beneficiary (i.e. a person specified in the policy as entitled to claim but who is not a contracting insured) is currently dealt with in section 48A of the ICA. A new definition of Third Party Beneficiary (TPB) has been inserted into the Act as the term is now used in a number of provisions other than section 48A.

The amended section 48AA applies where a retirement savings account (RSA) provider takes out a policy for the benefit of RSA holders. It provides RSA insurance holders the right to recover a benefit from the insurer in accordance with the contract notwithstanding that he or she is not a party to the contract. A change has been made in subsection 48AA(3) to make it clear that in defending an action made by a TPB the life insurer may raise defences relating to the conduct of the insured and the conduct that may have occurred either before or after the policy was entered into (e.g. non-disclosure by the insured).

Currently, section 48A applies to life policies that are effected on the life of one person, but expressed to be for the benefit of another person (a TPB). It is to be amended to:

- allow for circumstances in which a person whose life is insured under a life policy may be a TPB;
- ensure that a TPB who has a claim over money payable under a life policy may bring an action against the insurer in respect of the claim without the intervention of the policy holder; and
- ensure that the TPB is capable of giving a valid discharge to the insurer in relation to the insurer's obligations in respect of the claim.

The changes apply to:

- life policies originally entered into after 29 June 2014, and
- variations to life policies after 29 June 2014 that increase the sum insured under the policy; increase the number of life insureds under the policy; or provide one or more additional kinds of cover, but only to the extent of the variation.

The amendment allowing a life insured to be a TPB under a life policy corrects a long-standing anomaly whereby the pre-amendment ICA provisions arguably precluded a life insured (and upon death, his or her estate) from being nominated as a beneficiary of the death benefit. For instance, where an estate planning strategy required a benefit to be split between the estate (e.g. to fund a testamentary trust) and individual beneficiaries, this was not possible under the one policy, and a separate policy needed to be taken. The amendment will also rectify the situation where a child life insured under the Child Cover Option could not be nominated as a beneficiary of a parent's Life Care benefit.

Group life insurance

Amendments to the Act will make it clear that the duty of disclosure owed to the insurer applies not just to the policy owner but also to the life insured. After 29 June 2014, a failure to comply with the duty of disclosure is taken as having occurred before the proposed life insured became insured under a group policy. In assessing an individual life insured under a group policy, the policy is deemed to have been entered into at the time cover for the individual commences.

Summary

Advisers and their clients should be aware of relevant life insurance changes taking effect on 29 June 2014 as a result of amendments to the Insurance Contracts Act.