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Heather Gray
Lead Ombudsman - Superannuation
Australian Financial Complaints Authority
GPO Box 3
Melbourne VIC 3001
by email: consultation@afca.org.au

Dear Heather,

AFCA Approach Consultation - Superannuation

We welcome the opportunity to provide our views on AFCA's draft approach to s.29(6) s.29(7) of the Insurance Contracts Act (ICA).

Berrill & Watson Lawyers is a leading consumer law firm who represent consumers in life insurance disputes. We are one of the largest life insurance and superannuation practices in Australia. We are a firm who is highly specialised in life insurance and we act for consumers in every state in Australia.

Background

Prior to the introduction of s.29(6) and s.29(7) ICA, in circumstances where non-disclosure or misrepresentation occurred the only useful remedy that was reasonably available to an insurer was to avoid the policy under s.29(2) or 29(3) ICA. It was recognised by both the insurance industry and consumer representatives that avoidance was a blunt and often harsh remedy.

The harshness arises because a consumer may have applied for insurance and, for example, failed to fully disclose a mental health history. There were many instances where the consumer would later seek to claim for some other physical injury which is completely unrelated to any mental health condition. It was common in such cases that the insurer would then avoid the policy. This was the case even where the underwriting evidence showed that a mental health exclusion would have been applied by the insurer.

As can be seen from the above, the outcome is harsh because the consumer can't claim for their injury even though it was unrelated to the matter that wasn't disclosed (mental health) and which wouldn't have been captured by any exclusion which otherwise would have applied.

Sections 29(6) and 29(7) ICA were introduced as a part of a package of reforms to the ICA which occurred in June 2013. The effect of the reforms was to broaden the remedies available to insurers and to make the system fairer for insurers and consumers where a "relevant failure" occurred.

AFCA's Approach

At the date of writing this submission there has been no judicial guidance from the courts about the approach to be taken in respect of s.29(6) and s.29(7). We will deal with each section separately.

Section 29(6)

As AFCA's approach points out, s.29(6) ICA enables an insurer to retrospectively vary an insurance policy in certain circumstances, and s.29(7) operates to constrain the circumstances in which such a remedy might be exercised.

We agree with the AFCA approach that the onus must necessarily be on an insurer to establish all of the matters required to exercise a remedy under s.29(6).

We agree with the AFCA's approach that s.29(6) has no operation where the contract provides cover for death or a contract with a surrender value. It is our view that such a position is legally uncontroversial, and plain on the wording of s.29(10) of the Act. We agree with the approach that AFCA has provided here and which was previously set out

in AFCA determination 848983 in which it was said in respect of an income protection claim:

> *"As the IP policy contains insurance cover in respect of the death of the life insured, pursuant to s 29(10) of the Act, the insurer is not able to vary the IP policy to include a bilateral shoulder exclusion"*

It is our view that AFCA's approach in respect of how s.29(10) operates with s.29(6) is correct.

We agree with AFCA's approach which indicates that AFCA will require that an insurer to have given notice, which is sufficiently clear which evidences:

- "*whether the variation applies to total and permanent disability (TPD) cover and income protection (IP) cover, or whether it just applies to one or the other*
- *that the variation to the contract to apply a mental health exclusion takes effect from the start of the contract; and*
- *the exact language of the mental health exclusion so the life insured can reasonably know which conditions are and are not covered."*

In our view, the above are minimum requirements which must be provided in order to have satisfied the requirement under s.29(6) ICA to give notice in writing to the insured. That is, if any of the above matters have not been conveyed to a consumer in writing the AFCA ought to adopt the approach that the variation has not validly occurred.

Section 29(7)

As we have stated above, s.29(7) is an important guardrail which operates to constrain the circumstances in which an insurer can exercise a right of variation. An integral part of the design of s.29(7) ICA is that an insurer's position after variation cannot be inconsistent with what <u>other</u> reasonable and prudent insurers would do in the circumstances.

The reason for requiring the insurer to act in a manner not inconsistent with what "other" reasonable and prudent insurers would do is critical because it prevents an insurer who has a financial interest in the outcome from acting in a manner that is oppressive to a

consumer by producing a self-serving underwriting opinion. It also means that consumers can have confidence that the position the insurer has adopted is not driven by a profit motive. Indeed, the explanatory memorandum to the bill introducing the legislation specifically stated:

> "When an insurer is endeavouring to establish whether the variation is or is not inconsistent with how other reasonable prudent insurers would have varied a similar contract, an insurer would generally be required to seek a view from **one or more third parties** as to what other reasonable or prudent insurers would have acted. These third parties may include but would not be limited to underwriters." (our emphasis)

It is clear from the above that the parliament's intention when introducing the legislation was that an insurer seeking to exercise a right to vary a contract of insurance would need to produce evidence from other financially disinterested parties which confirms that the action they are taking is reasonable. This is a very important consumer protection mechanism which we submit must be adhered to, to ensure consumer confidence in the process.

We note that AFCA's approach currently contemplates that evidence which an insurer can produce to support its position can be:

- a statement from an external consultant underwriter
- a statement from a person working at a reinsurer; or
- a statutory declaration from a person working for the insurer who has sufficient experience with other insurers to comment on what other reasonable and prudent insurers would have done.

We submit that a statutory declaration from a person working for the insurer should not be accepted by the AFCA as evidence in support of its position, and nor should the opinion of a person working at a re-insurer if the re-insurer has any liability associated with the claim. This is because any such opinion would not satisfy the plain requirement in the legislation that there be evidence as to what "other" reasonable insurers would do.

Such evidence should not in our view be able to be relied upon by an insurer because a consumer could not have confidence that such an opinion hasn't been tainted by profit

motive and the fact that the person works for the insurer who is responsible for paying the claim.

In the AFCA Approach document AFCA has provided case study 2 to illustrate how this would apply in practice. In the case study, AFCA would allow the insurer who has liability for the claim to give its own evidence about what it believed other reasonable insurers would do. That is not an appropriate approach because it would enable an insurer with a profit motive to provide its own opinion to the detriment of a consumer, and it does not comply with the plain requirement in the legislation that the evidence be that of "other" insurers. The case study also refers to evidence of the head of underwriting at a re-insurer but the case study does not state whether that re-insurer holds any liability associated with the claim. The consumer needs to be able to have confidence that the retrospective variation has been done fairly, and not because of a profit motive. That can only be achieved it the person giving the opinion does not hold liability for the claim.

In relation to underwriting evidence generally, Courts have said that "hypothetical" underwriting evidence such as that required by 29(7) must be approached with caution when it is given by the insurer on risk for the claim. For example, in *Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited* [2017] NSWCA 71, the New South Wales Court of Appeal said as follows in relation to the evidence of an underwriter employed by the insurer defending the case:

> *"[87] Courts have repeatedly warned about the dangers of evidence as to likely conduct in hypothetical situations where the evidence is given through the "prism of hindsight". These warnings have generally been given in the context of evidence by injured plaintiffs as to what they would have done had they known of a particular risk which in fact eventuated. Ms Shepherd was not an injured plaintiff, but her evidence had some of the characteristics of hindsight evidence given by injured plaintiffs. It was evidence given in the interests of her employer with the benefit of knowledge that the insured risk had eventuated and that information had come to light which, if known at the time, might have justified Calliden in declining the risk. Evidence of this kind needs to be assessed not simply on the basis of the credit of the witness but also by reference to the objective probabilities."*

It is very important for consumers that they can be satisfied that they are being treated fairly. If insurers produce independent opinions from other underwriters who do not work for the insurer responsible for the claim (or the reinsurer who is responsible for the claim), then they can have a higher degree of confidence that the opinion produced is fair.

The importance of having a third-party opinion is also important bearing in mind that a consumer will almost never be able to produce any underwriting evidence because they will not have the underwriting knowledge or resources to enable them to do so. Accordingly, if an insurer is permitted to rely upon an internal employee's statutory declaration, even if that evidence isn't afforded any weight, it is likely to be the only evidence on that issue. That would be a very unfair approach in our view.

Given the above, we submit that when considering whether an insurer has satisfied the requirements under s.29(7) of the Act, the AFCA should require the insurer to produce evidence from other third-party insurers or reinsurers who do not have any liability associated with the claim.

We thank you for the opportunity to provide our views in relation to the consultation. We are happy to provide further clarification in respect of the above, should AFCA request the same.

If you have any questions, please contact the writer.

Yours sincerely,

Paul Watson
Principal
Berrill & Watson Lawyers