The AFCA Approach to cancellation of instalment contracts

We have created a series of AFCA Approach documents, such as this one, to help consumers and financial firms better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and complaint types that we see at AFCA. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about key issues.

1 At a glance

1.1 Scope

AFCA reviews complaints where a financial firm denies a claim because a general insurance contract was cancelled due to the consumer failing to pay a premium.

This paper discusses AFCA's approach to such complaints and will be useful for financial firms involved in the general insurance industry, their customers and representatives. The approach has been adopted from AFCA's predecessor scheme the Financial Ombudsman Service.

1.2 Summary

AFCA considers the following matters in these types of complaints:

- when the right of cancellation occurred
- whether the financial firm exercised its right of cancellation in a clear and unequivocal manner
- where the financial firm provided notice of cancellation, whether:
  - the notice was clear and unequivocal,
  - the financial firm complied with the requirements of sections 59 and 72A of the Insurance Contracts Act 1984 (ICA)
  - the appropriate timeframe had lapsed.

- where the financial firm did not provide notice of cancellation because it contained a policy provision that complied with section 62(2) of the ICA, whether:
  - this provision "clearly informed" the consumer of its effect (i.e. that it would cancel the policy without notification)
  - the appropriate minimum timeframe had lapsed (30 days)
  - the insurer exercised its right consistent with the policy provision.

In numerous instances, financial firms send letters to consumers informing them of the outstanding premium (reminder letters). In those cases, AFCA will determine whether the reminder letter:

- has the effect of cancelling the policy (if the financial firm is relying on such a letter in that regard) or
- provides an extension of time – that is, the financial firm purports to not exercise a right to cancel until the timeframe in the letter passes
- gives rise to a representation that the due date under the policy was extended and the consumer relied on this.

2 In detail

2.1 Cancelling an insurance contract

What is the difference between a financial firm failing to renew a policy and cancelling it?

Most general insurance policies expire at the end of the year as agreed by the parties when the policy is taken out.

Therefore, the financial firm's decision to not offer renewal is not a cancellation. It is simply a decision not to enter into another insurance contract with the consumer. Subject to providing notice of when the policy will expire and whether the financial firm will offer renewal (section 58 of the ICA), the financial firm has no further obligation.

In contrast, a cancellation is the financial firm terminating an existing contract earlier than agreed.

It can do so only under certain circumstances. Further, it must satisfy a number of criteria to ensure any such cancellation is effective.

Why must a cancellation be clear and unequivocal?

Generally, legal principles state a party can terminate (cancel) or seek performance of a contract (premium payment) in circumstances when the other party breaches a condition. In such circumstances, the innocent party will be required to choose (or elect) which set of rights to pursue.

This election requires an unequivocal act or clear words showing a choice made between two inconsistent rights. That is, if the party is seeking to cancel the policy, it cannot seek performance of it at the same time.

Further, once that choice is made, the party cannot back out of it.

These principles apply to insurance contracts.

When can the insurer cancel a general insurance contract?

In general insurance contracts, a financial firm is only entitled to cancel a contract in a manner predominantly allowed for under section 60 of the ICA.

Section 60(1)(d) states:

> "a person who is or was at any time the insured failed to comply with a provision of the contract, including a provision with respect to payment of the premium".

Insurance contracts where the premium is payable by monthly instalments ("instalment contracts") will often contain a provision that states when an instalment premium is due and payable.

AFCA accepts that when a consumer fails to pay a premium instalment on the due date, the financial firm has a right to cancel the contract the following day.

However, a right to cancel a contract does not automatically result in the policy being cancelled. Instead, the financial firm may elect to:

- cancel the insurance contract or
- seek payment of the outstanding premium.

How must a financial firm exercise a right to cancel?

If the financial firm elects to cancel the contract, it must provide written notification pursuant to section 59 of the ICA.

The exception to this is section 62 of the ICA, which is discussed in the next chapter.

In providing notification, the letter must:

- clearly and unequivocally state that the financial firm is cancelling the contract
- be sent after the right to cancel the contract arises.

How much time must the financial allow?

In providing notification, the financial firm must be mindful of when the cancellation becomes effective.

For instance, if the policy states a financial firm will cancel a policy one month after a premium remains unpaid, AFCA regards the cancellation as effective when that timeframe lapses.

This is consistent with fairness as well as:

- section 59(2)(b) of the ICA
- the financial firm's obligations to act with utmost good faith
- good industry practice.

However, if the nominated cancellation date is incorrect, this does not invalidate the cancellation notice.

Provided the right to cancel has accrued and the financial firm has exercised that right in a clear and unequivocal manner, the cancellation will be effective once the relevant timeframe passes.

2.2 Cancelling an insurance contract without notice

When can an insurer cancel the policy without notice?

Section 62 of the ICA allows an insurer to cancel a general insurance contract without notice if it satisfies the following criteria:

- the policy contains a provision that is inconsistent with sections 59 and 72A
- the financial firm seeks to rely on this provision when exercising a right to cancel
- one instalment premium has remained unpaid for at least a month
- the financial firm clearly informed the consumer of the effect of the provision before the contract was entered into.

What does 'clearly inform' mean?

AFCA considers that it is fundamental to clearly inform the consumer of the "effect" of unpaid or overdue premiums.

In AFCA's view, the "effect" requires the financial firm to clearly state that the policy will be cancelled without notification after an instalment payment remains unpaid for one month.

Some policies do not satisfy this requirement.

For instance, a provision may state that the policy will be cancelled one month after a premium is overdue. However, such wording is arguably consistent with sections 59 and 72A because it does not clearly state that the financial firm will cancel the contract without notice.

If a policy provision does not satisfy the criteria set out in section 62, the financial firm cannot cancel the policy without appropriate notice. If it does, AFCA's position is that the policy was cancelled incorrectly and is void in accordance with section 63 of the ICA.

Does the financial firm have to rely on the policy provision?

Even if the policy contains a provision that complies with section 62 of the ICA, the financial firm does not necessarily have to apply it.

Instead, when a right to cancel the contract arises, the financial firm can exercise its right to cancel the contract by:

- providing notice consistent with sections 59 and 72A of the ICA
- following the procedure set out in the policy provision.

In doing so, the financial firm should be clear as to what method it is choosing and follow through with the required steps.

For instance, if the policy sets out a process and timeframe of how the financial firm will cancel the policy that complies with section 62(2), the financial firm must follow through with it.

2.3 Sending reminder letters

Can reminder letters also be relied on to cancel a policy?

It is usual for financial firms to send letters to a consumer when payment has fallen overdue and allowing them another opportunity to pay the premium (reminder letter).

However, financial firms also rely on these letters as evidence that it exercised its right to cancel the policy. That is because the letters will often say that if the consumer does not pay a premium on a certain date, the policy will be cancelled.

As stated previously, a financial firm must clearly and unequivocally exercise a right to cancel the contract for it to be effective. Such a letter would not satisfy this requirement.

This is because the letter states the financial firm will cancel the contract only if something does not happen at a certain date. Such a communication is equivocal and would be considered a threat to cancel rather than the exercise of a right to cancel the contract. This is consistent with relevant case law.

What is the effect of a reminder letter?

It can be confusing as to when the one-month timeframe begins if the reminder letter sets out a new payable date for the premium.

AFCA's view is that if the letter clearly communicates the financial firm's intention to refrain from exercising a right to cancel until the date in the letter lapses, the financial firm must allow that date to lapse before exercising the right to cancel. If it does not, its attempt to cancel the policy is likely to be void in accordance with section 63 of the ICA.

Can a financial firm retrospectively cancel the policy after the reminder letter?

There have been instances of a financial firm seeking to cancel the contract after sending a reminder letter and having it apply retrospectively. For instance:

- a premium due on 1 April was not paid
- a reminder letter sent on 3 April allowed the consumer until 14 April to pay the premium
- the financial firm cancelled the policy on 1 May
- the financial firm stated the cancellation was effective from 1 April.

The right to cancel a policy is provided by section 60 of the ICA. Section 59 sets out the notice and timing requirement. In AFCA's view, section 59 of the ICA requires the cancellation be "in futuro". That is, the right cannot be exercised retrospectively.

Once the financial firm has exercised its right to cancel the contract, it can only operate prospectively.

If the consumer had a claim that arose before the financial firm exercised its right to cancel the policy, the financial firm cannot deny the claim based on the retrospective cancellation.

What if the consumer believed the due date changed because of the letter?

In some limited cases, consumers have stated that they received the reminder letter and relied on its contents as a representation that the instalment due date had been changed.

This can occur in particular where the insurer relies on the provisions of section 39 of the ICA. The consumer may consider the due date for the instalment has changed.

AFCA generally requires the following to be satisfied:

- the letter constituted a representation that the due date had been changed under the policy
- the consumer reasonably relied on that representation
- the consumer acted to their detriment as a result of relying on that letter.

In considering this argument, AFCA considers all the circumstances including communications between the parties leading up to the cancellation.

What are the consequences if the financial firm has not followed the ICA?

Section 63 of the ICA states that if the financial firm has failed to cancel the policy in accordance with the ICA, any cancellation is void.

AFCA's view is that this will generally apply if:

- the financial firm cancelled the policy before a right to cancel the contract arose
- the financial firm sent a letter attempting to cancel the policy that was not expressed in a clear and unequivocal manner
- section 62 of the ICA has not been satisfied when cancelling a contract without notice (see the next section).

3 Context

3.1 Case studies

The case studies below are based on determinations by one of AFCA's predecessor schemes, the Financial Ombudsman Service (FOS). While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA's approach to an issue.

Case 1: Unclear intention expressed

The consumer arranged a policy with the financial firm on 1 February 2014. The term was for one year and the parties agreed that the premium would be payable in monthly instalments.

The consumer failed to pay a premium instalment on 1 July 2014.

The financial firm sent a letter on 17 July 2014 stating the following:

> "As your instalment has not been paid by its due date, under the terms and conditions of your policy, it will be cancelled effective from 1 August 2014.
>
> However, you can still make a payment up until 1 August 2014 to continue this policy cover."

The financial firm relied upon this letter, particularly the first paragraph, as evidence of it exercising its right to cancel the policy.

However, when reviewing the contents of the entire letter, FOS did not accept it contained a clear and unequivocal intention to cancel the contract. This is because the second paragraph contradicted the first paragraph because it stated that the policy would not be cancelled if the premium was paid before 1 August 2014.

FOS's view was that the contents of the whole letter expressed an intention by the financial firm to refrain from exercising any right under the policy until 1 August 2014 passed.

Therefore, the financial firm could not rely upon this letter as evidence of an effective cancellation notice.

Case 2: Letter clear and unequivocal

This case is similar to the first except for one difference.

In this case, the financial firm sent a letter on 17 July 2014 that contained the following:

> "Under the terms of your policy, as your payment has not been paid by its due date, your policy will be cancelled effective from 1 August 2014.

> If you would like your insurance cover to continue, please call us on [number] …"

FOS accepted this was a valid cancellation notice because the first paragraph clearly and unequivocally expressed the financial firm's intention to exercise its right to cancel the policy.

Further, the second paragraph did not contradict that first statement. It simply said that if the consumer seeks to have insurance cover, it must contact the financial firm.

This could result in the financial firm choosing to offer a replacement policy. This is separate to the decision to cancel the existing policy.

In particular, there was no suggestion in the letter that on contacting the financial firm, the decision to cancel the policy would be withdrawn.

As a result, the financial firm was able to rely on this letter as evidence of exercising its right to cancel the policy. The cancellation took effect on 1 August 2014.

3.2 References

Definitions

Term	Definition
Debenture Financial firm	A bank or credit provider who is a Member of AFCA
ICA	*Insurance Contracts Act 1984*
Instalment contracts	A general insurance contract where the premium is payable by seven or more instalments a year

Useful links

Document	Title / Link
Insurance Contracts Act	This Commonwealth statute can be found at http://bit.ly/28PlNoZ.
Austlii	Austlii is a free resource that contains a full extract of most of the judgments issued in Australia over the past 20 years: www.austlii.edu.au