

Insurance Contracts Amendment Regulations 1999 (No. 1)

1999 No. 191

EXPLANATORY STATEMENT

Statutory Rules 1999 No. 191

Issued by the authority of the Minister for Financial Services and Regulation

Insurance Contracts Act 1984

Insurance Contracts Amendment Regulations 1999 (No. 1)

Section 78 of the *Insurance Contracts Act 1984* (the Act) empowers the Governor-General to make regulations not inconsistent with the Act, prescribing matters which are required or permitted by the Act to be prescribed by regulations, or are necessary or convenient to be prescribed by regulations for carrying out or giving effect to the Act.

Subsection 21A(9) of the *Insurance Contracts Act 1984* (the Act) requires regulations to be made to define an eligible contract of insurance. Subsection 22(2) of the Act allows for a form of writing to be prescribed in the regulations to be used for informing an insured of matters referred to in subsection 22(1). These matters are the general nature and effect of the duty of disclosure. Subsection 69(1A) of the Act allows for a notice to be prescribed in the regulations which is adapted to oral disclosure requirements.

The purpose of the Insurance Contracts Amendment Regulations 1999 is to give effect to section 21A of the Act. Section 21A was inserted in the Act as a consequence of amendments made by the *Insurance Laws Amendment Act 1998*. These amendments came into effect on 30 April 1998.

Section 21 A of the Act places an obligation on insurers to inform insurance customers of their duty of disclosure when entering into certain insurance contracts. The 'duty of disclosure' in relation to the insurance customer, is the requirement that they must disclose to the insurer any information which they know, and which a reasonable person in the circumstances would be expected to know, is relevant to an insurer's decision to provide insurance cover. Section 21A applies to certain eligible contracts of general insurance.

The regulations include a form of words prescribed for the purposes of section 21A. Insurers can use this form of words to inform insurance customers of their duty of disclosure. The prescribed form of words is advisory. An insurer may substitute another form of words, so long as these conform to obligations set out in Section 21A. Prescribed forms are set out for both written and oral disclosure.

Amendments are also made to the prescribed form of notice for consumer credit insurance, which comes within the definition of an eligible contract of insurance. Amendments to the notice for consumer credit insurance are necessary to ensure consistency with the obligations set out in Section 21 A.

Details of the regulations are set out in Attachment A. A Regulation Impact Statement is enclosed at Attachment B.

The regulations commence on gazettal.

ATTACHMENT A

Details of Proposed Regulations

Background

The *Insurance Laws Amendment Act 1998*, amongst other matters, inserted a new section 21A into the *Insurance Contracts Act 1984* (the Act) that came into effect on 30 April 1998.

Regulations are required to give effect to section 21A.

The amendments to the Act under section 21A create special rules for insurers to ensure insurance customers are informed of their duty of disclosure in relation to a number of categories of retail market insurance contracts. What constitutes an eligible contract of insurance is to be set out in the regulations. The general duty of disclosure rules under section 21 continue to apply to other types of insurance contracts.

A duty of disclosure applies to people seeking insurance who are required to disclose to the insurer any matter which they know, or which a reasonable person in the circumstances could be expected to know, is relevant to an insurer's decision to provide insurance cover. Where a person seeking insurance fails to disclose information in accordance with their duty of disclosure, an insurer may be entitled to avoid the contract. The insurance customer, therefore, needs to be given information to understand and comply with this duty.

Related amendments to section 22 of the Act prescribe forms of notice for the purposes of section 21A, which set out what information an insurer must present to an insurance customer. Separate forms of notice are provided in the proposed regulations, to differentiate between insurers informing insurance customers of their duty of disclosure orally, or in writing.

Purpose Of Section 21A

Generally, insurers obtain information by asking a person seeking insurance to complete a proposal form. Many proposal forms have vague or open-ended questions which require those seeking insurance to anticipate or interpret the real meaning and type of information the insurer is seeking. Insurance customers, particularly those seeking domestic and personal lines of insurance, frequently lack the knowledge and awareness to fully understand those issues which may be of significance to an insurer. The new section 21A is designed to redress this imbalance and improve the capacity of an insurance customer to comply with their duty of disclosure, by requiring an insurer to ask specific questions in respect of proposed contract of insurance, in default of which an insurer is deemed to have waived the duty of disclosure.

How Notice Is To Be Given

Section 22 of the Act operates in conjunction with section 21A, to specify how the insurer is to inform the insurance customer about the duty of disclosure and the consequences of failing to do this. There is a requirement in subsection 22(1) that the insurer must clearly inform the insurance customer of the nature and effect of the duty of disclosure before the contract of insurance is entered into. Subsection 22(2) provides that if the regulations prescribe a form of wording for written disclosure, that wording may be used to inform the insurance customer about the duty of disclosure. A prescribed form of wording is to be set out in the regulations for this purpose.

Oral Notice

A regulation making power in section 69 of the Act also allows a notice to be prescribed that is more suited to oral disclosure requirements. For example, where insurance is being marketed by telephone, insurers can give insurance customers information in writing after a contract is

entered into, provided that the information is given orally prior to concluding the contract. This information can include notification of the insurance customer's duty of disclosure, for which statutory wording may be provided in the regulations. An oral disclosure form of words will be prescribed in the regulations for this purpose.

Date of Commencement

The proposed regulations are to commence on notice in the Government *Gazette*.

Item 1

Name of Regulations

The regulations will be incorporated as amendments to the *Insurance Contract Regulations 1985*.

Item 2

An "eligible contract of insurance" is to have the meaning given it by regulation 2B. Regulation 2B is outlined in item 3 below.

Item 3

For the purposes of subsection 21A(9) "eligible contract of insurance" needs to be defined. The contracts of insurance that are to be defined as "eligible contract of insurance" for the purposes of subsection 21A(9) are the same as those contracts prescribed in Part 2 of the Insurance Contracts Regulations, namely:

- * Motor vehicle insurance
- * Home buildings insurance
- * Home contents insurance
- * Sickness and accident insurance
- * Consumer credit insurance
- * Travel insurance

There is one distinction between prescribed contracts and eligible contracts. Eligible contracts extend to include insurance taken out by all persons, not just natural persons. This means that it covers certain insurance contracts entered into by corporate entities, such as companies, as well as individuals.

The reference to "wholly" in the definition of an eligible contract, means that an insurer offering a contract of insurance combining elements of insurance that only partially includes an eligible contract of insurance, under a multiple cover proposal, can use the form of words prescribed for the purposes of section 21. Multiple cover insurance combines two or more types of insurance contracts under a single proposal. For example, home insurance with farm insurance. Confusion could arise where the insurance contracts fall into different classes of contracts subject to distinct disclosure rules under section 21 or 21A. The result would be the need to give out both types of disclosure notice. To simplify the situation, it will be sufficient for an insurer to give out a notice that meets the requirements of Section 21 in relation to all types of insurance contracts contained under a multiple cover policy.

The definition of an eligible contract of insurance incorporates a reference to new business between the insurer and insurance customer. The intention of this part of the definition is to only require insurers to use a section 21A notice when new business is being entered into. New business would arise when an initial relationship between the insurer and the insurance customer is established. This supports the obligation in section 21A of the Act, which specifically does not apply to renewals of eligible contracts. When an existing insurance policy is renewed for a further period on broadly the same basis as before, the answers previously provided by the insurance customer to the insurer's questions, provide the basis of disclosure in relation to the fresh contract. It is, therefore, not necessary to once again require the same specific questions to be asked and answered by the insurance customer.

Item 4

This item prescribes which form of notice is to be used for the purposes of sections 21 and 21A. The new Schedule 1, Part 3 notice, will be the prescribed notice in the case of 'eligible contracts of insurance', where insurers inform insurance customers of their of duty of disclosure in writing. The forms of notice prescribed in Schedule 1, Parts 1 and 2 of the regulations, will still be used to inform of duty of disclosure matters for general insurance (other than those defined as 'eligible contracts of insurance') and life insurance respectively.

This item also prescribes the oral form of notice to be used when an eligible contract of insurance is entered into. This notice is set out in Schedule 2.

The prescribed forms of notice, for both written and oral purposes, do not apply when the new contract is a renewal of an existing contract.

Items 5 & 6

These items are a series of omissions and substitutions to ensure that the regulations take effect as intended.

Item 7

This is to insert the new heading for Schedule 1: "Writing to inform insureds of general nature and effect of duty of disclosure".

Items 8 & 9

These are a substitution for Part 1 and Part 2 headings under Schedule 1. Part 1 refers to contracts of general insurance and Part 2 to contracts of life insurance.

Item 10

This sets out the prescribed wording for the written form of notice that insurers should be giving insurance customers when entering into a contract of insurance.

Insurance customers are to be informed of what they must tell the insurer and what the consequences are of not making a full disclosure of information relevant to the insurer. Those seeking insurance are also given the opportunity to seek further information or explanation regarding their duty of disclosure.

Item 11

This sets out the prescribed wording for the oral form of notice that insurers should be giving insurance customers when entering into a contract of insurance. It relates to the eligible

contracts of insurance as defined in the regulations, and would be used where an insurance contract is being entered into orally, such as over the phone.

Item 12

This is an amendment to replace the heading of Schedule 3 with "Consumer credit insurance".

Item 13

Consumer credit insurance (M) is a category of insurance contracts to which particular rules apply. Under Section 71A insurers have to give people considering buying CCI a notice in a form prescribed by the regulations. This form is set out in Schedule 2, clause 2 of the Insurance Contracts Regulations. Changes are made to the notice for the purpose of complying with obligations in Section 21A, under which CCI is classed as an eligible contract of insurance.

ATTACHMENT B

REGULATION IMPACT STATEMENT

Problem Identification

The problems with the current regulatory regime include:

- * The failure of insurers to make customers fully aware of their duty of disclosure in providing adequate information to insurers when entering into a contract.
- * The lack of prescribed wording in the regulations as to what should be included in the form of notice to consumers from insurers, indicating the duty of disclosure.
- * An inconsistency in the prescribed notice of duty of disclosure for consumer credit insurance (CCI), a category of insurance contracts to which special rules apply.

Specification of Regulation Objectives

The objective is to facilitate increased consumer awareness of the duty of disclosure when entering into an insurance contract with an insurer.

Identification of Alternatives

Option 1: No Specific Action

Under this option, no amendments would be introduced to the Insurance Contracts Regulations.

Option 2: Supplement the General Insurance Industry Code of Conduct

In this situation, insurers would follow the non-mandatory General Insurance Industry Code of Conduct in relation to duty of disclosure matters. The Code of Conduct could be reviewed and updated to include more substantial requirements for duty of disclosure, rather than having them placed in the Insurance Contract Regulations.

Option 3: Implement Section 21A requirements, but with no specific form of notice

Under this option, insurers would have an obligation under the law to inform those about to enter into a contract, of their duty of disclosure. This information could be provided in written form, or orally. However, no standard form would be included in the regulations to guide insurers as to what information they have to give in notice to customers. It would be left to the discretion of insurers to include what they see as relevant in informing customers of their duty of disclosure.

Option 4: Implement the full set of amendments to the Insurance Contracts Regulations

This option would also provide the obligation that insurers are to inform customers of their duty of disclosure. A form of notice would be included in the regulations to guide insurers on how they should inform customers and what information should be given.

Impact Analysis

Impact Group Identification

Groups likely to be affected by the proposals include:

- * The insurance industry (This includes general insurance companies and other retail companies marketing / providing insurance products);
- * Consumers of insurance products;
- * The Australian Securities and Investments Commission, the government regulator; and
- * Financial advisers.

Assessment of Costs and Benefits

An assessment of the costs and benefits of Options 1, 2, 3 and 4 above is outlined below. Analysis is generally of a qualitative nature, but quantitative data was supplied where available, for the purposes of this assessment.

Option 1: No Specific Action

The most significant benefit from retaining the status quo is slightly reduced compliance costs on insurers. They will be able to retain the present set of documents they use to obtain the required information from customers when writing a contract.

However, the cost to consumers of being inadequately informed of their duty of disclosure remains. Insurers are likely to keep using their often vague proposal forms while not informing customers that they have a duty to inform the insurer of all relevant information to an insurance contract. Many customers will remain unaware of the consequences of not fulfilling their duty of disclosure, in that the insurance contract written for them may become void. Consumers suffer loss when insurers are not required to pay out under a policy because in answering the insurer's questions, the insured did not fully discharge their duty of disclosure.

Option 2: Supplement the General Insurance Industry Code of Conduct

Although provisions exist in the General Insurance Industry Code of Conduct requiring insurers to inform customers of their duty of disclosure, there is no strict legal obligation on the insurer to do so. The Code does however impose obligations and sanctions on insurers subject to the Code. These sanctions may include:

- * naming a company that has breached the code in the Insurance Enquiries and Complaints Limited (IEC) annual report;
- * requiring a company to remedy or rectify a wrong under the code;
- * requiring a company to undertake a compliance audit; and
- * requiring a company to undertake corrective advertising.

Although these sanctions exist, insurers are not under a mandatory obligation to modify their practices to adhere to the Code in this area. Therefore, without legislative backing, the provision of information to customers regarding their duty of disclosure still may not be adequate.

Compliance costs would be similar if the measures proposed for the Insurance Contracts Regulations were implemented through the General Insurance Code of Conduct instead. However there may be benefits from implementing the measures in this way. It would be a market-oriented solution, which would give the insurers greater flexibility in meeting their obligations, while reducing the monitoring and enforcement costs of the government. There would also be more transparent information disclosure and more informed purchasing decisions for consumers, than if the measures were not in the industry Code of Conduct.

If this option were taken, the cost to consumers of not being adequately informed of their duty of disclosure may still remain. Without legislative backing, insurers are unlikely to significantly change their current processes and disclosure notices. Even with the industry enforced sanctions, some insurers have failed to adequately modify their practices to adhere to the Code in relation to duty of disclosure requirements. Figures from Insurance Equities and Complaints Limited (IEC) show that of approximately 200 complaints investigated this year in relation to duty of disclosure matters, about 50 of them were the result of insurers inadequately informing customers of their duty under the law. This translates to approximately one quarter of complaints and does not include the situations where formal complaints are not lodged with the IEC.

Option 3: Implement Section 21A requirements, but with no specific form notice

Benefits from implementing this option would accrue to consumers of insurance products. They will be better informed of their duty of disclosure and the consequences of not fulfilling this duty, because insurers will have an obligation to make them aware. This should result in more efficient information flows and less defaults on insurance contracts.

Implementing this option will increase compliance costs for insurers. They will have the once-off cost of preparing and printing new documents that include a notice about a customer's duty of disclosure to the insurer and what type of information the customer is required to give. Preparation of these documents will include legal costs incurred by insurers, to ensure that the legal obligation under the new regulations is being fulfilled.

Compliance costs may be higher than those for implementing the full set of regulations, as under Option 4 of this statement, because the form of notice will have to be developed from scratch, rather than being just an interpretation of the standard form contained in the regulations.

Option 4: Implement the full set of amendments to the Insurance Contracts Regulations

As in Option 3, consumers would significantly benefit from the introduction of the full set of amendments to the Insurance Contracts Regulations. They will be more adequately informed of their duty of disclosure and the consequences of not fulfilling this duty. Having more informed consumers should ensure a more effective and efficient operation of the insurance market.

Insurers will also have increased compliance costs under this option, because they will have to develop and print new proposal forms to fulfil their obligation under the law. However, under this option, a standard form of notice is outlined in the regulations, which will guide insurers in the preparation of the documents. This should ensure significantly lower legal costs in complying with the law and therefore lower compliance costs than Option 3. Sufficient lead time will be provided to the insurance industry to ensure they have adequate time to prepare new documents, while running down stocks of previously printed documents.

Other Requirements

Consultation

The amendments outlined have been developed after extensive consultation with the general insurance industry and their legal advisers, industry representatives, as well as with various

consumer groups. Comments have been sought on the various stages of the draft amendments, while a number of meetings also took place to discuss the measures.

- * The insurers and their legal advisers are generally supportive of the regulations, after changes had been made to incorporate their views. The regulations provide them with certainty as to their position in relation to duty of disclosure.
- * Consumer groups are very supportive of the regulations, as they provide greater protection for those seeking general insurance cover.
- * The IEC were supportive of the reforms, because they would like to see closer attention paid to duty of disclosure matters. Of particular concern to them are oral disclosure methods, as this is the area from which most complaints arise.

Conclusion and Recommended Option

A decision on which option is to be chosen depends on the perceived benefits of increased consumer protection, versus lower compliance costs for the insurance industry. The compliance costs for insurers are not unduly restrictive and will be one-off costs. However, the benefits to consumers of being more informed will be significant, especially if the number of defaults on contracts by insurers is reduced.

The benefits of increased consumer awareness and protection will outweigh increased compliance costs for insurers, while there will also be greater certainty for the insurance industry in discharging their legal obligation. The adoption of Option 4 is recommended.

Implementation and Review

When changing circumstances or market innovation necessitates revision of these regulations, they will be made in close consultation with the affected parties.