



ASIC

Australian Securities & Investments Commission

16 April 2004

The Secretary
Insurance Contracts Act Review Secretariat
Department of the Treasury
Langton Crescent
CANBERRA ACT 2600
By email: icareview@treasury.gov.au

Dear Sir/Madam,

***ASIC Comments
Review of Insurance Contracts Act 1984:
Insurance Contracts Amendment Bill, sections 40 and 54***

We refer to your email of 24 March 2004 which attached proposed amendments to sections 40 and 54 of the *Insurance Contracts Act 1984*.

Please find attached ASIC's comments on these draft amendments. If you have any queries, please do not hesitate to contact me on 02 9911 2622 or mark.adams@asic.gov.au.

Yours sincerely

Mark Adams
Director, Regulatory Policy
Policy and Markets Regulation

Attachment

Draft Insurance Contracts Amendment Bill, sections 40, 54 and 54A

1. General Comments

- 1.1 As a guiding principle we consider that any amendments that are made to sections 40 and 54 should be as clearly and simply worded as possible. This will ensure that the policy behind the provisions is clear and will also assist in resolving the difficulties and uncertainties previously experienced in the interpretation of the old provisions.
- 1.2 We also suggest that it may be helpful if the Explanatory Memorandum made it clear that sections 40 and 54A apply to both 'claims made' and 'claims made and notified' contracts.

2. Answers to specific questions.

2.1 Is the draft consistent with the recommendations made in the report into s54?

Section 40

- 2.1.1 We understand the amendments to s40 were intended to:
- (a) extend the reporting period for both 'claims made' and 'claims made and notified' contracts; and
 - (b) require that insureds be informed about the effect of a failure to notify within the time limit.
- 2.1.2 We suggest the following amendments be made to the current draft of s40. We consider our suggestions are consistent with the recommendations made by the Review in relation to s54.

Inform about the impact of a failure to notify

- 2.1.3 We suggest that s40(2A) should require the insured to be informed of the *impact* of a failure to notify before the end of the 45 day period, rather than just stating what the requirement for notification is. Certain provisions in the *Corporations Act 2001* (Cth) illustrate this type of disclosure notification requirement, which can also include a specifically worded warning (for example, see s949A). The following is a possible form of wording that you may wish to consider:

'You must provide a warning in writing to the insured to the following effect:

"You will not be covered under this policy for liability you may face in the future arising out of facts or circumstances that occurred during the period of cover if you do not report these facts or circumstances to the insurer no later than 45 days after the contract ends. Depending on the

*wording of your policy, you may be required to report in writing or orally. You should refer to your policy for information on reporting requirements. Generally, if you are not sure whether to report a fact or circumstance that might give rise to a claim under the policy, it is safer to report it.*¹

The reporting period

2.1.4 We understand that the object of the amendments to s40 is that, provided an insured notifies within the period of the contract or within the period of 45 days after the expiry of the period of cover, the insurer's liability cannot be reduced on the basis of a failure to notify. We suggest the following three amendments to the existing draft:

- (a) We think its arguable that s40 does not apply if an insurance contract contains a clause allowing the insured to give a notification of facts that might give rise to a claim after the end of the period of cover. This is because s40 does not seem to apply to contracts that allow for notification of facts after the period of cover expires. We suggest that to avoid this, the reference to the '*expiration of the period of insurance cover*' in proposed s40(3) be amended to the '*expiration of the period provided for in the contract for the giving of notice of facts*'. This would also be consistent with s54A(1);
- (b) We suggest that the 45 day reporting period should be minimum period, i.e. if the insurance contract allows for a longer period, then that longer period should apply for the purposes of s40(3). We understand the Review has been asked to consider a shorter period than 45 days. In any case, we suggest that the relevant period should be a minimum requirement; and
- (c) A further issue is whether s40(3)(b) should include the words '*as soon as was reasonably practicable*', in relation to the insured's obligation to notify of facts. As the draft Bill is presently worded, it may be open for an insurer to argue that s40 does not apply even where it has been notified of the relevant facts within the 45 day period on the basis that it was not notified '*as soon as was reasonably practicable*'. We understand that this was the drafting intention, i.e. that there are two tests that must be satisfied. We make the following comments:
 - i. We are concerned that this outcome could lead to potential uncertainty for insurers and for insureds. For example, insureds may mistakenly believe that if they notify of facts within the 45 day period they will be covered for any resulting claims. There may also be a potential for costly disputes about how quickly the insured could reasonably have made notification.

¹ We are cognisant of the fact that the legislation uses the term 'facts' rather than 'facts and circumstances' in this context. We have, however, adopted the latter phrase in the proposed consumer warning as part an attempt to make the warning more colloquial and user-friendly. (We are not suggesting that any change to the term 'facts' is generally needed in the legislation).

- ii. While it is understood that the prompt notification of facts is to be encouraged, the warning to consumers (referred to in paragraph 2.1.3 above) could be used instead to encourage early notification, for example by adding the following words:

*'...Generally, if you are not sure whether to report a fact or circumstance that might give rise to a claim under the policy, it is safer to report it, **and as quickly as possible.**'*

If the reporting period is to be shortened, we suggest that this point will become all the more important. In our view, a timeframe for notification of anything less than 45 days would further weaken the case for a separate *'as soon as reasonably practicable'* obligation.

Clarifying when the insurer 'becomes aware'

- 2.1.5 We suggest clarification of the test in s40(2B) of when the insurer 'becomes aware' the broker has provided the insured with the s40(3) information. One suggestion is that the test be modeled on the existing test for the provision of certain information to a person's agent in Regulation 7.7.01(2) of the Corporations Act 2001. For example:

'...the insurer is satisfied, on reasonable grounds, that during the period referred to in paragraph (2A), the insurance broker provided the insured with the information referred to in that paragraph.'

Clarifying when an insured 'became aware'

- 2.1.6 We understand that the test in s40(3) as to when the insured '*became aware*' of the facts that might give rise to a claim is subjective. That is, it takes into account the insured's appreciation of and level of understanding of the facts. We think this is appropriate and suggest that the Explanatory Memorandum makes it clear that the test is subjective. A similar clarification in relation to proposed s54A(1) would also be useful.

Minor drafting suggestions

- 2.1.7 In s40(3)(b) we suggest that '*them*' in the third line should be substituted with '*those facts*'.
- 2.1.8 The manner of notification referred to in s40(3)(b) as being '*in writing*' may be more appropriately worded '*as prescribed by the contract of insurance.*'

Section 54A

Explanatory Memorandum

- 2.1.9 We understand the intention of proposed s54A is to ensure that s54 does not operate to prevent an insurer, under a 'claims made' or a 'claims made and notified' policy, from refusing to pay a claim that is made against the insured after the period of cover, solely on the basis that the insured failed to notify it of facts of which the insured became aware before the end of the period for giving that notice. This intention could be supported by including in the Explanatory Memorandum a clear statement to the effect that s54A(2) is intended to cover both 'claims made' (s54A(2)(a)) and 'claims made and notified' policies (s54A(2)(b)).
- 2.1.10 Further, we understand that s54A is not intended to affect the operation of s54 where a claim *is* made against the insured during the period of cover. Section 54A is not intended to have any effect other than to exclude the operation of s54 in a specific circumstance. We suggest that the Explanatory Memorandum should clarify these matters, and could perhaps include examples.

Some examples could be along the following lines:

- (a) The insured becomes aware of facts that might give rise to a claim. The insured does not notify the insurer. Subsequently the third party claim is made and the insured becomes aware of the claim. All this occurs before the end of the period of cover. Under the contract of insurance, the insurer may refuse to pay the claim because of the failure to notify of the facts that may give rise to a claim. Section 54A does not apply in this case.
- (b) The insured becomes aware of facts that might give rise to a claim. The insured does not notify the insurer. Subsequently the third party claim is made before the period of cover ends. The insured, however, is not aware of the claim until after the proposed extended period for notification. Under the contract of insurance, the insurer may refuse to pay the claim because of the failure to notify of the facts that may give rise to a claim. Section 54A does not apply in this case.
- (c) The insured becomes aware of facts that might give rise to a claim. The insured does not notify the insurer. Subsequently the third party claim is made but after the period of cover ends. Under the contract of insurance, the insurer may refuse to pay the claim because of the failure to notify of the facts that may give rise to a claim. Section 54A does apply in this case.

Minor drafting suggestions

- 2.1.11 In ss54A(2), we suggest that the expression '*that effect*' in the first line should be substituted with '*the effect described in subsection (1)*'.

2.2 Is there a need to define 'claim'?

- 2.2.1 We have some concern that there may be confusion about what constitutes a third party claim against an insured for the purposes of s54A, and suggest that there would be a benefit in having a definition of 'claim', given the risk that

insurers may try to narrow the concept so that s54A, rather than s54, applies. As discussed, however, we recognise the difficulties in defining the term and agree that a legislative definition is not necessary at this stage of the review.

- 2.2.2 That being said, in order to alleviate some of the risk identified and to avoid confusion for insureds, we think it is important that the Explanatory Memorandum make clear that the common law definition of the term will override any narrowed definition of 'claim' that an insurer may seek to include in its policy wording.

2.3 Is there a need for greater prescription in the disclosure obligations under s40?

- 2.3.1 We consider the disclosure obligations should be clearer, as suggested at paragraph 2.1.3 above.

2.4 Should the amended section 54A extend to any other types of policies? If so, why?

- 2.4.1 See above comments at paragraphs 2.1.9 and 2.1.10. In short, we think that the Explanatory Memorandum clearly state that s54A applies to both 'claims made' and 'claims made and notified' policies. Otherwise, we have not at this stage reached a firm view on whether the proposed section should extend to other policy types.