

## Changes to the Insurance Contracts Act 1984 (Cth)

The *Insurance Contracts Amendment Act 2013* (Cth) passed into law last year. It makes a number of amendments to the *Insurance Contracts Act 1984* (Cth) (**ICA**) with significant commercial implications for insurers. Among others, these amendments include:

- placing a greater onus on insurers to obtain more information from insureds in determining whether or not to accept the risk of the insured; and
- extending the rights and obligations of third party beneficiaries to place them on an almost equal playing field as insureds.

Insurers should become familiar with these changes as many will begin to take effect between now and the end of next year.

### The duty to disclose and the duty to extract

Currently, section 21 of the ICA imposes a duty on the insured to disclose matters relevant to the decision of an insurer as to whether or not to accept the insured's risk. Often what ought to be disclosed by an insured is determined by what a "reasonable person in the circumstances" could be expected to know to be relevant.

The phrase *reasonable person in the circumstances* imports a hybrid objective-subjective test requiring courts to consider factors including the nature of the policy entered into by the insured, or the advertising or promotional material by which the insured was invited to enter the policy. However, the test excludes the "individual idiosyncrasies" of the insured, including a lack of experience with insurance policies or business acumen: *CGU Insurance Ltd v Porthouse* (2008) 235 CLR 103.

The *reasonable person in the circumstances* test has now been amended to also consider the nature of the insurance policy and the class of persons ordinarily expected to apply for such policies. Of course, there is uncertainty as to how this amended test will operate. The *Insurance Contracts Amendment Bill 2007 Exposure Draft Explanatory Memorandum* (Memorandum) however, provides further clarification of the words "class of persons who would ordinarily be expected to apply for insurance cover of that kind". Paragraph 4.55 of the Memorandum notes that in considering the "class of persons", the Court ought to inquire as to whether coverage is being provided to "sophisticated business clients or to unsophisticated consumers".

The amendments also alter section 22 to place a duty on the insurer to inform the insured in writing of the general nature and effect of the insured's duty of disclosure, including that the insured's duty to disclose continues until the policy is entered into. Failure to do so may have grave

consequences for the insurer. For example, the insurer may be barred from exercising any right against the insured in the event of the insured's breach of its duty to disclose.

Sections 21A and 21B require the insurer to make enquiries with the insured to extract the necessary information relevant in assisting the insurer to determine whether or not to accept the insured's risk. In making enquiries with the insured, the insurer should bear in mind the amended *reasonable persons in the circumstances* test outlined above. The insurer should consider the nature and complexity of the policy and the class of persons ordinarily expected to apply for such policies. The onus and the requisite assertiveness of the insurer will vary according to factors including the nature of the insured's business and the policy sought. The amendments to sections 21A and 21B also require the insurer to ask specific questions of the insured and prevent the insurer from asking broad catch-all questions. If insurers ask the insured a catch-all question, the insured will be absolved of its duty to disclose.

In sum, this suite of changes to the duty to disclose places a greater burden on insurers to be more active in assisting insureds to meet their own duties to disclose. Insurers should take steps to:

- consider the business acumen of prospective insureds;
- inform prospective insureds of the nature of information they need to disclose; and
- to make the necessary enquiries with insureds to assist the insurer in deciding on whether or not to accept the insured's risk.

## Third party beneficiaries

Insurers should also be mindful of changes expanding the rights and obligations of third party beneficiaries. A third party beneficiary is an individual or entity not expressly identified as a named insured in a policy, but is specified or referred to within the policy as a person or entity to whom benefits under the policy are extended. Currently, third party beneficiaries are not recognised in the ICA. However, as of 28 June 2014, changes aimed at levelling the playing field between third party beneficiaries and insureds will take effect.

Perhaps the most substantive expansion of third party beneficiary rights is the amendment to section 51. Currently, section 51 allows a potential claimant to bring a claim directly against an insurer under a contract of insurance, in the absence of an insured. For example, where an insured has become liable for damages to a person or entity, but has either died or for some other reason cannot be found, the person or entity can recover those damages directly from the insurer.

Section 51 has now been amended to allow a claimant to recover directly from an insurer for the liability incurred by a third party beneficiary to a contract of insurance. This amendment to section 51 necessarily exposes insurers to a greater volume of claims. Insurers should be more mindful of the way contracts of insurance are constructed and the potential for exposure to risk by way of third party beneficiaries to a policy.

Nevertheless, insurers can find some protections under amendments made to section 48. Generally speaking, insurers are entitled to a number of defences against claims from insureds. For example, a failure by the insured to disclose a pre-existing defect may enable an insurer to exclude itself from accepting liability arising from the defect. Section 48 extends these very same protections against claims from insureds to claims from third party beneficiaries.

Currently, section 41 provides that an insured may require an insurer to confirm to the insured in writing whether or not a contract of insurance applies to the relevant claim. In the event an insurer confirms the applicability of an insurance policy, the insurer must then confirm whether it intends to assume conduct of the defence of the claim on behalf of the insured. Section 41 has now been amended to confer on to third party beneficiaries this same right.

In sum, the solidification and expansion of third party beneficiary rights and obligations will potentially expose insurers to an increased volume of claims. Insurers should be more mindful of the third party beneficiaries to its policies, the nature of third party beneficiaries' involvement and the extent of their potential risk.

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