



Submission by the
Financial Rights Legal Centre
Consumer Action Law Centre
CHOICE
Public Interest Advocacy Centre
Financial Counselling Australia
Consumer Credit Legal Service (WA) Inc

The Treasury

Duty to take reasonable care not to make a misrepresentation to an insurer

February 2020

About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took over 22,000 calls for advice or assistance during the 2018/2019 financial year.

About the Consumer Action Law Centre

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just market place for all Australians.

About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney. Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

About Financial Counselling Australia

Financial Counselling Australia is the peak body for financial counsellors. Financial counsellors assist people experiencing financial difficulty by providing information, support and advocacy. Working in not-for-profit community organisations, financial counselling services are free, independent and confidential

About Consumer Credit Legal Service (WA) Inc

Consumer Credit Legal Service (WA) Inc. (CCLSWA) is a not-for-profit charitable organisation which provides legal advice and representation to consumers in WA in the areas of credit, banking and finance, and consumer law. CCLSWA also takes an active role in community legal education, law reform and policy issues affecting consumers.

Introduction

Thank you for the opportunity to comment on the Treasury's exposure draft legislation and materials re: Duty to take reasonable care not to make a misrepresentation to an insurer – implementing recommendation 4.5 of the Banking, Superannuation & Financial Services Royal Commission, including:

- Exposure Draft– Financial Sector Reform (Hayne Royal Commission Response–Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 4.5 (duty of disclosure to insurer) (**ED**);
- Financial Sector Reform (Hayne Royal Commission Response–Protecting Consumers (2020 Measures)) Regulations 2020: FSRC rec 4.5 (duty of disclosure to insurer) (**ER**)
- Exposure Draft Explanatory Materials (**EM**);
- Exposure Draft Explanatory Statement (**ES**).

This is a joint consumer submission from:

- the Financial Rights Legal Centre (**Financial Rights**);
- Consumer Action Law Centre (**Consumer Action**),
- CHOICE;
- the Public Interest Advocacy Centre (**PIAC**);
- Financial Counselling Australia (**FCA**); and
- Consumer Credit Legal Service (WA) Inc (**CLSWA**)

Our organisations have made comprehensive contributions to the Financial Services Royal Commission that led to an examination of the duty of disclosure.

We strongly support the introduction of a new duty to not make a a misrepresentation to an insurer. We do so for the following key reasons:

1. Evidence of poor consumer outcomes

The Royal Commission uncovered evidence of consumer harm arising out of the current formulation of section 29(3) of the *Insurance Contracts Act 1984 (IC Act)* – most notably in the TAL case study.

2. A greater onus is placed on the insurer than the consumer under the duty to not misrepresent

A duty to not misrepresent information moves the onus away from the consumer being required to disclose information, and onto the insurer. The insurer is now required to elicit the specific information that it needs, in order to assess whether it will insure a specific risk, and at what

price. The consumer does not have to “surmise or guess what information might be important” when answering a question the insurer asks. Instead, they are simply required to have acted in a reasonably careful manner.

3. *A determination of reasonable care is based on all relevant circumstances including a focus on insurer’s formulation of the questions asked*

An emphasis is placed on the insurer’s formulation of the questions and explanatory material in inducing the consumer’s compliance with their duty to take reasonable care. This emphasis is currently absent under the Australian duty of disclosure at section 21A. The clearer and more directed the questions under the new duty, the greater the likelihood that an insurer could demonstrate failure by an insured. This is in contrast to the current emphasis on whether the insured person should have reasonably been expected to have disclosed an answer to a specific question. We therefore support the section 20B as formulated to ensure that the insurer’s formulation of questions being asked is taking into consideration.

4. *The current duty of disclosure in retail insurance products is complex and built on a set of exceptions and qualifications*

Introducing a duty to not misrepresent is a clearer, more consumer-friendly principle upon which a simpler set of laws can be established. It is also in line with Royal Commission recommendations 7.3 and 7.4.

Summary of recommendations

We make the following minor recommendations:

- The EM should refer to the new Design and Distribution Obligations and its role in requiring firms to make a “target market determination” for the purposes of considering the type of consumer insurance contract and its target market.
- The ‘average person’ standard should be included in the legislation.
- Examples used in the EM should include scenarios that better reflect current practices.

Background to this EM

Royal Commission Recommendation 4.5 reads:

Part IV of the Insurance Contracts Act should be amended, for consumer insurance contracts, to replace the duty of disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer (and to make any necessary consequential amendments to the remedial provisions contained in Division 3).

The Royal Commission examined the duty of disclosure for life insurance under section 21 of the *IC Act*. The Royal Commission broadly outlines two principal concerns in relation to the duty of disclosure for life insurance contracts. They are:

1. Section 21 of the *IC Act* in its current form requires a consumer to understand what is relevant to an insurer's risk. There is a clear gap between what an insurer and/ or underwriter knows to be relevant, and what a consumer knows to be relevant to the risk.
2. Extending section 21A of the *IC Act* to life insurance contracts would not be suitable because a "duty to take reasonable care not to misrepresent" operated in a way which was far less complex than s.21A and was accordingly more suitable for consumer contracts.

The duty to take reasonable care to not misrepresent is the current duty that exists in the United Kingdom. In the Final Report of the Royal Commission, Commissioner Hayne it states:

for the reasons given by the UK Law Commission and the Scottish Law Commission, I recommend that the insurance Contract Act be amended¹

The reasons which Commissioner Hayne refers to in the United Kingdom (**UK**) and Scottish Law Commission joint report are quoted in the final report of this Royal Commission:²

The current law requires a consumer to volunteer information about anything which a 'prudent insurer' would consider relevant. This no longer corresponds to the realities of a modern mass consumer insurance market. Most consumers are unaware that they are under a duty to volunteer information. Even if they are aware of it, they usually have little idea of what an insurer might think relevant.

It is clearly important that insurers receive the information they need to assess risks. Most insurers, however, now accept that they should ask questions about the things they want to know ...

And

¹ See page 300, Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>

² See pages 298 & 299 Final Report

policyholders may be denied claims even when they act honestly and reasonably. Our survey of ombudsman cases shows that some insurers continue to use extremely general questions, where it is not clear what information the insurer is seeking. It is easy for consumers to misunderstand such questions, and therefore give inaccurate answers, even if they are doing their best to answer truthfully

The two reasons which are referred to in the UK and Scottish Law Commission Joint Report are equally applicable in the Australian setting.

Commissioner Hayne specifically considered extending section 21A to life insurance contracts, but considered that the better option was to adopt the duty to take reasonable care not to misrepresent.³ We support this view.

Consumer insurance contracts

Item 2, section 20A of the ED introduces the new duty in relation to:

- consumer insurance contracts; and
- proposed contracts of insurance that, if entered into, would be consumer insurance contracts.

These are defined under items 1 and 2, definition of 'consumer insurance contract' in subsections 11(1) and 11AB(1), and captures both general and life insurance contracts.

We note that personal, domestic or household purposes is not further defined under the *IC Act* but that the *ASIC Act* includes this formulation for consumer contracts at sections 12BC, 12BF, and 12EC. The *Corporations Regulations 2001 - Reg 7.1.17* also defines a personal and domestic property insurance product only insofar as it does not include marine insurance products as per the *Marine Insurance Act 1909*, workers compensation and compulsory third party compensation.

Consumer insurance contracts are defined in the negative under section 1 of the *Consumer Insurance (Disclosure and Representations) Act 2012 (UK)*:

an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession

On the face of it, we strongly support the broad scope proposed.

We also support:

- the presumption that the contract is a consumer insurance contract at section 11AB(3); and

³ Page 300 Final Report

- the amendment of the duty of utmost good faith under Part II of the IC Act so that the duty is limited to the new duty to take reasonable care not to make a misrepresentation: item 3, section 12.

The duty to take reasonable care not to make a misrepresentation

“Entered into”

Item 2, subsection 20B(1) of the ED ensures that the new duty applies when a consumer insurance contract is ‘entered into’ – that is if the contract is extended or varied (life insurance) or renewed, extended or varied in all other contracts.

We support this application as drafted.

Matters that may be taken into account in determining whether the insured has fulfilled the new duty

Item 4, subsection 20B(2) of the ED ensures that regard must be had to all the relevant circumstances of a particular case when determining whether the insured has fulfilled the new duty to take reasonable care not to make a misrepresentation to the insurer. This is expansive but specific examples are provided under subsection 20B(3). With only minor amendments, these examples mirror section 3(2) of the *Consumer Insurance (Disclosure and Representations) Act 2012 (UK)*.

This list of factors works in the favour of the insured since it is testing whether the insurer, as opposed to the insured, has exercised reasonable care to “induce” the consumer’s compliance with their duty to take reasonable care not to misrepresent. If the insurer has not acted in a professional manner in formulating relevant and specific questions, the law will allow a determination that it was reasonable for a consumer to have made a misrepresentation.

The effect of these provisions is to place the onus upon the insurer to ask questions in respect of any consumer insurance contract.

We support section 20B as drafted.

The type of consumer insurance contract in question and its target market

We note that the examples used are not necessarily reflective of modern insurance purchasing practices. Example 1.2 posits that:

Lesley entered into a consumer insurance contract for travel insurance by initially speaking to the insurer in person when attending her local branch then applying online.

While some insurance branches do exist, they are decreasing in number, and the more common experience is for somebody to either purchase over the phone or online.

We also wish to note that the EM does not refer to the Design and Distribution Obligations regime (DDO) and its role in requiring firms to make a “target market determination.” It may be worth referring to the interaction between these two reforms.

Explanatory material or publicity produced or authorised by the insurer

The insurance sector has a long history of creating documents that are long, not easy to read and incomprehensible.⁴ We strongly support a greater onus being placed on insurers to provide easily comprehensible, accessible material that explains the specific consumer insurance contract in question.

How clear, and how specific, any questions asked by the insurer were

We regularly see open ended general, ambiguous and confusing questions in disclosure scenarios. These regularly lead to poor outcomes for consumers.

Case study – Jerry’s story S183427

Jerry bought a motorbike in 2016 and took out comprehensive insurance using dealership’s selected insurer. Jerry does not recall being asked about his criminal record, only whether he had been incarcerated. Jerry had answered no, which was true.

Jerry had an accident in June and made insurance claim. The insurer told Jerry over the phone that he had not disclosed his criminal record.

Case study – Gary’s story – FOS determination 416952

Gary lodged a claim under home contents insurance policy for theft of jewellery and other items. His insurer refused to pay on basis he’d not disclosed his past criminal convictions relating to fraud and dishonesty offences when he took out policy.

The sales consultant asked the question “Have you got any unspent criminal convictions relation to fraud, theft, dishonesty, arson or malicious damage”. Gary answered “No”.

Gary did in fact have 4 “unspent” criminal convictions at the time he took out the policy and two of these related to ‘fraud, theft or dishonesty’.

FOS found the law relating to spent convictions is complex and varied and that a reasonable person in the circumstances would not be expected to understand what was meant by the expression “unspent criminal convictions” when used in isolation and

⁴ See Financial Rights, *Overwhelmed: An overview of factors that impact upon insurance disclosure comprehension, comparability and decision making*, September 2018 for examples https://financialrights.org.au/wp-content/uploads/2018/09/180904_Overwhelmed_FINAL.pdf

without any further explanation. Further, the sales consultant had failed to ask the relevant question in line with the insurer's standard script, specifically the part which stated "We do not need to know about criminal offences or convictions that the law permits you not to disclose. If you are unsure, you must seek legal advice".

FOS found that it was reasonable for Gary to believe that he was not required to disclose the convictions in response to the specific question asked by the sales consultant.

We strongly support a greater onus being placed on the insurer to provide clear, specific questions.

How clearly the insurer communicated the importance of answering those questions (or the possible consequences of failing to do so)

The inclusion of this factor must be read in combination with the fact that the current requirements under section 22 of the *IC Act* will not apply to consumer insurance contracts. As detailed in the EM, section 22 provides that the insurer cannot rely on its rights under the existing duty of disclosure unless it notifies the insured of their duty. However, the EM explains that this substitution does not reduce expectations that the insurer should give specific, clear communications to the insured.

This is an important shift because it ensures that insurers cannot simply provide information in a rote manner or hidden amongst disclosure documents.

It also ensures that insurers maintain better records of the provision of this information.

Whether or not an agent was acting for the insured

We support this factor being listed.

Average Person

We note that the EM elaborates on the application of the above factors by stating that the insured should be assumed to be:

*an average person with no special skills or knowledge, noting that the relevance of any particular factor will vary depending on the circumstances of the case.*⁵

There is no reference to this in the legislation. This contrasts to the current legislated conception of the reasonable person under:

- section 21 of the *IC Act* which refers to the "reasonable person" and
- section 3(3) of the *Consumer Insurance (Disclosure and Representations) Act 2012 (UK)* which refers to "the standard of care required is that of a reasonable consumer"

⁵ Para 1.31, EM

The reasonable person standard is a legal term with a long common law history. It is currently applied under the extant duty to the disadvantage of many consumers.

The 'reasonable person' is therefore a higher standard than an 'average person', and we consider the differences should be expanded on in the EM.

While we do support an 'average person' standard over a 'reasonable person' standard, we note that this may have a disproportionately negative impact upon those people experiencing some form of vulnerability – including but not limited to intellectual disabilities, physical disabilities, non-English speakers and the like. However this impact would be less so under an 'average person' standard than a 'reasonable person' standard.

We also recommend that the 'average person' standard should be included in the legislation.

Particular characteristics or circumstances of the insured that are known by the insurer must be taken into account

In determining whether the insured has taken reasonable care not to make a misrepresentation to the insurer, particular characteristics or circumstances of the insured individual known or the insurer ought to have known, must be taken into account: Item 4, subsection 20B(4).

This too mirrors the section 3(4) of the *Consumer Insurance (Disclosure and Representations) Act 2012 (UK)*. We support this subsection as drafted.

We note that the EM refers to 20(3) and (4) at paras 1.46 and 1.47. We believe that this should refer to 20(B).

We note that Example 1.8 states:

Kevin is dyslexic. He went to Roof Cover Pty Ltd and entered into a consumer insurance contract for a home contents insurance product.

Again, it is an unlikely scenario to go to an insurance branch. It would be preferable to include a scenario that better reflects current practice.

We also note that referencing the use of small fonts (literal fine print) with respect to poor eyesight might be useful to elucidate the principle here – it needs to be read (and reference needs to be made to) the principle under section 20B(3)(b). This is the need to provide “easily comprehensible, accessible material”. Small font, fine print or other generally inaccessible material should be avoided by insurers in *all* cases, not just those with particular eyesight issues.

Failed to answer a question

Section 20B(5) ensures that the insured is not to be taken to make a misrepresentation in respect of the new duty merely because they failed to answer a question or gave an obviously incomplete or irrelevant answer to a question. This reflects current law and places the onus on the insurer to follow up.

This is appropriate and we strongly support this sub section.

Fraudulent misrepresentation

We support the inclusion of this subsection.

Group Insurance

Items 26 to 29, section 32 of the ED applies the new duty to a life insured under a group life contract that is a consumer insurance contract, but not to the Trustee

We support this extension to life insured under group life contracts.

Remedies for breach of the new duty

The remedies for a breach of the duty remain those available under the existing law for non-disclosure and misrepresentations by the insured.

Relevant failure

We note that under items 1 and 13 to 31, definition of ‘relevant failure’ in subsection 11(1), sections 27AA, 28, 29, 31, 32 and 32A, a relevant failure to meet the new duty occurs:

- if the contract is a consumer insurance contract – a misrepresentation made by the insured in breach of the duty to take reasonable care not to make a misrepresentation; or
- for other insurance contracts – a failure by the insured to comply with the duty of disclosure or a misrepresentation made by the insured to the insurer before the contract was entered into.

This is a simple approach. This is also combined with the item 4, subsection 20B(6) where any misrepresentation made fraudulently is taken to be a breach of the new duty, and current section 28 and soon to be updated section 29 of the ICA.

The UK law includes a definition of “qualifying misrepresentation” so that it must be:

- deliberate or reckless; or
- careless.

Section 5: Qualifying misrepresentations: classification and presumptions

1. *For the purposes of this Act, a qualifying misrepresentation (see section 4(2)) is either—*
 - a. *deliberate or reckless, or*
 - b. *careless.*
2. *A qualifying misrepresentation is deliberate or reckless if the consumer—*

- a. *knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading, and*
 - b. *knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer.*
3. *A qualifying misrepresentation is careless if it is not deliberate or reckless.*
4. *It is for the insurer to show that a qualifying misrepresentation was deliberate or reckless.*
5. *But it is to be presumed, unless the contrary is shown—*
 - a. *that the consumer had the knowledge of a reasonable consumer, and*
 - b. *that the consumer knew that a matter about which the insurer asked a clear and specific question was relevant to the insurer.*

Under the UK formulation, the insurer's remedy depends on the consumer's state of mind. There is a distinction made between misrepresentations made by consumers that are "deliberate or reckless", and those that are "careless", with outcomes significantly less detrimental to consumers for those misrepresentations deemed "careless." The onus is placed on the insurer to prove that a misrepresentation is deliberate or reckless, and where the insurer cannot prove this, a misrepresentation is deemed to be careless.

If the misrepresentation was honest and reasonable, the insurer must pay the claim. The consumer is therefore expected in the UK to exercise the standard of care of a reasonable consumer, taking into account a range of factors, including the type of insurance policy and the clarity of the insurer's question.

If the misrepresentation was deliberate or reckless, the insurer may treat the policy as if it never existed and may decline all claims. It will also be entitled to retain the premiums, unless there was a good reason why they should be returned.

If the misrepresentation was careless, the insurer will have a compensatory remedy based upon what the insurer would have done had the consumer taken care to answer the question accurately. If the insurer would have excluded a certain illness, for example, the insurer need not pay claims which would fall within the exclusion but must pay all other claims. If the insurer would have charged more for the policy, it must pay a proportion of the claim.

It is our understanding that this explicit formulation in the UK is implicit in this current in that the same outcomes are achieved through application of sections 28 and 29 of the *IC Act*.

We support this formulation.

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Drew MacRae, Policy and Advocacy Officer, Financial Rights on (02) 8204 1386 or at drew.macrae@financialrights.org.au.

Kind Regards,



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