FINANCIAL OMBUDSMAN SERVICE

Panel Practice Note
No.1
PN1 S29 Insurance Contracts Act

The Investments Life Insurance and Superannuation division of FOS is effectively a successor to the Financial Industry Complaints Service ("FICS"), and the Investments Life Insurance and Superannuation Terms of Reference provide for the same procedures as set out in the FICS Rules as in force immediately before 1 July 2008.

Practice Notes developed by the FOS Panel under its procedures have been adopted by Investments Life Insurance and Superannuation division of FOS, for the guidance of parties.

The procedures set out in this Practice Note will apply from 1 July 2008. Apart from minor changes of terminology, they replicate the procedures of the equivalent FOS Practice Note 1 as in force from 1 January 2007.

In complaints referred to the Panel for arbitration, members who deny an insurance claim for non-disclosure or misrepresentation will be expected to provide evidence to demonstrate how their underwriting practices and guidelines would have operated had the non-disclosure or misrepresentation not occurred. As a guide, this information could include the following:

- Copies of any relevant underwriting guidelines, internal memos, manuals or other documents in force at the time the proposal was accepted (including sufficient information to demonstrate the currency of those guidelines etc);

- Where the guidelines etc. do not fully address the relevant considerations, or are not sufficiently specific or where there is a discretion, then a detailed statement signed by a staff member with relevant underwriting experience, setting out:

    - the details of the experience/expertise on which their opinion is based (in the same manner as any other expert witness),
    - how the information that was allegedly not disclosed or represented would have been taken into account, and what impact it would have had upon the decision whether to issue a policy and if so on what terms;

- Where the guidelines etc. do not fully address the relevant considerations, or are not sufficiently specific, or where there is a discretion, the insurer can also provide examples of comparable declinatures demonstrating the insurer's underwriting practice at the time the proposal was accepted.

- Where the guidelines etc. do not fully address the relevant considerations, or are not sufficiently specific, or where there is a discretion, and where the insurer cannot provide the appropriate statement from a staff member or provide examples of comparable declinatures demonstrating the insurer's underwriting practice at the time the proposal was accepted, then the member may provide a statement from independent underwriters expressing their opinion on the meaning and effect of the guidelines etc. Such a document would set out:

    - the details of the experience/expertise on which their opinion is based (in the same manner as any other expert witness),
    - how the information that was allegedly not disclosed or represented would have been taken into account, and what impact it would have had upon the decision whether to issue a policy and if so on what terms.

The above list is intended as guidance for insurers. Failure to provide the information set out above will not automatically be fatal to an insurer's case. However, the Panel will consider the strength of the evidence provided when deciding whether an insurer has demonstrated that it would not have issued a policy to the claimant (either on those terms or at all), as required when avoiding the policy under section 29. Where the evidence provided is insufficient to satisfy the Panel, it may proceed to determine the case without further reference to the member.

Explanation of the Practice Note

Introduction

The Panel has observed significant differences in the practices of insurers which claim to be entitled to remedies under subsections (2) and (3) of section 29 of the *Insurance Contracts Act 1984*. The Panel believes that there are important issues of proof in such cases. This Practice Note is intended to assist members, by giving guidance as to their onus of proof under section 29 and how they can best satisfy the requirements of that onus.

What section 29 requires

Section 29 of the *Insurance Contracts Act 1984* prescribes the remedies available to an insurer where the person who became the insured under a contract of life insurance failed to comply with the duty of disclosure or made a misrepresentation before the contract was entered into. If an insurer seeks to avoid a policy for non-disclosure or misrepresentation, it must prove both that the non-disclosure or misrepresentation occurred, and also that it was entitled to avoid the policy pursuant to section 29.

The effect of section 29(1)(c) of the Act is that the section does not apply in relation to a particular contract if the insurer would have entered into "the contract" even if the insured had not failed to comply with the duty of disclosure or had not made misrepresentation. In these circumstances, the section will be of no assistance to the member.

Under section 29(2) of the Act the insurer is entitled to avoid the contract from inception if the failure to disclose or the misrepresentation was fraudulent, subject of course to the insurer satisfying section 29(1).

Section 29(3) of the Act provides that an insurer may, within three years after the inception of the contract, avoid the contract if it "would not have been prepared to enter into a contract of life insurance with the insured on any terms if the duty of disclosure had been complied with or the misrepresentation had not been made".

Burden of proof under section 29(1) and (3)

In cases which come before the Panel, an important practical consideration is who bears the onus of establishing:

- for the purposes of section 29(1)(c), that the insurer would (or would not) have entered into the particular contract even if the nondisclosure or misrepresentation had not occurred; and

- for the purposes of section 29(3), that the insurer would (or would not) have entered into a contract of life insurance with the insured on any terms but for the nondisclosure or misrepresentation.

The Panel's view is that under each provision the insurer bears the onus of proof, and to assert a right to avoid a policy under section 29, it must provide evidence which is sufficient to satisfy this onus. This is consistent with the position on this issue taken by the courts, as shown recently in the decision of the Queensland Court of Appeal in *Schaffer v Royal & Sun Alliance Life assurance Australia Ltd* [2003] QCA 182.

The Investments Life Insurance and Superannuation Terms of Reference

In the Panel's experience, insurers have argued that it is enough for them to assert (without providing evidence) they would not have entered into either the precise contract, or any contract of life insurance (as the case may be) if the misrepresentation or nondisclosure had not occurred. This appears to be based on the assumption that the FICS Rules (and by inference the Investments Life Insurance and Superannuation Terms of Reference, which are identically worded) preclude the Panel from examining such issues.

The Panel does not agree with this view. The relevant provisions of FICS Rule 14,1, paragraphs (f) to (h) [and the equivalent paragraphs in Clause 14.1 of the Terms of Reference] state:

> "14.1 The Service cannot deal with the following complaints:…
>
> (f) a complaint about underwriting or actuarial factors leading to an offer of insurance on non-standard terms;
>
> (g) a complaint about underwriting or actuarial factors leading to the rejection of an insurance proposal for commercial or medical reasons;
>
> (h) a complaint about other factors leading to a rejection of an insurance proposal, except where the complaint is that the proposal was rejected maliciously, or on the basis of incorrect information;…"

The purpose served by these provisions is, in the Panel's view, quite clear, namely to prevent the Panel from questioning or exercising a discretion in areas where fundamental prudential or commercial considerations apply.

Such exclusions from the jurisdictions of Alternate Dispute Resolution bodies which operate in prudentially regulated areas in Australia are aimed at preventing the review of the reasonableness of policies the prime purpose of which are to maintain prudential soundness.

Clearly the Terms of Reference do not allow the Panel to question the appropriateness of an insurer's underwriting guidelines and practices which have led to the rejection of an insurance proposal or to the offering of insurance on non-standard terms. However, equally clearly the provisions have no bearing or application where the dispute concerns the rejection of a claim based on rights arising under section 29.

In other words, the Panel cannot tell an insurer who it must insure, or on what terms. It cannot deal with a complaint by a person against an insurer's decision not to issue a policy to them (unless the complainant has alleged that the decision was malicious or based on incorrect information).

However, it can deal with a complaint against an insurer's decision not to pay benefits under a policy because it has purported to avoid the policy. In dealing with such a complaint, it is entitled to ask the insurer to prove all the elements of its defence against such a complaint. This includes proving what the insurer's underwriting decision would have been if the misrepresentation or nondisclosure had not occurred. Doing so does not constitute an attempt to review or change an insurer's underwriting practices, merely a necessary attempt to establish what they were. It is therefore not precluded under the Terms of Reference.

Evidence required to satisfy section 29

As indicated in the Practice Note itself, the purpose of the Practice Note is to provide guidance to insurers by indicating what evidence may help to satisfy their onus under section 29. The strength of an insurer's case on this point will depend not on whether it has fully complied with the Practice Note, but on whether the evidence it provides satisfies the Panel that it would not have issued the policy in question (or any policy of life insurance). What evidence is sufficient to do this will vary from case to case, and each case will be dealt with on its own merits.

The Panel will not penalise an insurer simply because it does not provide, for example, declinature evidence, when the other evidence it provides is sufficient to prove that it would not have issued the policy in question.