MARKET TRENDS AND REGULATORY FRAMEWORK

1. Please give a brief overview of the insurance and reinsurance markets in your jurisdiction, identifying market trends.

The insurance market in Australia comprises four main limbs:

- Authorised life insurance and reinsurance companies. Around 31 life insurers operate in Australia, and as at September 2010 manage around A$234.7 billion, up by 5.3% since 30 September 2009 (at 1 January 2011, US$1 was about A$0.9). Life insurance companies can be subdivided into two distinctive limbs:
  - superannuation business;
  - ordinary business.
- Authorised general insurance and reinsurance companies. There are approximately 150 general insurers, mainly in the private sector.
- Registered health insurers. Australia has 39 registered private health insurance funds.
- Insurance intermediaries, including:
  - brokers;
  - insurer’s agents;
  - a small number of foreign insurance agents.

2. What is the regulatory framework for insurance/reinsurance activities?

Statutes

The following statutes apply:

- The Insurance Contracts Act 1984 (Cth) (Insurance Contracts Act), which regulates contracts of insurance and proposed contracts of insurance, modifying and supplementing the common law.
- The Insurance Act 1973 (Cth) (Insurance Act), which provides the system of authorisation for the conduct of general insurance business.
- The Life Insurance Act 1995 (Cth) (Life Insurance Act), which regulates the conduct of life insurance business through a system of registration.
- The Marine Insurance Act 1909 (Cth) (Marine Insurance Act), which regulates marine insurance.
- The Corporations Act 2001 (Cth) (Corporations Act), which contains uniform licensing, disclosure and conduct requirements for the financial services industry (including insurance).
- The Insurance Acquisitions and Take-overs Act 1991 (Cth), which governs changes of ownership of authorised general insurers or registered life insurers.
- The Health Insurance Act 1973 (Cth), which establishes the publicly available medicare and the Private Health Insurance Act 2007 (Cth), which regulates the health insurance business.

Codes of practice

Industry codes of practice also govern the general and life insurance industries. These include the:

- Life Industry Code, which is recognised in the Life Insurance Act and regulations.
- General Insurance Code of Practice, which is administered by the Financial Ombudsman Service Limited.

Both Codes are nominally self-regulatory, but have practical legal force due to legislative requirements that insurers subscribe to approved schemes of industry self-governance of which these are, at present, the only two available.

Regulatory authorities

The Australian Prudential Regulatory Authority (APRA) maintains a prudential regulatory scheme. APRA is responsible for promoting the safety and soundness of life and general insurance companies. The regulatory regime is strict and requires that all Australian insurers hold capital reserves adequate to meet their actual and expected claims costs.

The Australian Securities Investments Commission (ASIC), the market conduct regulator, administers the Insurance Contracts Act. ASIC also exercises consumer protection related functions under the Life Insurance Act and Insurance Act. ASIC has power to do all things that are necessary or convenient for the administration of insurance.

ASIC also has the power to supervise Australian financial markets, including the insurance market (Corporations Amendment (Financial Market Supervision) Act 2010 (Cth)). ASIC has broad power, with the consent of the Commonwealth Minister for Financial Services, to issue market integrity rules with regard to the activities or conduct of the insurance market.

The Treasurer oversees the Insurance Acquisitions and Take-overs Act 1991, governing change of ownership of general insurers or...
life insurers. The Commonwealth Department of Health and Services and the Private Health Insurance Advisory Commission (PHIAC) regulates the health insurance industry. In Australia, a considerable regulatory distinction lies between health insurance, on the one hand, and life and general insurance, on the other.

REGULATION OF INSURANCE AND REINSURANCE CONTRACTS

3. What is a contract of insurance for the purposes of the law and regulation in your jurisdiction? How does it differ from a contract of reinsurance?

Contracts of insurance
At common law a contract of insurance generally requires:

- A binding contract creating a legal obligation to pay a sum of money or its equivalent on the happening of a specified event.
- A legal entitlement on the part of an insured to receive money or money's worth under the contract on the happening of that event.
- A specified future event that is uncertain as to whether it will occur, or if it will occur, as to when the event will take place.
- The specified future event being outside the insurer's control or responsibility.
- The insured having an insurable interest in the subject matter of the insurance.

The Insurance Contracts Act modifies the requirements for certain contracts of insurance by removing the need for an insurable interest. The Corporations Act applies to contracts that would ordinarily be regarded as a contract of insurance, even if some of their provisions are not by way of insurance. Likewise, it regards as a contract of insurance contracts that include provisions of insurance but which would not ordinarily be considered a contract of insurance.

Contract of reinsurance
A contract of reinsurance differs from a contract of insurance as it involves the original insurer (reinsured) taking out a contract of insurance with a second insurer. The position in Australia is similar to that in the UK.

The main difference between a contract of reinsurance and a contract of insurance is that, unlike in a normal insurance contract, there is no relationship between the original insurance customer and the reinsurer.

4. Are all contracts of insurance/reinsurance regulated in your jurisdiction?

The Insurance Act regulates the conduct of general insurance and reinsurance businesses through a system of authorisation. The Life Insurance Act provides for prudential regulation of life insurers and reinsurers.

Federal law
The Insurance Contracts Act regulates contracts of insurance and proposed contracts of insurance. However, there are a number of contracts which are not regulated under the Insurance Contracts Act, including (section 9):

- Reinsurance.
- Insurance entered into (or proposed to be entered into) by a private health insurer (in respect of its business as a health insurer or health benefits fund).
- Insurance entered into (or proposed to be entered into) by a friendly society.
- Insurance entered into (or proposed to be entered into) by the Export Finance and Insurance Corporation (other than short-term insurance contracts).
- Anything to which the Marine Insurance Act applies (see below).
- Insurance entered into (or proposed to be entered into) relating to workers' compensation or compensation for the death or injury arising from the use of a motor vehicle.
- Insurance entered into (or proposed to be entered into) in the course of state insurance or Northern Territory insurance.

Therefore, for certain areas, such as reinsurance, common law rules remain of importance, for example, in relation to the duty of utmost good faith (see Question 18, Duty of utmost good faith).

The Marine Insurance Act regulates contracts of marine insurance and defines a contract of marine insurance as being a contract under which the insurer “undertakes to indemnify the insured in manner and to the extent thereby agreed against marine losses, that is to say, the losses incident to marine adventure” (section 7, Marine Insurance Act 1909 (Cth)). A marine adventure includes, for example, where any ship, goods, or movables are exposed to maritime perils, namely “the perils consequent on, or incidental to, navigation of the sea” (section 9, Marine Insurance Act). Note, however, that the Insurance Contracts Act, and not the Marine Insurance Act, governs the insurance of marine pleasure craft.

State law
There are some state Acts which can apply to insurance and reinsurance contracts not covered by the Insurance Contracts Act.

REGULATION OF INSURERS AND REINSURERS

5. Are all insurers and reinsurers regulated in the same way in your jurisdiction?

In Australia the type of insurance business in which an insurer is engaged affects the way in which it is regulated:

- General insurers are, for the most part, regulated by a system of authorisation under the Insurance Act and are subject to prudential supervision by APRA. Reinsurers must also obtain authorisation from APRA.
- Other types of non-life insurance, such as health insurance and workers compensation, are regulated by legislation specific to these insurance types.
- Life insurers are regulated through a system of registration under the Life Insurance Act, administered by APRA.

The conduct and licensing of general insurance providers and insurance intermediaries who provide prescribed insurances to
retail clients is also regulated under chapter 7 of the Corporations Act, which is administered by ASIC (see Question 8). These provisions do not apply to contracts of reinsurance.

### 6. Can insurers or reinsurers carry on non-insurance business?

Please summarise any restrictions on their business activities.

While there are no specific restrictions on insurers carrying on non-insurance business, APRA is unlikely to authorise a single entity which carries on both insurance and non-insurance business. However, APRA may provide authorisation to a separate entity within a conglomerate group of companies, where one or more other entities within the group carries on non-insurance business.

### 7. Are there any statutory limits or other restrictions on, or requirements relating to, the transfer of risk by insurance or reinsurance companies?

There are no statutory requirements relating to risk transfer.

The Life Insurance Act allows certain investment-linked contracts, the principal object of which is the provision of benefits calculated by reference to units. The value of the units relates to the market value of a specified class or group of assets of the party by whom the benefits are to be provided.

An insurer must have in place a reinsurance management framework to manage the selection, implementation, monitoring, review, control and documentation of reinsurance arrangements, having regard to such factors as the insurer’s (APRA’s Prudential Standard GPS 230 (Reinsurance Management)):

- Size.
- Business classes.
- Complexity of operations.
- Risk appetite.

An insurer must, as part of that framework, submit to APRA on an annual basis:

- A reinsurance management strategy.
- A reinsurance arrangements statement.
- An annual reinsurance declaration that:
  - the insurer has placed its reinsurance arrangements;
  - those reinsurance arrangements are legally binding.

APRA prudential guidance on reinsurance management envisages that insurers will have a target of ceding no more than 60% of their total written premium over any 12-month period. For captives, the target is 90%.

Both an APRA-regulated general and life insurer can transfer its insurance business to another APRA-regulated insurer, or amalgamate its insurance business with another APRA-regulated insurer’s business, only under a scheme confirmed by the Federal Court (section 17B, Insurance Act and Part 9, Life Insurance Act).

### OPERATING RESTRICTIONS

#### Authorisation or licensing

8. Does the entity or person have to be authorised or licensed in your jurisdiction? If so, please outline the key steps involved in this process and the requirements that must be satisfied.

**Insurance/reinsurance providers**

**General insurers and reinsurers.** Insurance companies must be authorised in Australia (Insurance Act and relevant regulations). The legislation specifically authorises Lloyd’s to carry on insurance business.

An applicant seeking authorisation must be incorporated and apply in writing to APRA. APRA can authorise a life or general (but not combined) insurance business, on appropriate conditions relating to prudential matters.


- Documentation to be supplied with the application.
- Minimum criteria.

The application process involves providing APRA with detailed information about the prospective applicant and its proposed business.

Typically, the overall licensing process takes between three to 12 months, depending on the:

- Complexity of the proposed business.
- Extent to which the applicant can base its operations on an existing, well-established and sound business model.

APRA has discretion to either authorise the application or refuse the application. Section 12 of the Insurance Act provides a non-exhaustive list of circumstances in which APRA can refuse an application. APRA will only authorise suitable applicants who have the capacity and commitment to conduct insurance business with integrity, prudence and professional skill, on a continuing basis. Applicants must comply with the prudential requirements outlined in the Insurance Act and Prudential Standards. APRA can authorise applicants subject to conditions relating to prudential matters, assessed on a case-by-case basis. For example, more rigorous prudential requirements may be set for newly authorised insurers in their formative years, or for those in specialist or unusual market niches.

**Life insurers.** Companies carrying on the business of life insurance must be registered under the Life Insurance Act. Applications for registration must be made to APRA and accord with the Life Insurance Regulations 1995 (Cth). Applicants should consult APRA’s Guidelines on Registration of Life Companies (www.apra.gov.au/Life/upload/Guidelines-on-registration-of-life-companies-2.pdf) for further information on the authorisation process. The process is comparable to that for general insurers (see above).
APRA can refuse to register the company if a registration requirement is not fulfilled. APRA may impose conditions on the registration of a company by written notice of their terms. There are also provisions for cancellation of registration.

Marketing insurance/reinsurance services

Any person who carries on a financial service business, must either (Chapter 7, Corporations Act):

- Hold an Australian financial services licence (AFSL) covering the provision of financial services.
- Be an authorised representative of an AFSL holder.

A person will be providing financial services if they:

- Provide financial product advice.
- Deal in a financial product.
- Make a market for a financial product.
- Operate a registered scheme.
- Engage in other conduct prescribed by regulations to be a financial service.

An insurer that is a pure product issuer, and does not provide any financial advice, may be exempt from holding an AFSL.

“Dealing”, for example, issuing or arranging, in connection with contracts of insurance, may also constitute a financial service requiring an AFSL. This means that the Corporations Act requirement applies to both insurance brokers and insurance agents.

ASIC regulates the marketing of financial products and licensing of financial service providers. Persons, bodies corporate or partnerships requiring an AFSL must lodge an application with ASIC. Applications can be completed online at www.asic.gov.au. Regulatory guides are provided online to assist applicants with the application process.

To grant the AFSL, ASIC must be satisfied that the applicant or the applicant’s responsible officers are of “good fame or character”. ASIC must impose conditions on the licences granted limiting the:

- Financial services that the AFSL holder is authorised to provide.
- Specific types of financial products for which those financial services may be provided.

This means that applicants must specify in their application the type of business for which they seek to be licensed to conduct and the particular financial products they will be dealing with. For example, an insurance intermediary that issues products on behalf of an insurer and which also provides advice to its clients about those products, must apply for an AFSL to cover both of those activities.

9. Please summarise the main exemptions or exclusions from authorisation or licensing that are available in your jurisdiction, if any.

General insurers carrying on “insurance business” in Australia must be registered with APRA or be exempted by legislative provisions relating to “direct offshore foreign insurers” (DOFI).

DOFIs carrying on insurance business in Australia must generally be authorised under the Insurance Act and comply with the same prudential regime as local insurers. However, the legislative provisions relevant to DOFIs do not apply to reinsurance or to:

- Insurance contracts for high value insureds that satisfy one of the following tests (based on average figures over a three-year period):
  - consolidated gross operating revenue of A$200 million;
  - consolidated gross assets of A$200 million; or
  - 500 or more employees.

(As at 1 January 2011, US$1 was about A$0.9.)

- Insurance contracts for atypical risks (for example, nuclear, biological risk, and war).

- Insurance contracts for unique risks that cannot reasonably be placed with an Australian insurer due to:
  - lack of market capacity;
  - a substantial difference in terms or price; or
  - other circumstances leading to substantially less favourable insurance.

- Contracts of insurance that are required by the law of a foreign country.

There are some mutual discretionary funds operating in Australia which provide benefits that fall short of insurance. APRA does not currently regulate these.

Restrictions on ownership or control

10. Are there any restrictions on the ownership or control of insurance-related entities in your jurisdiction (for example, age, nationality, qualification or other restrictions)?

Insurance/reinsurance providers

The following limitations apply (Financial Sector (Shareholdings) Act 1998 (Cth)):

- Shareholdings of an individual shareholder or group of associated shareholders in an insurer are limited to 15% of the insurer’s voting shares (subject to approval by the Treasurer for a higher percentage).

- Any foreign parent that acts as an insurer must have a diverse portfolio of ownership (subject to any exemptions provided by the Act).

APRA requires any substantial shareholder of an applicant to show that they are “fit and proper”. This means that each substantial shareholder must be able to demonstrate that it is well-established and financially sound.

APRA also has a “fit and proper” requirement for directors and senior managers of insurers, including provisions requiring the independence of some directors.

11. Do owners or controllers have to be pre-approved by or notified to the relevant authorities before taking, increasing or reducing their control or ownership of the entity?

The Treasurer’s approval is required for a person to hold more than a 15% stake in a financial sector company (Financial Sector (Share-
Insurance and Reinsurance 2011
Country Q&A

Ongoing requirements for the authorised or licensed entity

12. Please summarise the key ongoing requirements that the authorised or licensed entity must comply with.

The requirements for life and general insurers are similar, but not identical.

The key ongoing requirements that the authorised or licensed entity must comply with are as follows:

- An authorised insurer must have in place sufficient capital reserves to meet the minimum capital requirements.
- An authorised insurer must have assets in Australia that are more than its liabilities in Australia. Where an asset is made up of a chattel or real property (or equitable interest in that property) it is only considered an asset in Australia if either:
  - it is located in Australia; or
  - the legal title is held by:
    - the insurer or the insurer’s custodian (in the case of an Australian-authorised insurer); or
    - the insurer’s authorised Australian agent (in the case of a foreign insurer).

APRA requires regular audited financial reporting and the preparation of a Financial Condition Report by the appointed insurer’s actuary. An insurer must also have:

- An appropriate risk management framework in place.
- A reinsurance risk management framework (see Question 7).

Although an authorised insurer can outsource some of the above obligations, it must first obtain the approval from APRA to do so and must notify APRA of any outsourcing agreements to which it has become a party. In addition, APRA regularly conducts on-site supervisory reviews of authorised entities and assigns a confidential risk rating to that entity.

Penalties for non-compliance with legal and regulatory requirements

13. Please outline the possible consequences of an entity failing to comply with applicable legal and regulatory requirements (including the disciplinary powers any relevant regulators have, as well possible customer remedies). What recourse do policyholders have if they have done business with a non-approved entity?

The Corporations legislation also provides for possible imprisonment for certain offences.

Breach of other legal and regulatory requirements

There are a number of enforcement avenues open to APRA and ASIC for breaches of the legislation, ranging from:

- Cancellation or suspension of licences/authorisations and the imposition of licence conditions.
- The personal liability of the entity’s directors and officers.

The legislation allows the regulators to take enforcement action on behalf of policyholders who have been adversely impacted.

Where there is a major prudential compliance failure and perceived threat to policyholders, APRA also has powers to suspend the board and management and take control of life and general insurers.

Impact on policyholders who have done business with a non-approved entity

Contracts entered into with a non-approved entity should be enforceable at common law.

Restrictions on persons to whom services can be marketed or sold

14. Are there any restrictions on the persons to whom insurance/reinsurance services and contracts can be marketed or sold?

There are no restrictions, apart from the ordinary requirements for capacity to enter a contract.

Reinsurance Monitoring and Disclosure Requirements

15. To what extent can/must a reinsurance company monitor the claims, settlements and underwriting of the cedant company?

This will depend on the provisions of the relevant reinsurance agreement. In practice, there is usually a high level of communication about claims, settlements and underwriting between reinsurers and cedants.

Australian law imposes no positive obligation on reinsurers to monitor or exercise direction over claims, settlements or underwriting of cedants. However, the terms of reinsurance treaties and facultative agreements will often give reinsurers extensive contractual entitlements to do so. The extent to which they exercise those contractual rights, where conferred, will affect their legal rights in the event of any material non-disclosure or misrepresentation, breach of contract or other misfeasance on the part of the cedant.

Apart from certain state legislation which is relevant mainly to arbitrations, and federal statutes prohibiting misleading, deceptive and anti-competitive conduct, reinsurance contracts in Australia are not subject to any prescriptive statutory regime such as the Insurance Contracts Act (which governs cedants’ policies in most lines of business). The Australian common law of reinsurance contracts is similar in many respects to that of England and Wales and precedents from both UK and US jurisdictions have
considerable persuasive authority. “Follow the fortunes”, “follow the settlements” and “claims control” clauses are common in Australian reinsurance treaties and facultative agreements and are given full force and effect under Australian law.

16. What disclosure/notification obligations does the cedant company have to the reinsurance company?

Reinsurance contracts are contracts of insurance under Australian law and the common law duty of disclosure applies to them just as to a primary policy. However, the content of the information required to be disclosed and the provisions as to materiality and remedies for breach of it may vary. Section 21 of the Insurance Contracts Act, which sets out the content of the insured’s duty of disclosure in a contract of insurance (that is, in summary, that the insured has a duty to disclose matters that he knows to be relevant to the decision of the insurer whether to accept the risk, or that a reasonable person in the circumstances could be expected to know to be relevant), does not apply to a contract of reinsurance. The parties to a reinsurance contract are free to agree, however, that for the purposes of disclosure, the reinsurer is entitled to no better or wider scope of information concerning the underlying risk than the reinsured can require from the insured.

Alternatively, the parties can require that the common law “prudent underwriter” definition of the duty of disclosure governs their relationships with cedants and may well do so in the context of reinsurance arrangements where the claims history and profitability of an underlying book of business are material. In that event all of the UK and Australian case law dealing with the prudent underwriter test, materiality and the availability of the remedy of avoidance becomes relevant.

In Australia reinsurance, like insurance itself, is a contract requiring utmost good faith on both sides. The statutory implied term to that effect, which is inserted into contracts of direct insurance by section 13 of the Insurance Contracts Act, does not apply to reinsurance (see Question 18).

POLICIES – CONTENT REQUIREMENTS AND IMPLIED TERMS

17. Please outline the main general form and content requirements for insurance policies in your jurisdiction, including a description of the most commonly found clauses.

The Insurance Contracts Act creates a standard insurance cover regime for certain prescribed contracts:

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

An insurer must bring to the attention of an insured terms of the insurance contract that differ from the standard terms of a prescribed contract before the contract is entered into (section 35). Where a contract is not prescribed, insurers must inform insureds of unusual policy terms before the insured enters the contract (section 37).

Otherwise, insurers are free to offer their own preferred contractual terms, including one-off “bespoke” policies if appropriate.

However, the Insurance Contract Act will govern how these contracts operate, and it significantly modifies the common law in this respect.

18. Please identify any terms found in insurance policies in your jurisdiction that are implied by law or regulation (identifying the applicable laws or regulations and any mandatory provisions).

Duty of the utmost good faith

A “duty of the utmost good faith” is implied by law into contracts of insurance under section 13 of the Insurance Contracts Act and applies to categories of insurance falling within that legislation. The duty is described as a duty “requiring each party to (the contract of insurance) … to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith”.

The duty also exists at common law in relation to categories of insurance not regulated under that Act, for example: health insurance contracts; marine insurance contracts; workers compensation contracts; and reinsurance contracts (see Question 16). Its application at common law is problematic in a number of respects. For example, the only remedy for breach is avoidance of the contract, which is not much use if you are the insured.

Parties cannot rely on a provision of a contract of insurance where to do so would be to fail to act with the utmost good faith. In determining whether an insurer’s reliance on a provision of a contract of insurance would constitute a failure to act with the utmost good faith, the court will have regard to any notification of the provision that was given to the insured, including (but not limited to), whether notification of unusual terms has been made in accordance with sections 14(3) and 37 of the Insurance Contracts Act (see Question 17).

Other implied terms

The following are also implied, depending on the type of contract:

- In contracts for health insurance, there is an implied condition that an insurer will not be liable for medical expenses incurred in respect of professional services for which a Medicare benefit is payable (section 126, Health Insurance Act 1973 (Cth)). Any term that purports to exclude, restrict or modify (or has that effect) the application of all or any provisions of section 126 (including the implied condition in respect of Medicare benefits) will be void.
- In an eligible insurance contract (such as property and liability insurance over commercial and religious property) a terrorism exclusion will have no effect in relation to a loss or liability to the extent to which the loss or liability is an eligible terrorism loss (section 8(1), Terrorism Insurance Act 2003 (Cth)). A terrorism exclusion means an exclusion or exception for acts described using the word terrorism, terrorist or words of similar effect, or other acts substantially
similar to terrorist acts defined in further detail under section 5 of the Act. A contract of reinsurance is not an eligible insurance contract for the purposes of the Terrorism Insurance Act. The Terrorism Insurance Regulations prescribe a list of contracts which are excluded from the definition of eligible insurance contract, including, for example:

- a contract of professional indemnity insurance;
- a life insurance contract;
- a contract which contains provisions of insurance where the contract would not ordinarily be regarded as a contract of insurance.

If a terrorism event is declared, a scheme established under the Act provides reinsurance for insurers whose policies are affected by the legislation. Reinsurance through the Australian Reinsurance Pool Corporation (a statutory government body dealing with terrorism-related insurance claims and protection) is not automatic. It only applies where the insurer has chosen to reinsure some or all of its terrorism risk with the facility. The pool is supplemented by a retrocession programme, and a Commonwealth government guarantee, which is capped at A$10 billion. If the responsible Minister considers that the amount payable under the Commonwealth guarantee will exceed A$10 billion, the Minister must also announce a reduction percentage at the time a declared terrorist incident is announced. An insurer which does not have any reinsurance with the ARPC will not have the benefit of this reduction percentage applying to its policies.

19. Please identify customer protections which are generally included in insurance policies to supplement relief available under general law.

Consumer protection has been the subject of recent law reform following the new Australian Consumer Law (ACL) enacted in the Competition and Consumer Act 2010 (Cth). The ACL (which took effect from 1 January 2011) creates a single, national law concerning consumer protection and fair trading.

Significantly, new unfair contract terms provisions incorporated in the ACL do not apply to contracts of insurance (section 15, Insurance Contracts Act). At the time of publication, the exclusion of contracts of insurance is currently the subject of legislative review and consultation. This may result in an amendment to the ACL and/or further amendments to the Insurance Contracts Act (see Question 31).

At present, a number of consumer protection provisions are included in the Insurance Contracts Act, the most important of which are:

- In any proceedings where there is an allegation of fraudulent failure to comply with the duty of disclosure or fraudulent misrepresentation, the court may allow the insured to recover the (section 31):
  - whole of the amount that would have been payable if the contract had not been avoided; or
  - such part as the court thinks just and equitable in the circumstances.
- The operation of the Act cannot be excluded, restricted or modified to the prejudice of a person other than the insurer, by a provision of a contract of insurance (section 52).
- Any provision permitting an insurer unilaterally to vary a contract of insurance is ineffective (section 53).
- Where there is a fraudulent claim by a person that is not insured under the insurance, the insurer cannot avoid the contract but may refuse payment of the claim, subject to the court having the power to order an insurer to pay an amount that it assesses as just and equitable in the circumstances (section 56).
- Insurance cover is automatically extended if an insurer fails to notify the expiration of cover (section 58).
- Except as provided by the Insurance Contracts Act, an insurer cannot cancel the contract of general insurance and any reported cancellation in contravention of this section has no effect (section 63).

20. Please identify examples of standard policies or terms produced by trade associations or relevant authorities, if any, and explain how these can be obtained.

Numerous bodies and trade associations in Australia produce standard policies and terms that can be used by individuals and businesses in the Australian insurance sector, including the:

- Insurance Council of Australia (ICA).
- National Insurance Brokers Association (NIBA).
- Australian Insurance Law Association (AILA).
- Insurance Advisors Association of Australia (IAAA).

See box, Main insurance/reinsurance trade organisations.

These associations are easily contactable through their respective websites. Leading examples of a standard policy, for example, are the NIBA Mark IV and Mark V Industrial Special Risks (ISR) wordings.

21. Please identify common clauses in reinsurance policies, including follow the form and follow the fortune reinsurance, and standard provisions concerning choice of law, arbitration, and right to take part in the underlying adjustment. Is facultative or treaty reinsurance more common in your jurisdiction?

Both facultative and treaty reinsurance exist in Australia in all their many and varied forms although generally the terms of reinsurance agreements are similar to those used in the UK. There are three common clauses that arise in Australian reinsurance policies: “follow the settlement”, “pay as may be paid” and “follow the fortune” clauses.

A “follow the settlement” clause attempts to bind the reinsurer (in the absence of fraud) to good faith settlements made by the reinsured in a situation where, as a matter of law, the settlement falls within the risks covered by the policy. Accordingly, the reinsured is not required to prove its loss to the reinsurer, provided the reinsured has acted honestly and in a business-like manner in reaching such a settlement. A “pay as may be paid” clause may also restrict the reinsurer from challenging the settlement entered into between the parties. A “follow the fortune” clause is designed to preclude the reinsurer from refusing to pay its fair share of a judgment on the policy against the reinsured, including
damages, interest and costs where the case has been run for the reinsurer’s benefit as well as that of the reinsured.

**INSURANCE AND REINSURANCE POLICY CLAIMS**

22. What must be established to trigger a claim under an insurance policy?

The trigger for a claim depends on the terms of the policy. The onus of proof lies with the insured, who must show that on the balance of probabilities:

- There is a valid contract of insurance.
- An event occurred within the policy.
- The insured has suffered loss as a result of the event.
- The event is the dominant or effective cause of the loss.

23. Please provide brief circumstances in which third parties can claim under an insurance policy.

Under Australian law, it is important to draw a distinction between third parties with claims against the insured, claiming directly against the insurer, and noted interest beneficiaries claiming on the policy. Noted interest beneficiaries are a sub-species of insured rather than third parties proper.

A range of insurance covers provide cover to third parties. Traditionally, third parties could not claim under an insurance policy at common law with limited exceptions (see Trident General Insurance Co Ltd v McNiece Bros Ltd (1988) 165 CLR 107) because of the doctrine of privity. Section 51 of the Insurance Contracts Act provides that a third party to a contract of insurance has the right to recover where the insured has died or cannot, after reasonable enquiry, be found.

In respect of noted interest beneficiaries (third parties named as beneficiaries of the policy), section 48 for general insurance policies, and section 48A for life insurance policies, provide that if a third party is specified or referred to in the contract, whether by name or otherwise, as a person to whom the insurance cover applies, an insurer is prevented from raising lack of privity of contract as a defence. It does not, however, create a right or cause of action for noted interest parties against the insurer above or beyond the rights conferred by the policy, and they have the same obligations to the insurer as the contracting insured would have. The insurer has the same defences as it would have to a claim by the insured.

The application of these provisions is not straightforward. Since their introduction, there have been many disputes and litigation over the rights and obligations of beneficiaries.

In addition, in certain circumstances a third party can recover from the insurer of a company that has been deregistered an amount that would have been payable to the company under the insurance contract (section 601AG, Corporations Act 2001).

24. Is there a time limit outside of which the insured/reinsured is barred from making a claim?

There is no specific statutory time limit for making a claim under a contract of insurance/reinsurance. A contract of insurance may specify the time in which a claim must be made. Insurance contracts are also subject to the normal limitation periods for causes of action founded on breach of contract (normally six years, but three years in the Northern Territory). However, time will only start to run where there has been a breach of contract by the insurer; for example, refusing to pay a claim covered by the policy.

Section 54 of the Insurance Contracts Act also provides potential relief for late notification and other omissions (see Question 26, Circumstances where an insurer cannot refuse to pay claims).

25. Can the original policyholder or other third party enforce the reinsurance contract against a reinsurer?

Normally, an original policyholder or other third party cannot enforce the reinsurance contract against a reinsurer. A reinsurance contract is between the reinsurer and the cedant and the law of privity of contract applies to it in the same way as to other commercial agreements. Australia does not have general legislation similar to the UK’s Contracts (Third Parties) Act 1999.

There are, however, certain circumstances under which the proceeds of reinsurance can be collected and applied directly to the liabilities of cedants toward policyholders, where the cedant itself is no longer in a position to discharge them. In the insolvency of an insurer, proceeds of reinsurances collected by the liquidator may be applied in priority to the insurer’s liability under the relevant contracts of insurance to which they relate, rather than going into the general distribution (section 562A, Corporations Act).

An indicative statutory formula for determining payment amounts is provided, and case law determines how it is to be applied to the complexities of particular treaty and facultative reinsurance arrangements. Questions of “broad pooling” or “narrow pooling” of reinsurance recoveries and the application of the section to multi-line treaties and stop loss arrangements are beyond the scope of this chapter.

So-called “cut through” clauses in captive insurance arrangements sometimes purport to create privity of contract between the original insured and reinsurer, giving the insured a right to proceed directly against the reinsurer in the event of a disputed claim. These, however, are essentially tripartite contractual arrangements and derive their enforceability from the validity of that particular arrangement, rather than from legislation.

There is no general, government guaranteeing compensation to policyholders in the event of insurer failure. However, such schemes have been set up in the past on a one-off basis. An example is the partial compensation scheme which was established by the Commonwealth Government following the failure in 2001 of Australia’s second largest liability insurer, HIH Casualty and General Insurance Limited. Since then, substantial enhancements to the APRA’s Prudential Standards requirements for insurer solvency and capital adequacy have rendered further insurance failures unlikely although not, of course, impossible.

26. What remedies are available for breach of an insurance policy?

**Insurer’s cancellation of a contract of general insurance**

An insurer is not able to cancel a contract of general insurance except in accordance with the provisions of the Insurance Contracts Act (section 63, Insurance Contracts Act).
An insurer can cancel a contract of general insurance, subject to the operation of other provisions in the Act, in a number of circumstances (section 60):

- A breach of duty of utmost good faith.
- A breach of duty of disclosure.
- A misrepresentation.
- A breach of a provision of the contract.
- A fraudulent claim under the contract, or under some other contract in effect at the same time.
- The act or omission occurs after the contract has been entered into.

There is no equivalent to section 60 for contracts of life insurance. However, some life insurers have proceeded on the basis that they are entitled, under some circumstances, to cancel a contract under the common law.

Circumstances where an insurer cannot refuse to pay claims

Section 54 provides for circumstances where an insurer cannot refuse to pay claims by reason of some act of the insured or of some other person. That section governs contracts of insurance which allow an insurer to refuse to pay a claim because the insured or a third party has done some act (or omitted to do some act) after the contract was entered into. If the act or omission could not reasonably be regarded as capable of causing or contributing to a loss for which insurance cover is provided, the insurer cannot refuse to pay the claim. The insurer can, however, reduce its liability by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act or omission.

By contrast, the insurer may refuse to pay the claim where the act or omission could be reasonably regarded as being capable of causing or contributing to a loss for which cover is provided.

For section 54 to come into play the “effect of the contract of insurance” must be that the insurer may refuse to pay a claim. This “effect” must come from the contract of insurance.

There has been considerable judicial scrutiny of what constitutes a “claim” and an “omission” for the purpose of section 54(1), in particular, in the context of an insured’s failure to notify the insurer of a claim within the period of insurance cover under a claims-made policy. The insurer may not refuse to pay the claim only because of the late notification, although the insurer can contend that it is has been prejudiced by the late notification.

With respect to an insured’s failure to notify facts (circumstances), the High Court has held that failure to give notice of facts that might give rise to a claim in accordance with the contractual requirement to do so was an “omission” within the meaning of section 54. This was because the effect of the contract was that the insurer could refuse to pay the claim.

Failure to pay a claim promptly

An insurer that unreasonably withholds payment of money to a person under a contract of insurance may be liable to pay interest at the rate prescribed in the regulations (section 57, Insurance Contracts Act). Further, in some cases compound interest can be recovered representing either the borrowing or opportunity cost (assuming that such a loss can be established on the evidence).

---

INSOLVENCY OF INSURANCE AND REINSURANCE PROVIDERS

27. Please outline the regulatory framework for dealing with distressed or insolvent insurance or reinsurance companies, or other persons or entities providing insurance or reinsurance related services. Can excess coverage “drop down” to provide coverage at levels concerning which the existing coverage is insolvent?

APRA has power to supervise general insurers, including determining prudential standards and monitoring and investigatory powers, including the power to appoint a judicial manager (Insurance Act). The Life Insurance Act also provides for judicial management. As life insurers utilise statutory funds for policyholder funds, insolvency presents complex priority issues.

Australian law provides a number of methods for the external administration of insolvent companies generally (including insurance and reinsurance companies), both judicial and non-judicial.

The most frequently utilised non-judicial methods are:

- Voluntary administration.
- Receivership.
- Creditors’ voluntary liquidation or winding up.

The judicial methods involve judicial management and liquidation.

An example of recent experience of insolvency in Australia is HIH (placed in liquidation in 2001). Proceedings were commenced to wind up HIH and three associated companies in the New South Wales Supreme Court in March 2001 and liquidators of HIH were appointed in August 2001. Also in March 2001, a letter of request was issued by the New South Wales Supreme Court to the English court for the appointment in England of provisional liquidators over HIH under section 426 of the UK Insolvency Act 1986. The English provisional liquidators were duly appointed to HIH, the liquidation of which in the UK was ancillary to the principal Australian liquidation. That insolvency has subsequently proceeded to a complex scheme of arrangement.

In the event of insurer insolvency, there is no drop down of excess insurance to fill the gap, unless the excess policies themselves provide for it.

Section 562A of the Corporations Act sets out the manner in which the application of proceeds of contracts of reinsurance are to be paid. That section applies where:

- The company was insured under a contract of reinsurance against liability to pay amounts in respect of a relevant contract of insurance (which includes a contract of reinsurance).
- An amount in respect of that liability is received by the company or its liquidator under the contract of reinsurance.

If the amount received, after deducting expenses of or incidental to getting in that amount, equals or exceeds the total of all the amounts payable by the company under relevant contracts of insurance, the liquidator must, out of the amount received, pay the amounts payable under those contracts of insurance in priority to all payments in respect of the debt referred to in section 556 of the Corporations Act. The Insurance Act contains a provision providing for priority to Australian liabilities in the winding up of an authorised insurer.
28. Briefly describe the tax treatment for insurers, reinsurers, and other persons or entities providing insurance and reinsurance-related services in your jurisdiction.

The tax treatment of insurers, reinsurers and other persons is complex and requires specialist advice.

29. Are there special procedures or venues for dealing with insurance or reinsurance complaints or disputes in your jurisdiction?

Both insurance and reinsurance contractual arrangements are subject to the jurisdiction of the Australian courts, in the same manner as any other commercial activities. In addition, policyholders and other insurance consumers with grievances may refer their disputes to the Financial Ombudsman Service (FOS). The FOS has jurisdiction to resolve insurance disputes involving certain agreed maximum amounts, agreed by the insurance industry with the approval of ASIC.

Determinations in such disputes are binding on the insurer, by virtue of its contractual agreement to participate in the FOS Scheme, but not on the consumer who, if dissatisfied with the outcome, retains the right to take court proceedings in the normal manner. Most insurers agree to apply the FOS Scheme only to domestic, consumer and small business classes of insurance, which is all that the ASIC requires. The Scheme is free to the consumer, however, the insurers pay a fee in respect of each referral.

Both insurance and reinsurance disputes in Australia can be the subject of arbitration, mediation or other alternative dispute resolution procedures, however, in the case of direct insurance this must be agreed to by both parties after the dispute has arisen. Section 43(1) of the Insurance Contracts Act strikes down compulsory arbitration provisions in insurance contracts to which that Act applies. Arbitration clauses in reinsurance contracts are, however, generally enforceable in Australia (see Question 30).

30. Please give a brief overview of the main dispute resolution methods used to settle reinsurance claims.

Arbitration is the preferred method for resolving Australian reinsurance disputes and is conducted in accordance with the Commercial Arbitration Acts in the various Australian jurisdictions, generally using either the London Court of Arbitration (LCA) or the UNCITRAL Model Law on International Commercial Arbitration 1985 procedures. Otherwise, litigation is used.

Reform

31. Please summarise any proposals for reform of the law, regulation or rules in your jurisdiction relating to the provision of insurance or reinsurance services.

A draft bill to amend the Insurance Contracts Act will probably be passed in 2011. The principal amendments will:

- Allow electronic communications.
- Amend some aspects of non disclosure law.
- Clarify third party rights and duties.
- Enhance ASIC’s enforcement rights.

A breach of good faith will become a breach of the Act (see Question 18).

The recent Australian floods have highlighted problems with flood exclusions and this likely to be the subject of political scrutiny and urgent reform.

The distribution of insurance products and the payment of commission is the subject of continuing scrutiny.

There is continued focus on prudential regulation and capital changes are currently being considered by APRA for both life and general insurers and reinsurers.
Qualified. New South Wales, 1988; High Court, 1991; Federal Court, 1991; South Australia, 1992; Western Australia, 2000; Queensland, 2006

Areas of practice. Insurance and risk; insurance disputes; product liability.

Recent transactions
- Practice has a dual focus encompassing both risk management and large claims work.
- Undertaking portfolio review particularly in relation to product recall, contamination and extortion policy working. Addressing risk management issues including risk profiling, scenario planning, business continuity and disaster recovery plans.
- Providing specific risk services tailored to retail pharmaceutical and food industries while also providing analysis of risk allocation in connection with mergers and acquisitions.
- Acting for international and domestic insurers and reinsurers in arbitration, Supreme and Appeal court proceedings.

**JOCELYN KELLMAN**
*Clayton Utz*
T +61 2 9353 4139
F +61 2 8220 6700
E jkellam@claytonutz.com
W www.claytonutz.com

Qualified. South Australia, 1977; Victoria, 1983; New South Wales, 1995; High Australia, 1992; Western Australia, 2003

Areas of practice. Insurance and risk; insurance disputes.

Recent transactions
- Transurban CityLink litigation (Insurance Company): advising and acting for one of the project professional indemnity insurers in litigation in relation to issues involving the Burnley Tunnel.
- ANZ Banking Group: Fred is Clayton Utz’s client relationship partner and advises ANZ on various matters including captive insurance and reinsurance related matters, disputed claims, policy wording analysis and negotiation, and regulatory issues. Fred has conducted successful major reinsurance claim litigation on behalf of the Bank, resulting in a recovery in excess of A$114 million from local and overseas reinsurers.

**FRED HAWKE**
*Clayton Utz*
T +61 3 9286 6356
+61 4 3749 3663 (mobile)
F +61 3 9629 8488
E fhawke@claytonutz.com
W www.claytonutz.com

Qualified. South Africa, 1999; Australia, 2008

Areas of practice. Insurance and risk; dispute resolution.

Recent transactions
- Advising on policy interpretation, claims, indemnity and risk issues, as well as the insurance aspects of major projects and commercial transactions.
- Advising on D&O policies and deeds of indemnity, including directors’ liability issues.
- Advising on insurance issues in respect of mergers and acquisitions.
- Advising international clients on Australian general and life insurance legislation and regulation.

**AMANDA TURNILL**
*Clayton Utz*
T +61 2 9353 4134
F +61 2 8220 6700
E aturnill@claytonutz.com
W www.claytonutz.com

Qualified. Victoria, 1991; High Court, 1991; Federal Court, 1991; High Court of England and Wales, 1992; South Australia, 2003; Western Australia, 2003; New South Wales, 2005

Areas of practice. Insurance and risk; insurance disputes; product liability.

Recent transactions
- Advising insurers on insurance coverage issues and risk management in connection with product liability claims
- Advising on professional indemnity claims and coverage issues.
- Advising underwriters on the wording in catastrophe excess of loss reinsurance agreements in connection with insurance claims following natural catastrophes.

**DAVID GERBER**
*Clayton Utz*
T +61 2 9353 4600
F +61 2 8220 6700
E dgerber@claytonutz.com
W www.claytonutz.com

Qualified. South Africa, 1999; Australia, 2008

Areas of practice. Insurance and risk; dispute resolution.

Recent transactions
- Advising on policy interpretation, claims, indemnity and risk issues, as well as the insurance aspects of major projects and commercial transactions.
- Advising on D&O policies and deeds of indemnity, including directors’ liability issues.
- Advising on insurance issues in respect of mergers and acquisitions.
- Advising international clients on Australian general and life insurance legislation and regulation.