FSC FINANCIAL SERVICES COUNCIL

Cancellation of insurance policies for non-payment of premiums - AFCA Draft Approach Paper

FSC Submission

February 2021

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member organisations in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2. Introduction

The Financial Services Council (**FSC**) provides this submission in response to the Australian Financial Complaints Authority's (**AFCA**) letter dated 3 December 2020 in relation to AFCA's draft approach paper on the cancellation of insurance policies for non-payment of premiums (**Draft Approach**). We would welcome the opportunity to discuss further any queries you may have in connection with this submission. In this regard, please contact David McGlynn, FSC Senior Legal Counsel, on dmcglynn@fsc.org.au or by calling 0413 85 061.

3. Background

The position of the FSC and its life insurance members is that a risk only contract of life insurance may be cancelled provided the process is consistent with the requirements of section 59 of the *Insurance Contracts Act 1984* (Cth) **(s59)**. A policy with an investment component gives rise to a surrender value and the surrender value may only be forfeited for non-payment of premiums consistent with the requirements of section 210 of the *Life insurance Act 1995* (Cth) **(s210)**.

The industry's position is supported by commentary provided by Ian Enright and Rob Merkin in Sutton's Law of Insurance in Australia (Thomson Reuters, Sydney, 4th ed, 2015) (**Sutton's Law of Insurance in Australia**), and legal opinions from Mr Ian Jackman SC, dated 26 November 2015 and 15 December 2015 (collectively, the **Jackman Opinion**) which have been previously shared with AFCA *(see relevant extracts set out below).*

Sutton's Law of Insurance in Australia relevantly notes at 12.250:

> *Remarkably and unnecessarily, [the Insurance Contracts Act 1984] omits the failure to pay premium as a ground for cancellation on the basis that this ground is the subject of the Life Insurance Act 1995 s210. The better view is that s210 applies only to a policy with a surrender value. A surrender value is in an investment life insurance only.*

The Jackman Opinion dated 10 November 2015 relevantly notes:

> *17. First, sub-section 210(5) itself is confined to the concept of "forfeiting" a policy. As a matter of ordinary legal language, "forfeiture" refers to the loss or determination of a proprietary interest or right, rather than merely contractual rights: Legione v Hately (1983) 152 CLR 406 at 445 (Mason and Deane JJ); Kostopoulos v G. E. Commercial Finance Australia Pty Ltd [2005] QCA 311 at [53] (Keane JA, with whom McMurdo P and Dutney J agreed); Westminster Properties Pty Ltd v Comco Constructions Pty Ltd (1991) 5 WAR 191 at 197-8 (Malcolm CJ), 202-6 (Kennedy J). The more general term "cancellation" is apt to refer also to the termination of contractual rights. The distinction is preserved in the language of sub-section 59(3), which is part of a section dealing with cancellation, and recognises expressly that sub-section 210(5) is concerned with life policies that may be "forfeited".*
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> *18. Second, sub-section 210(5) must be read in the context of section 210 as a whole, which begins in sub-section (1) with the forfeiture of policies where the "surrender value" exceeds the total of overdue premiums and any other amounts owed under the policy. As it is sub-section (1) which provides for the circumstances in which a policy is liable to be forfeited for non-payment of a premium, it is necessarily to be read together with sub-section (5) which provides the procedure for forfeiture for non-payment of premium. The section, read as a whole, is not concerned with risk-only policies, as they do not have any surrender value.*

AFCA's Draft Approach paper notes that a "respectable argument" can be made that s210(5) only applies to life insurance policies with a surrender value. AFCA further notes that "eminent insurance lawyers agree that the law is unclear and disagree on which is the better interpretation". The FSC submits that the far more compelling legal analysis (particularly given the references to "*forfeit"* and "*surrender value*" *in s* 210, and "*forfeited*" in s 59(3)) supports the position that s210(5) only applies to *forfeiture* of policies with a surrender value and risk only policies may be cancelled in accordance with requirements of s59.

Consistency in decision making

AFCA states that previous determinations by AFCA and its predecessors have taken the view that s210(5) applied to all life insurance policies so maintaining this approach provides consistency in decision making. The FSC and its life insurance members disagree. While the Financial Ombudsman Service (**FOS**) had indicated that it considered s210 to set out the appropriate cancellation procedure, FOS and AFCA had previously agreed that it would not press this view given the divergence of legal opinion and lack of definitive caselaw on the correct interpretation of s210(5). This divergence of legal opinion is explicitly acknowledged by AFCA in the Draft Approach by the statement that "[*t]he law governing cancellation of life insurance policies is unclear."*

Despite adopting that position, AFCA has of its own motion chosen to reconsider its approach to the cancellation of policies for non-payment of premiums.

Fairness and the unintended consequences of AFCA's Draft Approach

AFCA's Draft Approach proceeds on the mistaken assumption that s210 is preferable to s59 as a notice under s210 provides the insured with an opportunity to maintain their policy by paying the premium before the policy is cancelled. AFCA asserts that a notice under s59 merely states that the policy will be cancelled and does not give the insured an opportunity to prevent the cancellation. The FSC disagrees that s210 is particularly more advantageous to customers. Section 59 offers customers the same opportunity to pay outstanding premiums as s210 and this rationale for adopting s210 carries little weight.

Further, the FSC disagrees that what is advantageous to customers ought to be the sole consideration in determining AFCA's approach. AFCA's remit is to do what is fair in all the circumstances, which requires consideration of fairness to life insurers and not just customers. There is no indication that the competing requirements have been afforded adequate consideration by AFCA. Further, this is a choice between competing legal provisions and the appropriate measure ought to be the correct legal interpretation.

Further, the FSC notes that insurers in many cases issue multiple notices regarding unpaid premiums and may follow up with telephone calls or other attempts at contact before cancelling the policy. In general, life insurers want customers to continue paying their premiums and maintaining their cover. It is contrary to an insurer's own interests to act precipitously in cancelling cover.

The FSC also anticipates some unintended consequences of this approach which will have an adverse impact on customers (particularly those in financial hardship) and the life insurance industry. There is no doubt that the notice requirements under s210(5) are more onerous than s59. By adopting s210(5) as the standard for cancellation, AFCA is likely to drive insurers to adopt a necessarily more formalistic and process driven approach to ensure technical compliance with the stricter requirements of s210(5) (or be at risk of, if AFCA's view were correct, continuing to be on risk for a putatively cancelled policy). The consequences of AFCA's interpretation may include:

a. There may be **less flexibility to assist consumers not to lose their valuable cover** as a result of insurers needing to adopt a more formalistic approach and stricter adherence to the timeframes. As noted above, the stricter interpretation may drive insurers to reduce the time afforded (and/or flexibility) to customers to pay outstanding premiums in order to comply with the more onerous notice provisions of s210(5), or to limit the number of warning notices issued before a final cancellation notice is issued. In particular, insurers may choose to adhere more closely to the s210(5) timeframes to avoid the burden of reissuing notices regarding outstanding premiums, or bearing any risk that a policy is not cancelled validly (see point d below). The less restrictive notice requirements of s59 allow insurers greater flexibility in offering time and options (e.g. a payment plan) to customers to pay outstanding premiums and this may be lost by forcing insurers to comply with the more restrictive notice requirements if premiums continue to be missed.

Once a customer's policy is cancelled, the barrier to obtain replacement cover may be high including the potential for additional requirements for further underwriting before new cover can be provided. This may result in the unintended consequence of existing customers losing cover that they may otherwise have been able to retain had insurers not been held to a more restrictive requirement but had more flexibility in approaching instances of outstanding premiums.

b. **AFCA's approach may drive a more formalistic approach and this does not align** with the expectations outlined by ASIC that life insurers work with customers in financial hardship on arrangements that can allow them to keep cover in place, such as allowing part payments and payment plans. It also does not align with the expectations of life insurers under the Life Insurance Code of Practice which requires insurers to consider alternative arrangements on the basis of financial hardship. Insurer's ability to be flexible may be reduced by the requirement to comply with the stricter s210 notice requirements and the less flexible timeframes required as a result.

c. **Direct financial risk** from AFCA's approach to cancellation for those insurers who have previously cancelled policies by written notice pursuant to s59 in reliance on what AFCA has conceded in the draft approach paper is a reasonable interpretation of the relevant law. AFCA adopting a different interpretation, particularly with a retrospective application which expose insurers to risks and a financial burden despite acting in compliance with what AFCA agrees was a reasonable understanding of the applicable law.

d. **Latent prudential risk** as a result of this uncertainty means that an insurer may be found to be 'on risk' for policies where premiums have not collected for some considerable time because the insurer understood that the policy had been appropriately cancelled pursuant to s59. This is an issue likely to be of great concern to regulators, particularly APRA.

   AFCA should be extremely reluctant to impose such an interpretation, particularly with retrospective effect, such a profound changes and concomitant financial burden on insurers without the express support of Treasury and the regulators. This is particularly so where AFCA agree the understanding that s59 is the appropriate law is well supported by legal opinion and there is no caselaw or direction from regulators to the contrary.

e. Even if AFCA were only to apply this interpretation with prospective effect, it ought to have careful regard to the **administrative and system costs** that insurers will incur in systems (particularly legacy systems for older products) and processes to align to AFCA's interpretation of the process for cancellation of policies of risk only insurance. These changes may take many months, requiring investment in effort, time and expenditure across a number of impacted business units within each insurer. For this reason, in the event AFCA applied its interpretation, it should only do so after an appropriate transition period, with all AFCA complaints in relation to cancellation for non-payment lodged in the transition period considered by reference to s59.

When is notice given?

AFCA's Draft Approach states that a "notice" under s210 or s59 is not taken as "given" on the date it is issued.

AFCA has clarified that it will consider a notice that is sent by mail to have been received by the customer on the seventh working day after it was posted in line with s160 of the *Evidence Act* (the **Postal Rule**).

There are no specific timing requirements spelt out in the *Insurance Contracts Act*, *Life Insurance Act* or the *Acts Interpretation Act*. Accordingly, if AFCA intends to consider the Postal Rule is the appropriate process when communicating with customers, the FSC submits that this ought to only be applied prospectively and after allowing for a transitional period for insurers to make change to systems and processes. The FSC notes the submissions above in relation to the impacts of retrospective changes where AFCA is adopting a new interpretation of legal requirements.

AFCA reiterates in its Draft Approach that its general approach is to do what is fair in all the circumstances, which it says might go beyond "strict compliance with the law if its application to particular circumstances would result in an unfair outcome". If AFCA intends to implement the Postal Rule, the FSC submits that AFCA must apply the Postal Rule consistently and in accordance with s160 of the *Evidence Act to give insurers certainty*, rather than to deviate from the "strict compliance with the law" where AFCA considers that would be fair in all the circumstances.

What if the complainant tries but fails to make a payment?

AFCA's Draft Approach concludes by asserting that if it "appears" that a customer took steps to pay the required premiums, but by mistake, confusion or some other reason failed to do so, it is unlikely that AFCA will find it is fair to treat the policy as being cancelled.

It is not clear what AFCA means by a customer "taking steps" to pay outstanding premiums but failing to do so. It appears that this scenario might even extend to a customer making only a "token" part payment of premiums to try and preserve their cover despite their failure to comply with the policy requirements. If AFCA intends to proceed by applying s210, in order to ensure consistency in decision making and so that insurers have some certainty as to how AFCA will apply its approach, AFCA ought to clarify the situations in which AFCA would likely find that it is unfair to treat the policy as being cancelled, even if the notice and timing requirements of s210(5) are met. This ought to ideally include specific examples to identify where AFCA considers that fairness requires an outcome even where s210(5) has been appropriately complied with.

The FSC notes that consistent decisions requiring insurers to reinstate cancelled cover, gives rise to the financial and latent prudential risks described above. The FSC submits that AFCA ought to be very reluctant, in the interests of fairness to all parties, to impose such obligations on insurers and the parameters for doing so ought to be laid out clearly for the benefit of all parties.

Existing complaints

AFCA has confirmed in its Draft Approach that it considers it very arguable that s59 can apply to the cancellation of risk-only life insurance policies. AFCA has also noted that this is an area of the law which remains unresolved.

For the reasons outlined above, the FSC submits that this is not the correct approach but, if AFCA is minded adopting that interpretation, AFCA ought to apply this prospectively and after a reasonable transition period. Similarly, any current systemic issue investigations ought to be closed. If AFCA intends to commence further possible systemic issue investigations in relation to compliance with s210, these investigations ought to be prospective and following a reasonable transitional period.

For similar reasons, any existing AFCA complaints in relation to cancellation for non-payment of premiums should be considered against s59.

Customer outcomes

Insurers have shown, both through the COVID-19 financial hardship initiatives undertaken by the FSC, and the general financial hardship obligations in the Life Code, a strong desire to afford a chance for customers to not lose their valuable cover (notwithstanding being behind on their premium obligations). It should not be lost on AFCA, that unfortunately, if s210 did apply, that the current flexibility, forbearance and options to help customers retain their cover, will not be readily able to be provided under the technical and strict s 210 notice requirements, as each time a customer is provided assistance or relief by the insurer (which is a discretion of the insurer) a new notice would be required.