Chambers
Global Practice
Guides

Definitive global law guides offering
comparative analysis from top-ranked lawyers

Insurance & Reinsurance 2022

Australia: Trends & Developments

Michael Polorotoff, Catherine McAdam,
Jeremy Peck and Andrew Toogood
Moray & Agnew

practiceguides.chambers.com

AUSTRALIA

Trends and Developments

Contributed by:
Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood
Moray & Agnew ***see p.9***

Introduction

Australia is a federation of states and territories bound together by the Australian Constitution. It has an overarching federal system of government with its own courts, although each state and territory within the federation has its own system of government and courts.

Like most countries that formed part of the British empire, Australia's system of government is modelled on the Westminster system, with a central hallmark being an independent judiciary. Australia's legal system was also inherited from common law of the United Kingdom. Insurance and reinsurance law are no different, albeit there have been statutory and regulatory modifications, including the enactment of the Insurance Contracts Act 1984 (Cth) (ICA) and the Corporations Act 2001 (Cth). The ICA aims to strike a fair balance between the interests of insureds, insurers and other members of the public, and to ensure that provisions in contracts of insurance and the practices of insurers in relation to such contracts operate fairly.

The Australian insurance industry continues to grapple with many evolving challenges and opportunities, including:

- the impact of the COVID-19 pandemic on business interruption claims, which has attracted high-profile "test case" litigation with mixed success for insurers as well as attention from the corporate regulator in terms of assessing pandemic-related claims in a fair and efficient manner;
- the ongoing legislative changes, including in relation to designating claims handling as a financial service and amendments to the duty of disclosure for consumer insurance contracts arising from the recommendations of the Financial Services Royal Commission (FSRC); and
- the increasing frequency and severity of cyber-related claims, which show no sign of abating.

This article provides a high-level snapshot of the key issues, and likely trends and developments facing industry participants and various lines of business.

Directors and Officers, Professional Indemnity and Financial Institutions

There continues to be ongoing significant reforms to Australia's class action regime, which is welcome news for the D&O market. This has included the passing of new legislation raising the bar for shareholder class actions in August 2021. Specifically, the continuous disclosure regime has been modified, with the materiality standard to be assessed based on the knowledge, recklessness or negligence on the disclosing entity's part as opposed to the previous no-fault or strict liability scheme. The Commonwealth Parliament is currently considering draft legislation which would enhance court oversight over the distribution of class action proceeds and establish a rebuttable presumption that a return to the general members of a class action litigation funding scheme of less than 70% of their gross proceeds is not fair and reasonable.

Contributed by: *Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood,*
Moray & Agnew

These proposed measures have been fiercely resisted by the plaintiff law firms and the litigation funding industry. Such reforms follow a suite of reforms in 2020 regarding the licensing of litigation funders and the registration of litigation funding arrangements as managed investment schemes.

Restoring balance

Overall, some balance is being restored to the D&O market and, in particular, the Side C market. Indeed, empirical research suggests that the number of new class action filings for shareholder class actions have fallen over recent years. This may be attributable to a number of factors, such as the legislative intervention outlined above, companies and management improving governance frameworks and systems, and/or plaintiff law firms and litigation funders directing their resources to other claims, including actions against the financial institutions following the material examined by the FSRC environment (see further below).

However, much uncertainty remains as to "class closure" for class action litigation, which impairs the ability of defendants and their insurers to quantify and assess the total quantum of representative proceedings. This is one area that desperately requires legislative reform and/or further judicial consideration at the appellate level following New South Wales Court of Appeal authority, which ruled that traditional pre-settlement class closure was not permissible. In relation to the latter, the Full Federal Court is expected to hear argument on whether the Court has power to order traditional class closure in the Boral class action in early 2022.

Third-party claims

Third-party claims against financial institutions continue to be filed at a steady pace. This is no doubt primarily attributable to the fallout from the FSRC, which revealed widespread misconduct and provided the roadmap for a production line of claims. Such claims have typically focused on conflicted remuneration, overcharging, fees for no service and mis-selling financial products, amongst other issues. This trend is expected to continue.

Corporate wrongdoing

The corporate regulator, the Australian Securities and Investments Commission (ASIC), continues to prosecute corporate wrongdoing and misconduct in a robust manner. Indeed, ASIC has commenced numerous proceedings seeking pecuniary penalty orders, adverse publicity notices and related orders. It is not uncommon for plaintiff law firms and litigation funders to be "waiting in the wings" for the outcome of such actions and relying on any admissions by the defendant for the purpose of separate claims seeking compensatory damages and other relief.

Cyber-risks and ESG

Cyber-risks, and environmental, social and governance issues (ESG) are proving to be the new frontier for companies and their directors/senior management in terms of risk management and governance. Time will tell if the COVID-19 pandemic will generate a raft of new claims but there has not been a groundswell of movement as this time.

Professional indemnity

In the professional indemnity space, financial services providers (including financial planners) and their insurers continue to be frustrated with the external dispute resolution process administered by the Australian Financial Complaints Authority. A recent report has recommended certain reform measures but it is not clear if these will be implemented or provide some much needed balance. Otherwise, it is anticipated that the fallout from the COVID-19 pandemic will lead to claims against investment advisers and other professionals. Non-compliant cladding claims

remain a concern for construction professionals and their insurers.

Life and Personal Insurance

Radical changes to Disability Income Insurance

Life insurers were required to make significant changes to Disability Income Insurance (DII) from 1 October 2021. These changes have been dictated by the Australian Prudential Regulatory Authority (APRA), in response to several years of material losses sustained in the Australian IP market. Australian life insurance companies collectively lost around AUD3.4 billion over the five years to December 2019 through the sale of DII to individuals. For this reason, APRA intervened to stabilise the industry by announcing several guidelines that require insurers to address unsustainable product design features and pricing issues to ensure DII continues to be offered in the future. The four key changes are as follows.

Income at risk

DII payments should be consistent with the principle of indemnity, thereby avoiding moral hazard as much as possible. For policyholders with stable income, DII benefits will be based on annual earnings in the 12 months prior to claim (rather than the best 12 months in the last 36 months). For policy holders with variable income, DII benefits will be based on average annual earnings over a period of time appropriate for the occupation of the policy holder and reflective of future earnings lost as a result of disability.

Income replacement ratio

Income replacement ratios are now capped at 90% of earnings at the time of claim, for the first six months of claim – and thereafter 75% of earnings, for the remainder of the claim. Prior to 1 October 2021, it was possible to insure 100% of earnings due to the features and ancillary benefits of DII policies. However, this reduced incentives to return to work, thereby potentially impeding better health outcomes and increasing claims durations.

Term of the policy

From 1 October 2021, the maximum term of the policy is five years. This is a significant change from previously, where contracts were often guaranteed renewable until retirement age. After the five-year period, a new policy must be entered into that reflects the terms and conditions that apply to new contracts then on offer by the life company. If a client enters a new contract after the initial five years, medical underwriting is not required; however, any changes to the client's occupation, financial circumstances and dangerous pastimes must be updated and reflected in the new policy. An example of the effect of this is that if after the initial five year period the policyholder's occupation has changed to one with a higher risk (eg, white collar to blue collar), premiums will likely increase.

Benefit period

Life companies must have:

- effective controls in place to manage the risks associated with long benefit periods, including specific product design features; and
- set internal benchmarks for new DII policies with long-term benefit periods, which reflect their risk appetite and the effectiveness of their controls.

Currently, the majority of DII policies have long benefit periods. Whilst this is not inherently inappropriate, this change aims to manage the associated risks, such as motivation to return to work and adverse impacts on claim duration. Methods by which insurers may control long-term claims include tiered or stricter disability definition, tiered income replacement ratios, or lower maximum termination ages. In particular,

Contributed by: *Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood,*
Moray & Agnew

it is likely that more prescriptive disability definitions will be imposed after two years.

Breach reporting

In December 2020, the Commonwealth Parliament passed legislation to strengthen the existing breach reporting regime for Australian Financial Services (AFS) licensees, consistent with recommendations of the FSRC. This applies beyond life insurers.

A number of other recommendations were given effect by this legislation, including a recommendation to introduce breach reporting requirements for Australian Credit Licensees (ACL) through amendments to the National Consumer Credit Protection Act (NCCP).

The new regime, which will now also include ACLs, will be effective for all reportable situations occurring on or after on 1 October 2021. The types of reportable situations include:

- "core obligation breach" or likely core obligation breach that is, or could be, "significant"; or
- additional reportable situations – the licensee (or its authorised representative) has engaged in conduct constituting gross negligence or serious fraud.

The licensee has 30 days to report to ASIC from the time they have knowledge that, or there are reasonable grounds to believe, or are reckless as to knowing, a reportable situation has arisen.

There is also a new obligation for the licensee to report to ASIC within 30 days if the licensee has reasonable grounds to believe that a reportable situation has arisen in relation to any other licensee.

Claims handling – a "financial service"

The delegation of claims handling services by Australian insurers is common. Delegating claims handling services provides another company with authority to assess and settle claims. However, claims handling services are now subject to the financial services provisions of the Corporations Act and insurance claims managers (defined as those who carry on a business of handling and settling claims for one or more insurers) are required to obtain a financial services licence. There is generally an associated obligation to provide the services efficiently, honestly and fairly. This reform extends to other lines of business as well.

Cyber

The last 12 months have seen a significant jump in the number and severity of cyberattacks and, in particular, ransomware attacks. The risk has been intensified with the increased vulnerability arising from most of the Australian workforce working remotely and the increase in the fintech industry, causing large amounts of sensitive data to be held. This has sharply focused the attention of insurers, regulators and insureds.

The growing losses have resulted in changes to the dynamic of the insurance market. There has been a rapid increase in the number of businesses taking up cyber-insurance. At the same time, premiums have increased and there has been a marked decrease in limits. Some capacity has left the market altogether. Further, insurers continuing to write the cover are undertaking much more stringent underwriting analysis, including, at times, the employment of third-party cybersecurity consultants to test the durability of a prospective insureds' systems.

Major insurers have publicly discussed the possibility that payments to ransomware criminals may not form part of the cover offered by them in the future. In this regard, the Commonwealth

Government has set out its ransomware action plan, in which it states that it "does not condone paying a ransom to cybercriminals". The government notes that ransom payments demanded from insured organisations are often tailored to the insured amount under a cyber-insurance policy. The Government is currently considering whether to outlaw the payments of a ransomware demand. Major insurers have indicated their support for such a legislative step.

Security Legislation Amendment (Critical Infrastructure) Bill 2020

In other significant steps, the Commonwealth Government has passed the Security Legislation Amendment (Critical Infrastructure) Bill 2020. The bill proposes to expand the scope and substance of regulatory obligations on private owners and operators of critical infrastructure assets under the Security of Critical Infrastructure Act 2018 (Cth). In addition, it proposes to confirm extraordinary power of government intervention in response to cybersecurity incidents affecting critical infrastructure assets, under which the Minister for Home Affairs can authorise the Secretary of the Department of Home Affairs to undertake direct intervention and control the systems of the entity under attack.

The legislation also mandates ransomware incident reporting to the government. This notification requirement imposes another set of cybersecurity reporting obligations on businesses and their insurers in addition to the notifiable data breach reporting obligations under the Privacy Act and the cybersecurity incident reporting obligations under the CPS234 (for financial institutions). This fractured regulatory approach is burdensome and it would be hoped these obligations can be met with a single notification at some stage in the future.

The reality and severity of ransomware attacks have also brought into sharp focus the potential exposure for directors of companies where decisions need to be made as to the payment of ransoms and the exposure that might arise for directors in relation to their obligations to ensure the security of their companies' systems and also ensuring the company does not suffer losses as a result of a decision not to pay any ransom. A decision by the Federal Government on the legality of ransom payments would bring much clarity to insurers and the directors of insureds.

Liability, Industrial Special Risk and Property

The law relating to liability (injury and property) throughout Australia has been relatively stable since reforming legislation was introduced in the early 2000s. Such reforms essentially codified tests of causation and negligence, and provided additional specific defences (including proportionate liability for non-injury claims). These reforms were to address an "insurance crisis" arising from steep premium increases and a perception that court judgments did not reflect public expectations.

The body of case law surrounding this state-based legislation continues to develop incrementally to provide increasing certainty to those in the industry. As there has not been a repeat of those steep premium increases or the same media criticism of court judgments, these reforms have effectively had a stabilising effect.

Liability claims

The nature of liability claims changed with the 2017 Royal Commission report into Historical Institutional Child Sexual Abuse, leading to a surge of historic abuse claims against state departments and religious bodies. While a National Redress Scheme provides for no-fault compensation, the abolition of limitation periods for such abuse claims and the ability to set aside prior confidential settlement agreements

Contributed by: *Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood,* ***Moray & Agnew***

has facilitated these challenging claims being brought.

Further, latent/exposure injury claims have not diminished despite the use of asbestos products effectively being banned approximately 40 years ago given the presence of those products from prior use (with Australia having the highest use in the world) and the emergence of fibrotic silicosis claims for workers in the artificial stone industry.

The complexity and uncertainty surrounding liability for work-related accidents continues with diminishing no-fault workers compensation benefits and limitations on recovering damages from employers encouraging injured workers to pursue non-employers and attempts to maximise their potential compensation. This is further exacerbated by the increasing use of contractors or labour-hire workforces (including on mining and infrastructure projects), which effectively shifts liability to entities not directly involved in the work system or site, including by means of contractual assumption of risk. The permutations of potential outcome for these claims adds to the uncertainty for insurers.

Property

Australian property insurers continue to be affected by volatile and increasing natural risks, with bushfire, storm and flood damage claims a large feature of the last few years. Prior uncertainty and inconsistency as to flood cover has largely been resolved through the use of a standard definition of the exclusion. Against the background of climate change concerns, the insurance industry continues to call for improved regulation and action to avoid or mitigate the impact of these natural risks as a more economic approach than increased premiums.

The industry's exposure to COVID-19 business interruption claims appears to have substantially diminished following the initial hearing of the "second test case", but with judgment pending in the appeal. The first test in late 2020 was unfavourable for the industry when it was unanimously held (and later refused leave to appeal) that standard pandemic exclusions in business and ISR policies which referenced the repealed Quarantine Act, rather than the current Biosecurity Act, were ineffective. The second test case addressed more coverage issues over ten particular claims.

Ultimately, the insurers succeeded in their declining of cover for nine of the ten claims based largely on findings that "prevention of access" extensions did not cover losses resulting from actions taken by authorities in response to a disease in circumstances where the policy also contained a disease extension – as it was incongruous for both extensions to apply. Further, causally, the closure of premises and consequent losses were not suffered as a result of an outbreak. The appeal of the second test case was heard in early November 2021, with judgment pending, but a further appeal to the High Court is likely.

Recent and current concerns

Combustible cladding claims have been emerging over the past four years, with the building owners and the construction and insurance sectors grappling with the unexpected cost of replacing cladding. Recent judgments, including at appeal level, have so far dismissed technical arguments that cladding was potentially compliant with applicable building codes and that consultants who specified such cladding have "peer professional opinion" defences based upon most industry participants specifying the same products.

Continuing concerns with the performance of engineers and builders, and challenges with legal recourse against them for defects, led to the introduction in NSW of legislation to impose

(if not, confirm) a duty of care on builders and designers with a ten-year retrospective limitation period. The object is to improve building standards or otherwise hold participants responsible, but an incidental effect is increased exposure of insurers for building defect claims. This reform also has significant implications for construction professionals (including architects and building surveyors) and their PI insurers, discussed below.

The past year also saw a revival of claims based upon policy rectification and alleged breaches of the duty of utmost good faith – possibly indicating more aggressive attempts to pursue claims against insurers.

Marine Law

Marine law in Australia remains relatively settled, with the majority of claims being governed by the Marine Insurance Act 1909 (Cth) (MIA). While there had been discussions to amend the MIA previously to bring the MIA in line with the amended version of the Marine Insurance Act in the United Kingdom, these discussions have stagnated and it appears that the momentum for change may have been lost.

The other relevant legislation in relation to marine claims in Australia are:

- the Admiralty Act 1988, which extended the admiralty jurisdiction from the Federal Courts to the State and Territory Supreme Courts; and
- the Carriage of Goods By Sea Act 1991 (COGSA), which gives effect to a modified version of the Hague–Visby Rules (which are a set of international rules adopted by countries in relation to the governance of the bill of lading/waybill for a cargo ship being chartered along with the liabilities that may be imposed on the party agreeing to the charter).

In some insurance claims for damage to marine assets, the ICA may apply if a court deems that the MIA does not apply in relation to the claim. This issue as to which act applies was looked at in the decision of DMS Maritime Pty Limited v Navigators Corporate Underwriters Limited [2020] QSC 382. In that case, the Court held that the policy was one of marine insurance as the policy was issued in relation to losses which must be regarded as "substantially incident to marine adventure".

COVID-19 had a huge effect on all aspects of the marine industry globally in 2021. COVID-19 has destabilised the global container freight supply chain, delayed shipments and caused freight rates to rapidly rise, putting intense pressure on Australian exporters and importers. These issues have predominantly been caused by the surge in demand for shipping and COVID-19 outbreaks forcing numerous port operations to temporarily shut down, resulting in congestion and delays, with cascading effects across the globe.

The ACCC reports that some Australian exporters are struggling to meet their contractual obligations. As restrictions remain in place around the world, it is expected that litigation will be pursued in 2022 in relation to the various supply chain delays and breaches. It is reported that only 10% of vessels arrived at their designated due time in 2020/2021 and the supply chain issues look to be only getting worse with the developing outbreak of the Omicron variant of COVID-19.

The marine industry was also dramatically affected in March 2021 by the *Ever Given* obstructing the Suez Canal for six days, effectively stopping the majority of global shipping. While the dispute between the *Ever Given* and the Suez Canal Authority appears to have resolved, further litigation is expected to arise against the *Ever Given* as a result of the delays and loss of goods caused by the *Ever Given's* actions.

Contributed by: *Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood,*
Moray & Agnew

Moray & Agnew is a leading national law firm of over 650 people, including over 100 partners. The firm serves domestic and international clients from offices in Sydney, Melbourne, Brisbane, Canberra, Newcastle and Perth. The insurance practice is highly regarded and a pre-eminent market leader. It includes 88 partners and 191 other lawyers working exclusively in insurance law and related areas. Moray & Agnew represents all the major Australian and international insurance participants, including local carriers, Lloyd's of London, brokers, reinsurers, claims managers, all tiers of Australian government and insureds. The firm's specialty focus is acting in defence of third-party claims, pursuing recoveries and advising on complex coverage issues in a cost effective and pragmatic manner. Built on a solid history in insurance law, client demand has guided the firm's growth into commercial litigation and dispute resolution, construction and projects, corporate and commercial, property and development, and workplace legal services.

The firm would also like to thank Daniel Coloe for his contribution to this article.

AUTHORS

Michael Polorotoff is an experienced and accomplished insurance law practitioner. He specialises in defending professionals across a broad range of industry sectors and advising local and international insurers and reinsurers on complex coverage issues, especially in the D&O, PI and FI areas. He is well regarded for his tenacious, yet considered and strategic, approach in advancing his clients' interests.

Catherine McAdam leads Moray & Agnew's Sydney life insurance practice. Her expertise extends to all aspects of life insurance, including conducting litigation, advising regarding remedies available under relevant legislation and life insurance advisory work. A testament to Catherine's expertise is the longevity of her client relationships. Clients value Catherine's commercial and pragmatic advice in this often-sensitive area. She is highly aware that the financial services industry faces increasing regulation and scrutiny, and that litigation has potential reputational and financial costs to insurers. Catherine conducts disputes with an eye to achieving the best possible outcome while enhancing the reputation of her clients.

Contributed by: *Michael Polorotoff, Catherine McAdam, Jeremy Peck and Andrew Toogood,* ***Moray & Agnew***

Jeremy Peck is a highly skilled insurance law practitioner and has experience working in both in-house and private practice roles. With over 20 years' insurance law experience, Jeremy acts for a wide range of insured professionals, with a particular focus on financial services professionals, construction professionals and directors and officers. Jeremy also has a close interest in the progression of the industry and seeks to contribute to the development of industry members through his participation on the Victorian committee of the Australian Professional Indemnity Group. Prior to joining Moray & Agnew, Jeremy spent several years working in London and maintains strong connections with his London market network.

Andrew Toogood is an accredited specialist in commercial litigation with over 20 years' experience representing and defending insurers' interests in property liability, property damage, and recoveries claims. This includes considerable success in obtaining excellent recovery outcomes in large-scale property damage cases. His experience with property damage claims, fraudulent claims and recoveries covers a wide range of situations and circumstances, including site contamination, train derailments, major loss fires (over AUD30 million), electrical and mechanical malfunctions, floods and water ingress, oil spills, defective building products and works. In his wider practice, Andrew has successfully handled product and public liability claims, construction disputes, commercial litigation, dust disease and toxic tort claims and seafarers' claims.

Moray & Agnew

Level 24
233 Castlereagh Street
Sydney
NSW 2000
Australia

Tel: +61 2 9232 2255
Fax: +61 2 9232 1004
Email: info@moray.com.au
Web: www.moray.com.au

MORAY&AGNEW
LAWYERS