



A SHIFTING LANDSCAPE

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A shifting landscape

Australia is facing a massive shake-up following the recent findings of the royal commission into financial services. *Australasian Lawyer* speaks to leading legal experts to discover which areas of the sector are being hit the hardest



AUSTRALIA IS IN the midst of volatile times, a reflection of the hardening global market and the renewed focus on ‘doing the right thing’. Now, more than ever, the sector is seeing the importance of restoring trust following the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

As Chris Wood, partner and national practice group leader for commercial insurance at Sparke Helmore Lawyers, points out, regulatory and societal scrutiny – combined with the fast pace of change in technology,



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Chris Wood, partner and national practice group leader for commercial insurance, Sparke Helmore Lawyers

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customer behaviour and cybercrime – has put the local industry under unprecedented pressures and constraints.

Key issues for Australia

Wood refers to the thought leadership report published by Global Insurance Law Connect – a network for which Sparke Helmore Lawyers is the sole Australian representative – which highlights three pressing issues for the country.

The construction boom has had a ripple effect on the insurance industry, particularly with the rising incidence of building failures such as non-compliant cladding. Insurers are experiencing the pain points around financial lines insurance and have seen a record number of class actions and 'event-based' claims in the space. Lastly, climate-driven disasters are occurring with increasing frequency.

"Unsurprisingly, climate change is the biggest issue of them all," says Wood. "Reinsurers have been sounding the alarm for many years and, anecdotally, it is a standing agenda item for all major players. With climate-driven disasters impacting more of the population than ever before, there is intense debate about whether parts of Australia are becoming uninsurable – with some places already considered too disaster-prone to insure."

Wood believes insurers are facing the tough task of balancing what is often controversially referred to as a 'social licence to operate', against the harsh realities of climate change-induced risk in the property and related cover space. This could very well



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Paul Hopkins, managing partner, Carter Newell Lawyers

be because of the royal commission fuelling public expectations around access to and affordability of cover; or the perceived past conduct of some insurers.

On the other hand, Paul Hopkins, managing partner at Carter Newell Lawyers, places strong emphasis on the problems facing the construction sector.

"We've seen an increase in media and government scrutiny following building defect claims for high residential projects such as Opal Tower and Mascot Towers, as well as scrutiny due to cladding issues," says Hopkins.

The extent of the problem shouldn't come as a surprise. According to *Four Corners*, data from the Australian Bureau

of Statistics suggests that there have been 667,394 apartments, flats or units built across the country from the end of 2000 up until March this year. A study by Deakin and Griffith Universities also concluded that 70% of the buildings built after 2003 in Australia's east coast states had at least one defect. Experts also told *Four Corners* that "high-rise defects were a problem in every state and territory".

Apart from the cladding issue, the property sector in general is under great scrutiny following the increase in investigations by government bodies into participants in the space. In Queensland, several agencies and landlords were successfully prosecuted by the Residential

Tenancies Authority for breaches of the residential tenancies legislation. In Victoria, Consumer Affairs made Hoskins Maroondah pay almost \$900,000 in fines for underquoting.

The third important issue that Australia is grappling with is the rise in claims across most (if not all) industries. As Hopkins explains, unless you're managing your business appropriately, there will be poor outcomes, and people and companies will be sued. This is truer than before, as a result of the tension generated by the findings of the royal commission.

"We've seen an increased number of class actions in the financial services sector," says

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Hopkins. “Given the quantum of these claims, they invariably involve numerous insurers with divergent interests. In several cases, insurers have been prepared to be joined to these proceedings in order to have a greater input in claim management and strategy.”

Wood also points to issues in the directors and officers (D&O) and financial lines space, which he believes is seeing continued fallout from the royal commission.

“There is of course litigation spinning out of the royal commission’s findings, but the regulatory impact is also starting to bite,” says Wood. “We are starting to see some interesting decisions coming out of the Australian Financial Complaints Authority; insurers are even being told they ought to

pay for claims under policies where there has never been a contract of insurance in existence through simple consumer misunderstandings of process.”

Hopkins says a marked increase in litigated claims has been observed over the last 12 months, particularly in the management liability space. While he and his team are huge advocates of the ADR processes and only take matters to trial if absolutely necessary (and once cost-protective offers have been made), Hopkins says plaintiffs “have become more bullish” and are prepared to “chance their arm” by taking matters to trial. Previously,



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John Van de Poll, partner, Holman Webb Lawyers

most of these cases would have been resolved through mediation; instead, they are now occupying weeks of court time.

The saga continues

Although the issues highlighted above are more pressing in nature, that’s not to say they are the only ones affecting the sector. As Wood aptly puts it, “the insurance law space is a broad church and a lot can happen in six months”.

The employment and cybercrime liability spaces are also facing their own share of problems.

“Employee fraud is continuing to make headlines,” Wood says. “Companies routinely purchase fidelity cover to protect themselves from direct theft of money or goods, but might be missing the not-so-obvious risk – that a rogue employee will defraud a third

party who then seeks to recover from the employer or its insurer.”

For John Van de Poll, partner at Holman Webb Lawyers, both employment practices and the cyber space continue to be coverage areas that businesses don’t give enough weight to when losses occur, unlike the more traditional business lines (property and liability).

“The increased occurrence of losses in those spaces is definitely improving business literacy with those forms of coverage,” says Van de Poll. “Within the cyber space in particular, I suspect Australia is lagging

behind the North American experience where claims experience and consequently premiums have increased significantly. My expectation is that, with an ongoing tightening of the Lloyd’s market in particular, rates in both classes will continue to rise for Australia over the next two to three years.”

Anticipating upcoming moves

Van de Poll says that while Australia is coming to grips with the royal commission’s findings, the sector is also anticipating which of the various recommendations will actually be implemented.

He believes there are two that require special mention: the potential imposition of Unfair Contract Terms (UCT) legislation on insurance contracts and, secondly, the extension of the Australian Financial

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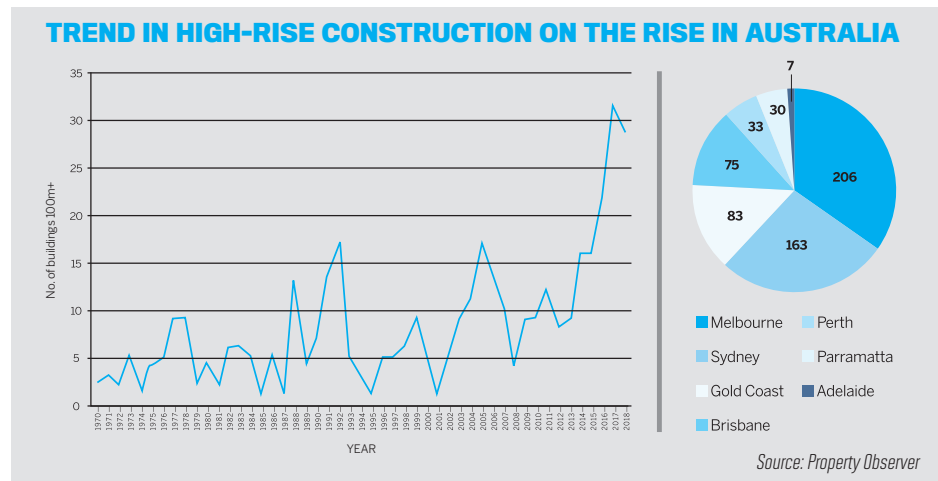
Services Licence (AFSL) requirements to the provision of claims handling services.

"The significance of the UCT legislation is that it allows consumers and small businesses to challenge whether the terms of a policy are fair – where the policy is a standard-form policy offered by the insurer," Van de Poll explains.

He refers to the example of terms identified by the royal commission as unfair: "terms that permit an insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policyholder, are terms that are unfair".

"Policy terms and conditions are drafted by underwriters on the basis that they have certainty around what they are insuring or more importantly not insuring," he says.

"The loss of that certainty, in my opinion, would inevitably lead to increased premiums



in the consumer and small business space to compensate for that doubt."

Claims handling has historically been excluded from AFSL obligations, but Van de Poll believes the royal commission has presented some compelling logic for why it should be included.

It says, "There can be no basis in principle or in practice to say that obliging an insurer to handle claims efficiently, honestly and fairly is to impose on the individual insurer, or the industry more generally, a burden it should not bear. If it were to be said that it would place an extra burden of cost on one or more insurers or on the industry generally, the argument would itself be the most powerful demonstration of the need to impose the obligation."

In Van de Poll's view, the burden will not be created by handling claims efficiently, honestly and fairly, but rather by the other obligations imposed by the AFSL, especially for insurers whose claims are not handled locally.

Looking ahead

Hopkins believes a key challenge for the sector has been (and will continue to be) the pricing and availability of insurance, particularly in the insurance liability space.

"There has been a large-scale withdrawal of capacity from London, and at the same

time local providers have also made an exit," he explains. "If insurance is able to be obtained, it is often on more restrictive terms, with a high level of self-insured retention and lower limits of liability."

For Wood, the settlement of disputes through tribunals or government agencies, rather than traditional adversarial or internal processes, will continue to challenge insurers' 'social licence to operate' and their appetite for some risks. This is especially true as they deal with their ability to price outcomes not contemplated prior to the royal commission's report.

The question that interests him is where future growth in the insurance market is going to come from.

"Growth within the mature insurance market, including Australia, is stagnating," he says. "Carriers and brokers are looking for opportunities for growth in emerging economies, and for Australian insurers it's hard to ignore that Asia-Pacific is home to nearly a third of the world's population."

As Van de Poll points out, the tightening of the London market over the last year or so is also likely to continue to be replicated in the local market. It will be interesting, especially for insurers, to see how the sector navigates through these complex and challenging times. **AL**