MACQUARIE UNIVERSITY LAW SCHOOL

BAC CHAT

DECEMBER, 1979

REGULATING INSURANCE INTERMEDIARIES

The Hon. Mr. Justice M.D. Kirby
Chairman of the Australian Law Reform Commission

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INQUIRY INTO INSURANCE CONTRACTS

In September 1976 the Federal Attorney-General referred to the Australian Law Reform Commission a number of questions relating to the reform of the law governing insurance contracts. After the appointment of a team of consultants representing all branches of the insurance industry, consumer groups and academics, the Commission proceeded to issue a discussion paper containing many proposals for reform. (D.P.7, *Insurance Contracts*, 1978). Public hearings and industry seminars were held in all parts of the country. Following discussions with the industry, its consultants and the Federal Treasurer, the Commission decided to advance its report on one aspect of the reference, namely the regulation of insurance intermediaries. The organisations representing insurance brokers in Australia have been pressing for some time for the introduction of legislation to govern admission to the business of broking and to control its practitioners. The Treasurer has assured brokers that there will be legislation on this subject but not until after the government has had the opportunity to consider the report of the Law Reform Commission.

The report is in draft form and will be completed early in 1980. The Commissioner in charge of the Insurance Contracts reference, Mr. David St.L. Kelly, will be returning to the University of Adelaide in February 1980. It is expected that the report and draft legislation will be in the hands of the Attorney-General and the Treasurer soon after the commencement of the Autumn Sittings of Parliament in 1980. It is not possible nor would it be appropriate, for me to foreshadow here the conclusions of the Commission. A number of important decisions remain to be made. The purpose of this note is simply to sketch some of the chief issues.

THE DISCUSSION PAPER PROPOSALS

How does the question of the regulation of insurance intermediaries become so vital for a new law on insurance contracts? Much insurance in Australia is not negotiated directly across the counter by the insurance company itself. Life insurance in particular, but general insurance as well, must be "sold". Any reformed law, designed to deal realistically with the balance that must be struck between the rights of the insured and the rights of the insurer, must take into account the way in which the contract comes about in the first place. The discussion paper identifies various classes of insurance intermediaries, particularly "agents" and "brokers". Agents are tied to single insurers or a limited number of them by agency agreements. They operate principally in the area of life insurance. Brokers are not so tied, they do little life work. They are expected to be impartial as between insurance companies generally and to get their client, the insured, the best possible appropriate cover for the best price. Unfortunately, the terms "agent" and "broker" are used loosely. Employees are described as agents. Agents sometimes describe themselves as brokers. Brokers are sometimes called (rarely by themselves or each other) insurance agents.

The discussion paper pointed to the different legal consequences that arise from dealing with an agent or a broker. It listed reasons why some form of regulatory control might be desirable :

* For a clear demarcation between agents and brokers, with their differing services and duties
* To impose legal liability on insurers for the acts of agents, within the scope of their agency
* To impose professional indemnity insurance on brokers
* To protect the public from broker insolvency, a growing problem of recent years
* To ensure that the public is alerted to the degree of impartiality that can be expected of the intermediary with whom it is dealing
* (Possibly) to improve standards of training and expertise

The discussion paper analysed various forms of regulation (notabl a looser registration system or a strict licensing system) and the classes of intermediary which should be required to submit to regulation. The discussion paper also drew attention to the conflict of interest and duty that could arise in present arrangements by which brokers, receiving funds from the insured, invest those funds for a period, to their own advantage.

In the public hearings and seminars, no topics attracted so much commment as these. The issues involved divided the insurance industry generally and intermediaries in particular.

SOME ISSUES TO BE FACED

Responsibility for Intermediaries. Even in respect of its agents, an insurer's responsibility is presently a limited one. It extends only to conduct which is within the actual or apparent authority of the agent. It may be, and often is, excluded by contract. The broker is, for most purposes of the law, regarded as the agent of the insured rather than the insurer. In many cases the agent interviews the applicant for insurance and puts to him the questions contained in the proposal form. Sometimes agents fill in the particulars for themselves and merely secure the applicant's signature. Where, on a loss occurring, the proposal form is found to be inadequate or inaccurate, the insurer may deny liability on the basis of misrepresentation or non-disclosure. The extreme view of the insured's responsibility for such conduct of the insurance agent has come under increasing criticism in the courts. It is said to ignore the realities of the generally dependent position of the insured in today's mass insurance market. Recent legislation in New Zealand and Manitoba seeks to clarify the legal position and to fix the insurer with responsibility for a wider r of conduct by its agents. It also limits cases of exclusion of liabi

If such principles were adopted, it would scarcely be fair to extend them to a broker, properly so called, whose business it is to choose among competing insurers to the advantage of his client, the insured. If a clear distinction is drawn between agents (who operate for the insurer and brokers (who operate for the insured,) it would not be fair to fix the insurer with liability for the acts of the latter. But that raises at least two consequential issues. The one is the recourse that may be had to the insured in the event that the broker, after receiving a premium, becomes insolvent before remitting that premium to the insurer. The second is the extent to which some protection can be given to the insured for professional incompetence and even dishonesty on the part of the broker. Here, there is no such simple solution as passing liability, by enactment of general law, from a small incompetent unit (the intermediary) to a larger, viable unit (the insurer) as may justly be done in the case of agents. If a solution is necessary to protect the innocent insured and to spread the costs of the marginal risk of negligence, incompetence and dishonesty, it must be found in an organisational system of some kind, the principal purpose of which is to protect the insuring public which deals with brokers.

Regulation Machinery. What regulation machinery should be introduced, for what specific purposes and to whom should it extend? Brokers have been licensed in Queensland since 1916. The pressure for national legislation has been vigourous, particularly since 1977. Complaints by brokers about the current lack of regulation, identify the issues they want regulation to address :

* Standards of competence and fitness to be a broker
* Impartiality of brokers
* Protection of the insured against negligence and dishonesty by brokers
* Financial soundness and probity of brokers

Various schemes of regulation have been put forward. Care must be taken to avoid the anti-competitive features which are inherent in some forms of regulation. If the ultimate aim is the protection of the insuring public, the entrenchment of existing practitioners in a "cosy club" behind a wall of legal protection could ultimately cost the community more than the gains procured.

Thought should therefore be given to a form of regulation that avoids monopolising tendencies, rejects an overly bureaucrati solution and targets its reforms at particular subject areas that need to be addressed. Among those areas are undoubtedly the following :

* The need to ensure that brokers possess professional indemnity cover and fidelity insurance cover
* The need to separate funds held by a broker for transmission to an insurer from the funds held by brokers on their own account
* The need to prevent at least the worst forms of speculation with funds received by brokers from their clients
* The need to limit the time during which insurance brokers hold clients' funds, received for transmissio to insurers
* The need to distinguish clearly between tied agents and brokers and to forbid the use of the term "broker" by people who are not in truth free to negotiate the best insurance available for the client's needs.

Requirements of the above kind could not be achieved with some form of regulatory control, whether by coercive supervision or self-regulation, whether by licensing, registration or criminal sanctions. In a publicly released commentary on the Commission's discussion paper, the Australian Treasury, in its *Submission*, August 1979, has urged a system short of licensing. But a system of registration may not involve sufficient protection for the public. Though licensing systems have an anti-competitive element, registration systems permit unregistered persons to enter the relevant occupation. The differences between registered and unregistered practitioners may not be clear to the insuring public. Advertising campaigns, designed to draw the distinction to community attention, may have limited or ephemeral impact.

If a system of regulation is introduced, numerous consequential questions must be asked and answered. They include the lines of administrative review and appeal, the definition of wilful conduct that will be restrained by punitive criminal sanctions and the extent to which there should be grafted on to regulatory control, positive efforts designed to improve the expertise and ethics of insurance intermediaries in Australia.

These and other issues are now in the melting pot. The Law Reform Commission's report should act as the catalyst. The reform of the general law and the provision of modest administrative machinery aimed at specifically identified defects, will be the aim of the Commission's exercise. There has never been such an endeavour in Australia to mobilise informed opinion in an attempt to improve the industry and the law by which it is governed. It is not too much to expect that the 1980s will see not only great changes in the insurance industry and the marketing of insurance but also reform of the law and the provision of national legislation which will adjust the law of insurance contracts to the realities of today's insurance market.