THE INSURER'S RIGHT TO CHOOSE RISK

In his scholarship-winning essay, Jason Courtenay examines the challenges and opportunities for the insurer during the assessment of risk, and how these can help find a balance between the interests of insurers and the insured.

by Jason Courtenay

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OVERVIEW

The right of an insurer to choose the risk it wishes to accept is a concept at the heart of insurance. This essay will argue that while certain recent developments, namely proposed amendments to discrimination law and issues around mental health and broadening judicial interpretation of section 54 of the *Insurance Contracts Act* ('Act'), appear to diminish this right by restricting the application of the policy terms at the time of a claim; in practice, these developments have little effect on the real risk being insured. In looking at each of these developments in turn, this essay will argue that striking a balance between the interests of insurers and insureds requires insurers to look beyond the surface of what or who is being insured when offering policy terms and, instead, focus on making objective assessments of the substantive nature and scope of the risk.

Conversely, there needs to be acceptance from consumers that it is not reasonable or economically sustainable to expect that insurers accept any and all risks.

In order to accurately and fairly assess risk in the current technological climate, insurers will need increasing access to big data in order to ensure that risk assessment is based on reliable, current and comprehensive information. However, this will also create issues surrounding data security and privacy that insurers will need to manage.

THE IMPORTANCE OF AN INSURER'S RIGHT TO CHOOSE THE RISK IT WISHES TO ACCEPT

The Insurance Council of Australia describes 'rigorous risk assessment' as being the basic principle that underpins the successful operation of insurance models.[1] Customers purchase policies based on their assessment of certain events occurring, and insurers offer them cover based on their assessment of the cost of covering any claims.[2] In theory, the higher the risk, the more premium is charged for the policy and, where claims risk outweighs the benefit gained from premium, either for the individual risk or across the insurer's whole book, the insurer may refuse to accept the risk. This business model of price setting and acceptance or refusal of risk based on risk assessment allows for the transfer of risk to occur in a commercially viable way.[3] Disruption to this model by legislative, or other mandate, can adversely impact on the commercial viability of the industry, discourage positive behavioural changes in consumers to mitigate risks, and reduce product development and offerings in the market.[4]

Accordingly, it is important for the sustainability of the industry as a whole that insurers retain autonomy to make their own assessments of risks through underwriting processes in order to select which risks to accept or decline, as well as setting premium price.

PROPOSED AMENDMENTS TO DISCRIMINATION LAWS AND ISSUES AROUND MENTAL HEALTH IMPACTING ON INSURERS' RIGHT TO CHOOSE RISK

Anti-discrimination legislation and *Ingram v QBE*

Twelve of Australia's 13 anti-discrimination acts contain exemptions that make it lawful for an insurer to discriminate on the basis of personal characteristics in refusing to provide insurance, or discriminating in respect of the terms and conditions of an insurance policy being provided if the discrimination is based on actuarial or statistical data on which it is reasonable for the insurer to rely and the reliance is reasonable having regard to the data and other relevant factors.[5] If no such actuarial or statistical data is available and cannot reasonably be obtained, discrimination is permitted if the discrimination is reasonable having regard to any other relevant factor.[6] Other relevant factors may include medical or professional opinion, actuarial advice, individual customers' circumstances and practices of other insurers.[7]

The application of the insurance exemption was recently put to the test in the Victorian Civil and Administrative Tribunal decision of *Ingram v QBE (Australia) Limited*.[8] QBE had provided the plaintiff with a travel policy containing a blanket exclusion for mental illnesses. Subsequent to incepting the policy, the plaintiff was diagnosed with major depression and, acting upon medical advice recommending against overseas travel, the plaintiff cancelled her trip and sought to claim her travel expenses. QBE denied the claim on the basis of the mental illness exclusion.

The main issue in dispute in *Ingram* was whether QBE's decisions to provide a travel policy with a blanket mental illness exclusion and then to deny indemnity on the basis of that exclusion were based on actuarial or statistical data upon which it was reasonable for QBE to rely. The Tribunal determined there was no evidence that QBE had relied upon any actuarial or statistical data with respect to mental illnesses in offering the policy or denying the claim. It was determined that it was more likely that QBE had based its decision to include the policy exemption on mere perceptions of the prevalence of mental illness in the community and as portrayed by the media.[9]

What *Ingram* makes clear is that it is important for an insurer to be able to articulate the nature and scope of the risks it chooses and those it declines, based upon the existence and reliance of empirical evidence. In *Ingram*, QBE was shown as having a general perception that persons who suffered from a mental illness would be more inclined to make a claim than persons not suffering from a mental illness, and therefore posed a greater risk. However, in the absence of any objective evidence to support that perception, it is unclear exactly what QBE understood the nature and scope of the risk to be. This raises the question of whether the insurer was actually covering the risk they intended to.

On the other hand, it is not reasonable to expect insurers to expose themselves to proven risks, at least without having the protection of increased premium or altered terms. Had QBE gone a step

further and demonstrated that persons with the plaintiff's condition were more likely to cancel flights, then it is probable the denial of indemnity would have been lawful. Alternatively, specific exclusions may have been imposed that were more relevant to the plaintiff's personal circumstances. For instance, CGU offers a travel policy that covers mental health claims but excludes claims for 'disinclination to travel' due to a mental health condition including 'nervousness, anxiety, depression, or stress-related disorders'.[10] Such an exemption may have been sufficient to protect QBE's interests in *Ingram*.

Amendments to anti-discrimination legislation

In 2012, the Federal Government introduced the *Exposure Draft of the Human Rights and Anti-Discrimination Bill 2012* ('Bill'). The Bill would have consolidated Australia's anti-discrimination legislation and, relevantly, introduced a general exemption for 'inherent requirements'. It remains to be seen whether the project will proceed.

However, it is submitted that the current exemption model should be retained as the express insurance exemption provides insurers with certainty when making decisions that could otherwise be considered unlawful discrimination. It is beneficial to both insurers and insureds that decisions are based on risks that can be evidenced by actuarial and statistical data as this will promote social equity, but also greater accuracy in pricing of risk.

"It is not reasonable to expect insurers to expose themselves to proven risks."

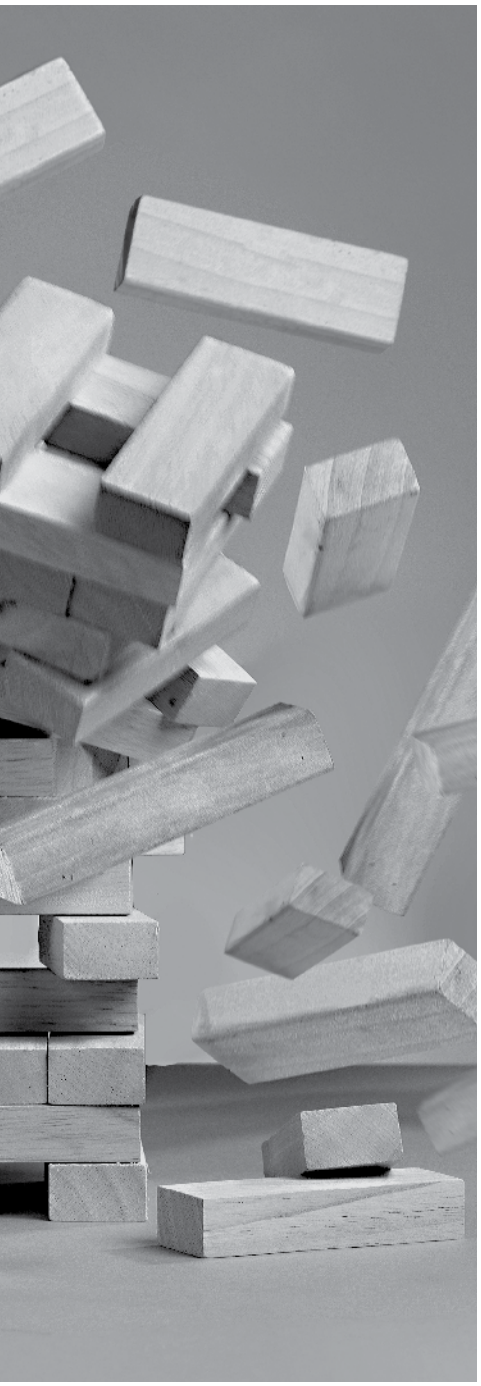
During the consultation process for the Bill, mental health agencies and advocate groups such as the Mental Health Council of Australia, beyondblue and Victoria Legal Aid pushed for amendments to the insurance exemptions in anti-discrimination legislation that would, *inter alia*, require insurers to provide statistical or actuarial data relied upon in the course of lawful discrimination, upon request.[11] It is submitted that, whilst transparency in providing reasons for refusals to grant cover is important, it is equally important to ensure that the commercial sensitivity of actuarial and statistical data is protected.[12] Insurers invest significant resources into analysis of internal claims data and external data to create meaningful information from an underwriting perspective. In the interests of protecting insurers' commercially sensitive underwriting information, it is recommended that any legislative requirement on insurers to release actuarial or statistical data be scaled back so that certain details in respect of internal claims be kept confidential, for instance, reserve and settlement figures and details that could identify individual clients.

Broadening interpretation of section 54 of the Act

The broadening interpretation of section 54 of the Act as seen in *Maxwell v Highway Hauliers*[13] is another example where legal developments may result in the diminishing of insurers' right to choose the risk they wish to accept by restricting the application of policy terms at the time of a claim.

Section 54 of the Act essentially operates so that:

- where there is an act or omission on the part of the insured that occurs after the inception of the policy
- the act or omission constitutes a breach of the policy terms
- the breach would entitle the insurer to refuse to indemnify in the event of a claim
- the insurer has not suffered any prejudice as a result of the breach in that there is no causal connection between the breach and the loss that is the subject of the claim, the insurer is prevented from denying the claim in full, or the claim is reduced by the



amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of the act or omission.[14]

The intention behind section 54 of the Act is to focus on the substance of the risk being assumed by the insurer under the relevant contract of insurance, rather than its form, by avoiding technical drafting devices.[15]

In *Maxwell,* the insured trucking company sustained property damage due to two trucks being involved separate accidents. It sought cover under a motor vehicle fleet policy for the value of the damage. It was a condition under the policy that the insured's drivers undergo a psychiatric evaluation through an approved third party provider. In each incident, the driver had not undergone the psychiatric evaluation and the insurer sought to deny cover on the basis of breach of the policy.

Both parties accepted that there was no correlation between the drivers' failure to undergo the psychiatric evaluations and the circumstances surrounding the separate incidents. Ultimately, the Court determined that the insurer was preventing from relying on the breach to deny the claims.

Similar to QBE's rationale in *Ingram*, the insurer in *Maxwell* clearly assessed the risk of persons with a mental illness driving trucks as being a greater risk than persons without mental illness. With supporting actuarial and statistical data to make this connection, the insurer was acting reasonably and lawfully. However, the necessary question to ask in balancing the interests of the insurer and the insured is what risk was the insurer trying to cover and was the insurer's right to choose this risk diminished by not being able to rely on the contractual breach to deny cover? The answer is no as there was no suggestion that mental illness played a part in the incidents occurring. Accordingly, the operation of section 54 of the Act did not serve to undermine the insurer's intent when framing the risk it wished to accept.

THE ROLE OF BIG DATA IN ENABLING INSURERS TO ACCURATELY DEFINE AND CHOOSE RISK

Big data can be utilised by insurers to more accurately assess the substantive nature and scope of risk. Big data is an overarching term that describes any voluminous amount of data that has the potential to be mined for information.[16] In this context, data describes raw, unorganised material such as numbers or words, whereas information is data that has been presented in a way that is given meaning and can be analysed.[17] Big data is characterised by its sheer volume, velocity and variety.[18]

There are significant opportunities for insurers to access more data to analyse its value for underwriting purposes. In its submission in response to the Productivity Commission's Issue Paper on *Data Availability and Use*, IAG made the following statement in relation to data:

"As a risk-based product, insurers' access to sophisticated data is critical to their ability to assess and price risk that is specific to an individual. Better availability of data would provide insurers with information they could use to more accurately assess the risk of providing cover…"[19]

The Insurance Council of Australia has emphasised that it will be necessary for raw data sets held by the public sector to be structured into a form where it can be easily interpreted by members of the public.[20]

Federal and State Governments should increase the amount of public sector data that is made available to insurers and the public generally in an electronic format that can be easily interpreted. The public sector already makes available certain data that is highly instructive for insurers, including data held by the Bureau of Meteorology, Australian Bureau of Statistics, Geoscience Australia and the Geocoded National Address File.[21] The more public data that is made available, the more information insurers will be able to rely upon when assessing risk, and this will result in more accurate insurance coverage for a wider range of risks and enable better mitigation

and risk management measures in the community.[22]

In its submission on *Data Availability and Use*, IAG has stated that it welcomes private businesses sharing data with one another, directly with consumers and with the public sector. However, unlike the public sector where there is a stronger case for arguing that data should be shared with the community at large, sharing of data by the private sector is likely to create issues regarding the release of commercially valuable information. For this reason, the State and Federal Governments should refrain from mandating the release of data within members of the private sector.

IAG has suggested that the sharing of data between businesses be done by way of trading and commercial transaction. The concept of a free market for data is appropriate and regulation should occur through industry body regulators and by private agreements between members.

With respect to release of data to consumers, IAG has suggested that Australia look to overseas models such as the United Kingdom and the United States, where there are already a variety of initiatives in place to allow consumers to access their data in a portable electronic format.[23]

Access to more data creates issues relating to privacy breaches and cyber security. Accordingly, it will be important for insurers to take a leading role in ensuring compliance and having remedial action plans in place to mitigate loss in the event of cyber breaches. As reliance on big data becomes more prevalent in society generally, there will undoubtedly be a rise in cyber and privacy breaches and with it, a rise in the importance of cyber liability insurance.

CONCLUSION

In a free market economy, insurers should be able to make their own assessments of the risk they wish to accept. However, given that insurance is a necessary safeguard for many people and organisations, it is important that insurers do not seek to avoid the actual or substantive risk they intended to cover by relying on legislative exemptions unreasonably or technical drafting devices.

Conversely, it is important that consumers acknowledge that insurance (at least general insurance) as a private industry, for the most part, is not intended to act as a social security scheme. Accordingly, there needs to be understanding that there are legitimate commercial reasons insurers may refuse to provide cover, provide cover on altered terms or deny indemnity in the event of a claim.

"The more public data that is available, the more information insurers will be able to rely upon when assessing risk."

To ensure that insurers engage in practices that are both commercially viable and fair, it is important that insurers have access to as much information as possible to ensure their underwriting processes accurately identify the scope and nature of risks.

All references, cases and legislation referred to were current as at 24 October 2016. References and bibliography provided online at: anziif.com