INSURANCE LAW 76022 NOTES

Essential Characteristics of General Insurance: Risk Transfer & Loss Spreading

A contract that contains insurance and non-insurance-type provisions is an insurance contract if, taken as a whole, the primary purpose of the contract is to ensure: ***Sibthorpe v London Borough of Southwark* [2011]**.

Risk Transfer

Primary Purpose

The risk of transfer aspect of insurance is effected by a private arrangement made solely or primarily for that purpose.

- A contract that intends to transfer risk can be insurance even if the risk is not transferred because of something done or not done by the insured before or at the time of a loss: ***Steadfast Insurance Co Ltd v F & B Trading* [1971] HCA**.

Adverse Affect

Insurance involves an insurer promising to make good a specified category of loss if the injured suffers such loss as a result of a transferred risk eventuating: ***Re Commonwealth Homes and Investment Co Ltd* [1943] SASR**.

The risk transferred must be a risk that would adversely affect the interest of the insured or beneficiaries of an insurance arrangement if it eventuates.

Insurance can be classified as either '***indemnity'*** or '***contingency'***.

Indemnity insurance contract

By an indemnity insurance contract, an insurer promises to indemnify against a specified category of financial loss suffered by an insured as a result of the happening of transferred risk.

- If a transferred risk eventuates but does not hurt the insured financially, then the insurer has nothing to indemnify against.
- With indemnity insurance, the nature of the contract requires that the risk transferred be adverse to the interest of the insured.

Contingency insurance contract

By a contingency insurance contract, an insurer promises to pay an agreed amount upon the happening of a contingent event irrespective of the actual financial loss that an insured would suffer if such event happens.

'Adverse affect' is a reference to the potentially adverse financial impact of a risk eventuating on an insured.

Uncertainty (fortuity)

The notion of risk requires uncertainty (fortuity): ***Beresford v Royal Insurance Company* [1938] AC**.

- There can be no transfer of risk if there is no risk to transfer: ***Prudential Insurance Co v Inland Revenue Commissioners* [1904]**.

The 'uncertainty' requirement also means that property insurance will not cover an insured for damage to or destruction of property brought by:

- 'wear and tear' if some wear and tear is inevitable during the insurance period;
- 'inherent vice' – this means the deterioration of an item 'as a result of its natural behaviour in the ordinary course of things… without the intervention of any fortuitous external accident or casualty.

Legally binding

There is only insurance if an 'insurer' is legally bound to accept the financial burden of a specified event if it happens: ***The Barclay MIS Group of Companies v ASIC* [2002]**.

- The essential characteristic of risk transfer is missing if arrangement allows an insurer to choose whether or not to pay for a loss that falls within the scope of the risks described in the arrangement.

Payment of money or some corresponding benefit (money's worth)

An essential characteristic of an insurance arrangement is that an insurer promises to pay an insured money or some corresponding benefit (money's worth) for an insured loss: ***Digital Satellite Warranty Cover v Financial Services Authority* [2013] UKSC**.

Loss Spreading

Loss spreading is the primary characteristic of the public aspect of insurance in that insurance works by a large number of insureds with similar risk profiles each privately transferring the same class of risk to the one insurer.

- If payable, the 'premium' is the price paid by each insured to join a premium pool established by an insurer.
  - Because each insured's risk of loss is spread across all the insureds participating in the pool, the premium is usually tiny compared with the size of a loss of an insured might suffer if an insured event occurs.
    - The terms and conditions of each insured's private arrangement will determine their entitlement to payment out of the premium pool in the event of a loss.

The Non-Essential Characteristics of Insurance: Contract, Indemnity, Premium and Profit

Contract

Insurance arrangements are usually created by contract, but can be product of statute.

> "it is the relationship of indemnity that exists between insurer and insured, rather than the source of that relationship, that is the essence of the concept of insurance": ***R v Cohen; Ex Parte Motor Accidents Insurance Board* [1979]**.

Indemnity

The above quote is not true, because:

- Not all insurance is indemnity; and
- Not all indemnity arrangements are insurance.

Premium

Insurance usually involves an insured paying to an insurer a fixed amount (premium) in consideration for the transfer of risk to the insurer, but that is not a necessary element of insurance: ***R v Cohen; Ex Parte Motor Accidents Insurance Board* [1979]**.

- Premium will not usually be a feature of an insurance arrangement if the arrangement is created by deed or statute.

An insurance arrangement is aleatory (random) because the dollar value of the parties' respective performance is unequal. That is, when the arrangement is made, the parties to it:

- Know the cost (premium) payable for the risk (if any); but
- Do not know if an event specified by the arrangement will happen during the insurance period and, if it does, how much the insurer will be obliged to pay the insured.

DIVIDING INSURANCE INTO CATEGORIES

Introduction

Insurance can be divided into the categories of:

- General insurance;
- Marine;
- Life; and
- Health insurance.

General insurance can be categorised into 4 categories:

- Indemnity and contingency;
- First party and liability (third party);
- 'occurrence' and 'claims made'; and
- joint and composite.

MARINE INSURANCE

The *Marine Insurance Act 1909 (Cth)* (*MIA*) is concerned with insurance contracts that provide cover against losses incident to a marine adventure.

It applies to all marine insurance, except:

- state marine insurance that does not extend beyond the limits of the state concerned (s 6); and
- marine insurance contract 'made in respect to a pleasure craft (**s 9A**).

A marine insurance contract is an insurance contract that indemnifies against 'losses incident to marine adventure: **s 7 MIA**. There is a 'marine adventure' where (**s 9(2)**:

(a) any ship, goods, or other movables are exposed to maritime perils. Such property is in this Act referred to as ***insurable property***;

(b) the earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;

(c) any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.

"Maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints, and detainments of princes and peoples, jettisons, barratry, and any other perils, either of the like kind, or which may be designated by the policy.

- The MIA does not define 'sea'. At CL, it includes inland waters to the extent they are affected by the 'ebb and flow of the tide': *Gibbs v Mercantile Mutual Insurance (Australia)* [2003] HCA.
- The term 'perils of the seas' in the definition of 'Maritime perils' 'refers only to fortuitous accidents or casualties of the seas'.
    - 'It does not include the ordinary action of the winds and waves': **MIA Sch 2, r 7**.

A contract can be a marine insurance contract for the purpose of the MIA even if it also covers land risks, so long as the subject matter insured is substantially a marine adventure: **MIA s 8, *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur (Australia) Ltd* [1986]**.

LIFE INSURANCE

The ***Life Insurance Act 1995 (Cth) (LIA***) sets out to protect the owners and beneficiaries of life insurance policies by controlling the entry of companies into the life insurance market and the way in which companies in the market carry on life insurance business: **s 3**.

- The ICA contains provisions that affect the rights and obligations of the parties to, and beneficiaries of, a life insurance contract 'that constitutes a life policy within the meaning of the LIA: **s 11(6) ICA**.

By **s 9(1) LIA**, the following constitute a life insurance policy except to the extent that they fall within the desorption contained in **s 9(2)**.

(a) a contract of insurance that provides for the payment of money on the death of a person or on the happening of a contingency dependent on the termination or continuance of human life;

(b) a contract of insurance that is subject to payment of premiums for a term dependent on the termination or continuance of human life;

(c) a contract of insurance that provides for the payment of an annuity for a term dependent on the continuance of human life;

(d) a contract that provides for the payment of an annuity for a term not dependent on the continuance of human life but exceeding the term prescribed by the regulations for the purposes of this paragraph;

(e) a continuous disability policy;

(f) a contract (whether or not it is a contract of insurance) that constitutes an investment account contract;

(g) a contract (whether or not it is a contract of insurance) that constitutes an investment-linked contract.

SECT 9(2) states:

A contract that provides for the payment of money on the death of a person is not a life policy if:

(a) by the terms of the contract, the duration of the contract is to be not more than one year; and

(b) payment is only to be made in the event of:

(i) death by accident; or

(ii) death resulting from a specified sickness.

GENERAL INSURANCE

General insurance can be either ***indemnity*** or ***contingency***.

- Most insurance is **indemnity**.

Indemnity Insurance

With an indemnity insurance contract, an insurer promises to indemnify against financial loss suffered by an insured as a result of the happening of a risk transferred to the insurer by the contract.

An insurer's promise to indemnify is a promise to 'make good' any financial loss suffered by an insured as a result of an insured event occurring, by paying to an insured the amount of the loss: ***Bofinfer v Kingsway Group Ltd*** **[2003] HCA**.

Contingency Insurance

Contingency insurance protects against the adverse financial impact of a contingent event that:

- Cannot, or cannot easily, be calculated (e.g. financial value of the loss of an eye); or
- The insurer does not want to indemnify against (e.g. actual loss of income as a result of sickness or accident).