

Insurance Contract Law Review Options Paper: Submission by Commerce Commission

Submitted to

Ministry of Business, Innovation and Employment

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Commerce Commission submission on Insurance Contract Law Review Options Paper

Introduction

1. The Commerce Commission (the Commission) appreciates the opportunity to make a submission on the Ministry of Business, Innovation and Employment's (MBIE) April 2019 Options Paper *Insurance Contract Law Review (Options Paper)*¹. We look forward to our ongoing engagement with MBIE on this topic.
2. The Commission acknowledges that the insurance market plays an important social and economic role and that the pricing of insurance risk is complex. At the same time, the Commission considers that MBIE has identified policy issues relevant to ensuring that New Zealand's insurance contract law supports insurance markets to work well.
3. We have focused our submission on the issue of unfair contract terms (UCTs) in insurance contracts. We also comment briefly on the issue of a duty to disclose as it relates to the issue of understanding and comparing insurance policies.
4. Our views have been informed by our practical experience enforcing provisions of the Fair Trading Act 1986 (FTA) that prohibit the use of UCTs (the UCT Provisions), and by feedback we receive from stakeholders. While we acknowledge that there are differences between insurance contract law in New Zealand and Australia, we provide examples from Australia where relevant.

Unfair contract terms

5. The UCT Provisions² provide that certain listed terms at s 46L(4)(a) - (g) in relation to insurance contracts cannot be assessed for fairness and must be taken to be terms that are reasonably necessary to protect the legitimate interests of the insurer. These terms relate to:
 - 5.1 the subject or risk insured against;
 - 5.2 the sum insured;
 - 5.3 exclusions/limitations of liability on the happening of certain events;
 - 5.4 the basis on which claims may be settled;
 - 5.5 payment of premiums;

¹ <https://www.mbie.govt.nz/dmsdocument/5157-insurance-contract-law-review-options-paper>

² A term is "unfair" if it: a) would cause an imbalance in the rights and obligations of the parties to the contract; b) would cause detriment to a party to the contract; and c) is not reasonably necessary to protect the legitimate interests of the party who would benefit from the term.

- 5.6 the duty of utmost good faith; and
 - 5.7 requirements for disclosure.
6. We have found UCTs in other sectors for example, in the telecommunications, retail electricity and gym sectors. Given the exclusions at s 46L(4) of the FTA, the Commission has not reviewed contracts in the insurance sector for compliance with the UCT Provisions.

Australian Experience

7. In response to the Australian Treasury's Proposals Paper *'Extending unfair contract terms protections to insurance contracts'*³ published in June 2018, the Australian Competition and Consumer Commission (ACCC) supported the proposal to extend protections against UCTs to insurance contracts.⁴

Commission View

8. The Commission notes that the law that governs insurance contracts consists of various items of legislation and case law. Some of these laws are also under review, such as legislation relating to the conduct of financial institutions.⁵ We recommend that MBIE continues to consider the interrelationships between different amendments, and the operation of insurance law as a whole, when considering any amendment to one or more of those laws. For example, some of the issues that could be addressed by the extension of the UCT Provisions to insurance contracts, could also be addressed by the options being considered for duties to disclose information and understanding and comparing policies.
9. In our view, extending the application of the UCT Provisions to insurance contracts would provide consumers and businesses with clear and consistent protection against UCTs across the economy and over time. We are in general not supportive of sector-specific exceptions to general legal requirements or prohibitions, such as the otherwise widely applicable UCT laws under the FTA.
10. And we consider the existing UCT law is capable of accommodating the business needs of the insurance industry. For example, terms that are reasonably necessary in order to protect the legitimate interests of the insurer would still be permitted, and terms that define the main subject matter of the contract or set the upfront price payable under the contract could not be declared unfair. In addition, to the extent that inconsistency with sector specific laws or regulation arose, we note that the FTA provides that a term may not be declared to be unfair where that term is required or expressly permitted by any enactment, such as any law specifically regulating the insurance sector.

³ https://treasury.gov.au/sites/default/files/2019-03/t284394_UCT_Insurance_Contracts_Proposals_Paper_Aug.pdf

⁴ https://treasury.gov.au/sites/default/files/2019-03/Australian-Competition-and-Consumer-Commission_1.pdf

⁵ <https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/conduct-of-financial-institutions-review/>

11. The kinds of terms currently listed as exempt in s 46L(4)(a) - (g) may still be subject to scrutiny as reasonably necessary to protect the legitimate interests of an insurer, and they could be considered fair. However, as with all other sectors, the onus would be on the insurer to demonstrate that terms are reasonably necessary to protect their legitimate interests. Assumedly, this could be done through the provision of actuarial or other data or analysis if terms which potentially could be unfair were said to be justified by an assessment of insurance risk.
12. Of the Options being considered we therefore **support Option 2** - remove all insurance specific exemptions from the FTA so that the UCT Provisions would apply to insurance contracts.
13. A further benefit of Option 2 is that it ensures that certain add-on insurance products, such as vehicle hire add-on insurance, would be covered by the UCT Provisions. Currently, it is unclear whether the UCT Provisions apply to such products.

Other options

14. We do not support the other options for the following reasons:
 - 14.1 Under Option 1, the insurance-specific exemptions under s46L(a) – (g) would be removed. Instead, the law would define the main subject matter of an insurance contract broadly as terms that clearly define the insured risk accepted by the insurer and the insurer’s liability. This broad definition would mean that policy limitations and exclusions that affect the scope of the cover would be considered as part of the main subject matter and would not be open to review. The risk with this broad definition of the ‘main subject matter’ is that it would be so broad so as to circumvent the intent of the UCT provisions and operate similarly to the exemptions under s46L(a) – (g).⁶
 - 14.2 Furthermore, Option 1 suggests that legislation could explicitly treat a term as reasonably necessary to protect the legitimate interests of an insurer (and therefore not able to amount to a UCT) if the term reasonably reflects the underwriting risk accepted by the insurer and it does not disproportionately or unreasonably disadvantage the insured. In our view, it is preferable that the test for unfairness remains consistent across all standard form contracts to provide certainty. We accept that underwriting risk must be appropriately reflected in the terms of insurance contracts. That risk may be excluded from being unfair because it is reflected in price or the main subject matter of the contract. In other cases, we consider that the existing requirement to consider the legitimate interests of the insurer is sufficiently broad to provide

⁶ The ACCC also agrees that “the exemption for the ‘main subject matter of the contract’ should be drafted and interpreted narrowly. A broad interpretation would circumvent the intent of the UCT protections.”
Pg 3 of https://treasury.gov.au/sites/default/files/2019-03/Australian-Competition-and-Consumer-Commission_1.pdf

for appropriate consideration of underwriting risk to justify a term that may otherwise be considered to be unfair.

- 14.3 Under Option 1a, the regulator would issue guidance to help define what the generic exceptions mean in the insurance context. We consider that our general guidance relating to the application of the UCT Provisions could apply equally to insurance contracts without the need for special guidance to be developed. In any event, if all insurance-specific exceptions are removed from the FTA, we would need to adapt and update our current guidance on the UCT provisions accordingly. If sector specific guidance on the application of the UCT Provisions was considered useful in addition to our general UCT Guidelines, the Commission is able to issue that guidance without being directed to do so by statute.
- 14.4 Under Option 2a, core terms would be exempt unless they are not transparent and prominent. A disclosure requirement would place some greater onus on insurers to bring terms to the attention of their customers but so long as they did so, there would be no scope to enquire further into the fairness of the term. This would appear to fall short of the policy intent of this review to provide greater protection for consumers against the use of insurance contract terms which disadvantage consumers and are not reasonably necessary to meet the legitimate interests of the insurer.

Consistent application of the UCT provisions

15. In line with a previous Commission submission on MBIE's December 2018 Discussion Paper '*Protecting business and consumers from unfair commercial practices*', we consider that the current UCT Provisions could be strengthened and that this strengthening should equally apply to insurance contracts. Specifically, we submitted that:
 - 15.1 the UCT Provisions should be extended to apply to contracts entered into by all businesses regardless of size where inequality of bargaining position can be made out under the existing UCT Provisions;
 - 15.2 the UCT Provisions should be amended to allow for private enforcement by those affected; and
 - 15.3 breach of the UCT Provisions should give rise to existing criminal sanctions when the UCT is proven (i.e. without first needing a declaration from the Court that the term is a UCT and the trader to continue to use the UCT following the declaration), as well as to the other FTA civil remedies.
16. Consistent with an economy wide protection against UCTs applying to standard form contracts, we support amendments relating to the insurance sector being extended to all insurance contracts and all businesses entering into insurance contracts. The UCT Provisions require the assessment of whether a contract is a standard form contract to take into account the bargaining power of the parties, which party

prepared the contract and the ability to negotiate the terms of the contract.⁷ We consider that these are appropriate factors to take into account when determining whether the UCT Provisions should apply to a contract entered into by a business, rather than a simple question of business size. We do not favour the inclusion of size, turnover or similar limits to determine which businesses have the protection of the UCT Provisions.

17. Currently the Commission has sole responsibility for the enforcement of the UCT Provisions. Only the Commission can apply to a court to have a UCT declared to be unfair. Unless a court has previously declared a term to be unfair, businesses that include UCTs in their standard form consumer contracts are not civilly or criminally liable for doing so. In practice, businesses can include a UCT twice in a contract before any sanction applies.
18. If, for example, a consumer takes a contractual matter to a court and the contract contains UCTs, the court would likely be required to enforce the term against the consumer, unless it could invoke other principles of consumer law to decline to do so. Private enforcement and immediate access to a financial sanction of some sort would allow greater enforcement of the UCT Provisions, more effectively deter the use of UCTs and encourage greater compliance.

Duty to Disclose and Understanding and Comparing Policies

Commission View

19. At this time, the Commission does not take a position on the policy options set out in the Options Paper relating to the duties to disclose information or understanding and comparing policies. We generally support clear requirements relating to the disclosure of information and support any proposals that enable consumers to better understand and compare policies.

Australian Experience

20. We note the relevant recommendations of the ACCC inquiry into the home, contents and strata insurance⁸ market in northern Australia.⁹
21. The ACCC released its interim report in December 2018 and made 15 recommendations to improve the northern Australia insurance market, including increasing insurers' disclosure obligations to their customers. The relevant aspects of the ACCC's recommendations are summarised in Box A below.
22. In particular, we note the types of terms that may benefit from clear agreed definitions, which would then also help consumers understand and compare policies.

⁷ Such considerations apply in section 46J(2), but presently only in respect of trader-to-consumer contracts.

⁸ Strata insurance, also called body corporate insurance, covers common contents and property under the management of a strata title or body corporate entity. Source: <http://understandinsurance.com.au/types-of-insurance/strata-insurance>

⁹ <https://www.accc.gov.au/media-release/northern-australian-insurance-needs-immediate-action>

Box A: ACCC recommendations on disclosure obligations and understanding and comparing policies

The ACCC's interim report on northern Australian home, contents and strata insurance¹⁰ recommended standardised definitions of prescribed events which would provide greater certainty for consumers and facilitate comparability of products. Currently only the term 'flood' is well defined in Australian law.

The report also recommended that disclosure requirements be increased for insurers such that insurers clearly disclose the types of costs that will count towards the sum insured amount for buildings (such as the costs of demolition, debris removal or for professional fees) where these are not provided for through a separate allowance under the policy. This information should be provided on any sum insured calculators used by the insurer and alongside the sum insured figure. The rationale for this recommendation was to help consumers understand why and how calculator estimations can differ and empower them to make more informed decisions about their nominated sum insured.

Furthermore, the interim report recommended that the Insurance Contracts Regulations should be amended to require that renewal notices for home, contents and strata insurance clearly disclose the premium, the sum insured and any excess of the expiring policy. Insurers should also provide this information upon request. This recommendation would allow consumers to easily identify how the insurer proposes to vary these terms from the previous year and seek explanation of any changes.

23. We thank MBIE for this submission opportunity and would be pleased to provide any further assistance. If you have any specific questions on this submission please contact Yvette Popovic on [REDACTED] in the first instance.

¹⁰ Ibid.