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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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By portal at: www.mbie.govt.nz/insurance-contracts

Submission on Options Paper - Insurance Contract Law Review – Insurance & Financial Services Ombudsman Scheme ("IFSO Scheme")

1. What is your feedback regarding the objectives for the review?

We agree with the objectives.

2. What is your feedback in relation to the options for disclosure by consumers? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option (including the status quo) do you prefer and why?

The IFSO Scheme supports Option 1, being the approach taken by the UK and set out in the Consumer Insurance (Disclosure and Representations) Act 2012 ("CIDRA"). However, in the UK, CIDRA does not apply to commercial organisations, which have a duty to give the insurer a fair presentation of the risk.[1] We believe the approach taken in Option 1 is an appropriate balance of consumer protection and insurer resourcing. Targeted questions to assist an insured with disclosure obligations are already a feature of most policies and, therefore, Option 1 should not impose significantly more compliance cost on insurers.

We note that Option 2 is the Australian approach, which has been in effect since 1984.[2] It is preferable to the status quo, but does not go far enough. Imposing an active duty on consumers to identify information an insurer needs will probably still pose a barrier to some consumers who do not fully understand their obligation of disclosure.

[1] Section 3 of the *Insurance Act 2015*
[2] *Insurance Contracts Act 1984*

Option 3, imposing an obligation on an insurer to obtain medical information, would result in significant compliance costs. In addition, it would not apply to general insurers and their customers, so is of limited scope.

3. Should insurers be required to warn consumers of the duty to disclose? Why/why not? Should insurers be required to warn all insureds of the duty to disclose, including businesses?

Yes and we agree with Design option 1. Most insurers already warn consumers of the duty to disclose as a matter of practice, which includes having an insured sign and acknowledge that they understand the duty and have complied with it. We note, however, that this often does not have the intended effect, as the extent of the duty and its consequences are not widely understood – often both by consumers and their advisers.

4. Should insurers have to tell consumers what third party information they will access, when they will access it and if they will use it to underwrite the policy?

Yes and we agree with Design option 2. (We understand and support both Design options, provided they are in addition, but not as an alternative, to consumer disclosure Options 1-3.) A requirement for an insurer to inform customers about whether and when they will access third party information would assist consumers. We believe that there should also be an explicit statement that an insurer may choose not to obtain medical notes, even though they have the option to do so. This view is based on our experience of complaints where a consumer has failed to appreciate the difference between giving consent to the insurer to obtain information and the insurer actually obtaining it.

5. What is your feedback on the options in relation to disclosure by businesses? In particular: Should businesses have different disclosure obligations to consumers? Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option (including the status quo) do you prefer and why?

For larger businesses, there is not the same imbalance of power present as for small businesses or consumers. Those larger organisations are much better equipped to understand and assess what their risks are. Therefore, we believe the UK test of fair presentation of risk should be used for larger businesses, as set out in Option 2.

6. If we have a separate duty of disclosure for businesses, should small businesses have the same duty as consumers? Why/why not? If so, how should small businesses be defined?

The IFSO Scheme's jurisdiction includes complaints made by small businesses, defined as 19 or fewer full-time equivalent employees, as set out in s.63 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ("FSP

Act"). In our experience, the level of understanding by small businesses of insurance obligations, such as the duty of disclosure, is generally on a similar level as consumers. Therefore, it would be appropriate to apply the same test for both consumers and small businesses, which would also be consistent with the FSP Act.

7. If a duty of fair presentation of risk is adopted, should businesses be allowed to contract out of the duty? What are the costs and benefits of allowing businesses to do so? If businesses are allowed to contract out, should the duty apply to all businesses?

Large businesses should be able to contract out of the duty in the same way as businesses can under the Insurance Act 2015 in the UK. However, we note that if small businesses are subject to the same requirement to fairly present the risk, there could still be a significant imbalance that would not be addressed by the ability for the parties to contract out.

8. What is your feedback in relation the disclosure remedy options? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why?

The most appropriate option for the remedy for non-disclosure is dependent on which non-disclosure test for consumer disclosure is eventually selected. Given our preference for the UK approach (Option 1), we would choose Option 1 again as the most appropriate option and would not add anything to the assessment of intention which is required under the UK test. Proportionate responses are the fairest outcomes to balance stakeholder interests.

Option 2 prevents avoidance, even when an insurer would not have entered into the contract initially. The IFSO Scheme understands the value of the prohibition from a consumer protection perspective, but we have some real concerns about requiring an insurer to provide cover to a consumer who is essentially uninsurable. This could have a flow on effect for other consumers in the form of increased premiums.

Option 3 relates only to materiality and not to intention – encouraging fraud or intentional non-disclosure is not good policy.

9. Is it fair to require insurers to pay claims that are not connected to a non-disclosure or misrepresentation, even if the insurer would not have entered into the contract had they known the facts?

The answer to whether this is "fair" will, of course, depend on one's perspective. The requirement for an insurer to pay a claim unrelated to the non-disclosure or misrepresentation does not address the fundamental problem with the current prudent underwriter test and remedy of avoidance. It is difficult to see how this Design option 1 could be either in addition, or an alternative, to Option 1 of the remedies. We believe that a requirement to have a proportionate remedy for non-

disclosure as set out in Option 1 would cover this issue in a more appropriate and substantially fair manner.

10. Should insurers be able to offer reduced cover or ask the insured to cover the difference in order to recoup the amount they would have charged if they had the facts? Why/why not?

It is difficult to see how this Design option 2 could be either in addition, or an alternative, to Option 1 of the remedies. If a consumer has been careless and induced the insurer to enter the contract, Option 1 gives the insurer the right to vary the terms. This design option could only apply where the insured did not know of the facts at the time the contract was entered into and, in those circumstances, was not in a position to be able to disclose. Therefore, the insurer should not be able to retrospectively underwrite on the basis of information which was not known about by the insured at the time.

11. Should we clarify that where a contract has been avoided and all claims rejected, the insured is not required to refund claims money if it is not easily returnable and would [be] hard and unfair to the insured?

Yes, we believe that the approach outlined in this Design option 3 would be appropriate. Generally, it is rare for insurers to attempt to recover past claim payments. However, we have seen it where the insurer can prove the insured has acted fraudulently. On a fair and reasonable basis, we would generally take the view that, unless the insured had in fact acted fraudulently, an insurer should not be entitled to seek recovery.

12. Do you agree that section 35 of the Contract and Commercial Law Act should not apply to insurance contracts? Are there any other sections of the Contract and Commercial Law Act that should not apply to insurance contracts?

The IFSO Scheme agrees with Design option 4.

13. Do you agree with the proposed change to the misrepresentation provisions in the Insurance Law Reform act 1977? Why/why not?

Yes, we agree that the Insurance Law Reform Act 1977 ("ILRA") misstatement provisions should be replaced. As set out in our submission of 13 July 2018 on the Review ("our 2018 submission"), our experience indicates that a number of insurers in the life, health and disability sector do not understand that there is a difference between misstatement under the ILRA and common law non-disclosure, because the same remedy of avoidance applies to both.

14. Which of the terms in Table 4 are unfair? In your opinion, are they exempt from the unfair contract terms prohibition?

Under the Fair Trading Act 1986, the IFSO Scheme has no ability to look at unfair terms, or make any decisions about them. In our 2018 submission, we limited our concerns to questioning whether the Review should accept the "no exceptions" stance in future legislation.
It appears that our 2018 submission is in accordance with the preliminary view that some of the examples could be exempt, but would otherwise be seen to be unfair.

The UCT example of an "***Insurer … mak*[ing] *unilateral changes to a contract***" has been attributed to the IFSO Scheme. We note that the concerns we expressed in our 2018 submission specifically related to a case study and referred to a life/health product, where a unilateral change had been made and an insured with pre-existing conditions could not move to another insurer. There is no broad principle, in respect of general insurance, where unilateral changes to a contract become an UCT, because an insured is able to move to another insurer.

We would like to comment on the UCT example given of the declinature of the vehicle claim where the insured is not able to contact the at fault third party. This is an additional benefit for third party fire and theft policies, which has been added to benefit consumers in circumstances where they would previously have had no cover for their own vehicle. Therefore, we do not believe that this additional cover could be called an unfair term.

15. What is your feedback on the UCT options? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why?

The IFSO Scheme prefers Option 2. We acknowledge that certainty for insurers is important, but that must be weighed against sufficient consumer protection against UCTs.

16. What is your feedback on the options to help consumers understand and compare contracts? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which options do you prefer and why?

Option 1 – We support plain English policies in principle, but not as a requirement. There has been a general move towards plain English policies in recent years. However, given that policies are legal contracts, some terms have been defined over the years, to provide certainty and consistency. Therefore, there are risks involved in a blanket requirement for plain English.

Option 2 – We support clear definitions for core policy terms in principle, but note the practical difficulties in assessing and complying with this option.

Option 3 – Given our experience that the majority of consumers do not read and/or understand their policies, we support this option, as it should make key information more accessible. However, providing a summary can also raise issues about consistency with the policy document as a whole and could give rise to consumer misunderstandings and, possibly, disputes over policy cover.

Option 4 – We believe that, while the idea of a comparison platform is to be supported, policies are often difficult to compare. We do not believe that it is appropriate for a prohibition on terms which make comparison difficult, nor forced compliance.

Option 5 – In principle, the IFSO Scheme supports the requirement for insurers to disclose key information clearly in plain language. However, from a practical perspective, we wonder how this can be achieved in a useful manner that balances stakeholder interests i.e. who determines what key information is?

17. What is your feedback on the options in relation to intermediaries? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why?

The IFSO Scheme believes that Option 1 is the most appropriate in the circumstances. The status quo provides some protection for an insured, where Option 3 provides none. Insurers are in the best position to take responsibility for intermediaries.

18. Can the issues with the status quo be overcome with insurers contractually requiring representatives to pass on all material relevant information? What are the benefits of a statutory obligation requiring representatives to pass on information?

We would have no objection to a contractual requirement, given the current remuneration models. We believe the issue is a lack of training, which is best remedied by the insurers.

19. Should consumer insureds be treated differently from commercial insureds in relation to these issues?

While we understand that consumers are more reliant on intermediaries, we do not believe it would be appropriate to make a distinction in these circumstances. This is because it is about the fundamental role of the intermediary; intermediaries often deal with a variety of insureds. We believe it could create unnecessary levels of complexity, cost and uncertainty.

20. What is your feedback on the options in relation to section 11 of the Insurance Law Reform Act 1977? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why? Are the options preferable to the status quo?

We prefer the status quo with s 11 of the ILRA. While we agree that some rewording to achieve clearer, more concise language would be appropriate, we believe the application of s 11 is not widely understood i.e. it deals with exclusions in circumstances likely to increase the risk of a loss covered by the policy, as opposed to a loss not covered by the policy at all.

In *Barnaby v South British Insurance Ltd* (1980) 1 ANZ Insurance Cases 60-401, the Court made the following observations:

> "*The key to this section is to be found in the last words of para. (b): the section is designed to deal with those kinds of exclusion clauses which provide for circumstances likely to increase the risk of a loss which the policy actually covers. The most common examples are found in the field of motor vehicle insurance, such as driving a motor vehicle whilst under the influence of alcohol, or driving a motor vehicle which is in an unsafe condition. The section is not designed to deal with exclusion clauses which specify the kind of loss or the quantum of loss to which the cover does not apply at all ... A 'fault, defect, error or omission in design' is not a circumstance the existence of which excludes liability on the part of the insurer for a loss otherwise covered, nor is it a circumstance likely to increase the risk of occurrence of a loss otherwise covered – it is a kind of loss which the policy does not cover at all*" (emphasis added).

Essentially, therefore, s 11 of the ILRA cannot be used to remedy those situations which fall outside the risk taken by the insurer and the cover provided under the policy for the consumer. In our experience, the provision is working as it should be and so we are not particularly in favour of either of the proposed options; the Law Commission's recommended reform effectively only applies to vehicles and the UK position in Option 2 is untested.

21. What is your feedback on the option to provide that Section 9 of the Insurance Law Reform Act 1977 does not apply to time limits under claims made policies? In particular: do you agree with the costs and benefits of the option? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that

should be considered? Is the option preferable as compared with the status quo?

The IFSO Scheme would rarely, if ever, deal with claims made policies. However, given the Law Commission's recommendation based on the legal effect of *Sinclair Horder O'Malley & Co v National Insurance Co of NZ Ltd* [1995] 2 NZLR 257, we support the amendment to s 9 of the ILRA.

22. If the option is adopted, should there be an extended period (e.g. 28 days) for notifying claims or potential claims after the end of a policy term?

Yes, we agree that would be fairer for an insured at the end of a policy period.

23. What is your feedback in relation to the option for section 9 of the Law Reform Act 1936? In particular: Do you agree with the costs and benefits of the option? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option (including the status quo) do you prefer and why?

The IFSO Scheme has no jurisdiction to consider the issues raised by s 9 about third parties' rights to claim directly against the insured person's insurer, but supports the Law Commission's recommendation.

24. If the option is adopted, should it apply to insolvency only? Should third parties be required to get leave of the court? Should reinsurance contracts be excluded from the application of the option?

The IFSO Scheme has no jurisdiction to consider the issues raised by s 9 about third parties' rights to claim directly against the insured person's insurer, but supports the Law Commission's recommendation.

25. What is your feedback to the options in relation to the duty of utmost good faith? In particular: do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? What option do you prefer and why?

In our 2018 submission, the IFSO Scheme proposed codification of the duty of utmost good faith, for certainty and accessibility. While the duty is often referred to in terms of the insured's duty of disclosure at inception and duty of honesty at claim time, there has been no clear guidance about an insurer's duty, until *Young v Tower Insurance Ltd* [2016] NZHC 2956; [2018] 2 NZLR 291. We believe that Option 2 is the most appropriate with flexibility for judicial interpretation, as opposed to the status quo set out in Option 1.

26. What is your feedback on the proposal to consolidate non-marine insurance statutes into a single statute?

The IFSO Scheme agrees that consolidation of the various insurance statutes is appropriate.

27. What is your feedback on our proposed approach in relation to the Marine Insurance Act 1908?

We have no comments to make.

28. Are the above provisions redundant? Why/why not? Are there other redundant provision in the legislation covered by this review?

We have no comments to make.

29. What is your feedback on the proposed option in relation to registration of assignments of life insurance policies?

We have no comments to make.

30. Should the maximum payment amounts for life insurance policies for minors be increased? Why or why not?

The IFSO Scheme believes it would be appropriate to have the maximum amounts increased to cover funeral costs.

I hope our comments are of assistance to the Review and encourage you to contact us if further case studies are required, or any clarification is needed of the submission made by the IFSO Scheme.

Yours sincerely

Karen Stevens
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