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Financial Markets Policy
Building Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
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By email: ***insurance review@mbie.govt.nz.***

Introduction

American Income Life Insurance Company (*AIL*) welcomes the opportunity to make submissions on the exposure draft Insurance Contracts Law Bill.

AIL is a life insurer selling mainly to communities, including lower income households and migrantworkers, which have traditionally not been well-served by other insurers in New Zealand.

AIL is one of the few life insurers that specifically services this market segment in New Zealand. It focuses mainly in selling level premium term life contracts, which remain affordable to policyholders as they age, avoiding the steep premium increases of yearly renewable plans typically offered by other insurers.

AIL operates a branch in New Zealand, with assets held in a dedicated Custodial Fund that ensures protection of its New Zealand policyholders. Its home office is registered in the State of Indiana, United States of America.

AIL responds to the questions raised in the Consultation Paper below:

Submission on *Exposure draft Insurance Contracts Bill*

Your name and organisation

Name	Joel Scarborough (Senior VO, Corporate, Legal & Compliance)
Organisation (if applicable)	American Income Life Insurance Company (*AIL*)
Contact details	Privacy of natural persons

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Responses to consultation paper questions

Part 1: preliminary provisions	
1	*Do you have any feedback on Part 1 of the Bill?*
	AIL agrees with the purpose of the Bill described in clause 3.
Part 2: disclosure duties and duty of utmost good faith	
2	*Do you have any feedback on the Bill's provisions in relation to the duty for consumers to take reasonable care not to make a misrepresentation, including the matters that may be taken into account to determine whether a consumer policyholder has taken reasonable care not to make a misrepresentation?*
	AIL is supportive of the new duty for consumers to take reasonable care not to make a misrepresentation. The new duty correctly reflects that insurers, not policyholders, are better placed to know what is material to their decision whether to enter into insurance contracts and on what terms. Accordingly, insurers should have the onus to ask comprehensive and sufficiently specific questions to elicit the information they consider to be material. However, at the same time, a reasonable balance must be struck. If the duty creates too much uncertainty or propensity for non-disclosure of clearly material information, insurers may reasonably be expected to ask policyholders an excessive number of questions out of caution, as well as increasingly reviewing medical records and other sensitive information. Should this occur, it would make the application process onerous, overly intrusive, time consuming and costly. It could result in increased numbers of applicants being declined insurance where insurers have any lingering doubts about the veracity of the answers they provide or where there are inadequate third party records to verify the answers provided. **Clause 14 should articulate what policyholders are expected to do in practical terms to comply with their duty.** Informing policyholders that they must take "reasonable care" not to make misrepresentations does not provide adequate guidance to policyholders as to how they are expected to comply with their duty and creates the risk that policyholders will bring their own value judgements to whether they are taking "reasonable care".

Further layers of obscuration exist in clause 14(2) specifying that whether reasonable care must be determined by with regard "to all the relevant circumstances", and by clause 15(1) specifying matters that "may be taken into account" as including things other than what the policyholder did or did not do in response to the questions asked.

This lack of clarity about what the duty means in practice could result in divergent interpretations of it by insurers, including in their disclosures of the "general nature and effect" of the policyholder's duty that are required under clause 55.

Accordingly, AIL submits that the clause 14(1) should be amended to specify some normative standards of behaviour that policyholders must meet to comply with the duty. These should include requiring that the policyholders:

(a) answer the insurer's questions honestly;

(b) have reasonable grounds to believe that their replies to the insurer's questions are accurate and complete;

(c) if they are unsure about what would be an accurate answer, to disclose their uncertainty, explain why they are uncertain and review any relevant materials they can reasonably access in the time available before answering, inform the insurer that they are unsure, or decline to answer the question;

(d) if they volunteer any information that was not asked for, they must act honestly and carefully;

(e) take reasonable steps to check the information previously provided if the insurer asks them to confirm the accuracy of that information; and

(f) take reasonable steps to let the insurer know if they do not understand the question being asked.

"Misrepresentation" should be defined to include the provision of incomplete information and non-responses in certain circumstances

AIL submits that additional certainty would be obtained by "misrepresentation" being defined in the Bill.

First, the "misrepresentation" definition should specify that the provision of incomplete information may constitute a misrepresentation. Without such clarification, there is the risk that some policyholders may consider that misrepresentation covers only affirmative misrepresentations and not the provision of misleadingly incomplete information. That misrepresentations may occur by omission has been recognised under the Fair Trading Act 1986 and under general contract law.

Secondly, while AIL agrees with the intent of clause 17 if that intent is that insurers should not treat an obviously unintended omission to respond to a question as a misrepresentation that there is nothing relevant to disclose, and that an obviously incomplete answer should not be interpreted as indicating the answer is complete. However, there is a risk that clause 17 could be interpreted that all omissions are not misrepresentations, even deliberate or reckless ones. The Consultation Paper gives the impression that omissions cannot be misrepresentations on page 7 where the Paper states that a misrepresentation is "effectively to not [sic] answer any questions asked by the insurer truthfully and accurately". There is no mention of the need for completeness in responses, that the omission to respond must be obviously not an answer from the context, or that policyholders can not deliberately or recklessly omit to disclose known relevant facts by not responding to questions. AIL acknowledges that the use of "merely because" potentially preserves the ability for deliberately or recklessly not responding to questions to avoid disadvantageous consequences, could be interpreted as a misrepresentation, but it would be helpful if clause 17 is amended so it is clear that a failure that is not obvious to provide complete responses, or to disclose facts which a reasonable person would know are relevant to a reasonable insurer, would be a misrepresentation.

AIL submits also that the Bill should have a clause equivalent to section 2(3) of the Consumer Insurance (Disclosure and Representations) Act 2012. Section 2(3) provides that:

"A failure by the consumer to comply with the insurer's request to confirm or amend particulars previously given is capable of being a misrepresentation for the purposes of this Act (whether or not it could be apart from this subsection)."

In its *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* report that led to the enactment of the UK Act, the UK Law Commission considered that such a provision would apply where (at [5.52]):

"… an insurer writes to a consumer on renewal with a statement of the information it holds about the consumer, asking if anything had changed. It would also apply where the insurer takes information from the consumer over the phone, and then sends the consumer a statement of fact, asking the consumer to contact them if the statement is incorrect.

The UK Law Commission stated further:

"5.53 This provision simply states that a failure to respond to the request to amend particulars may amount to a misrepresentation. It will then be a question of fact, in all the circumstances of the case, whether the consumer's failure to respond is or is not reasonable. A failure to respond may be considered reasonable, for example, if the letter is confused or unclear, or if the insurer has failed to provide an adequate means of response."

It is possible that the words "merely because" in clause 17 are intended to cover the non-response cases described by the UK Law Commission. However, because it is reasonably foreseeable that these cases will arise, it would be desirable for the Bill to specifically address them – and to do so consistently with the UK legislation.

Clause 14 should more closely follow section 3 of the Consumer Insurance (Disclosure and Representations) Act 2012 (UK)

Section 3(3) of the UK Act provides that the standard of care required is that of a reasonable consumer, but this is subject to:

(a) if the insurer was, or ought to have been, aware of any particular characteristics or circumstances of the actual consumer, those are to be taken into account (section 3(4)); and

(b) a misrepresentation made dishonestly is always to be taken as showing lack of reasonable care (section 3(5)).

There is no direct equivalent of section 3(3) in the Bill. The equivalent of section 3(4) is clause 16 of the Bill; the equivalent of section 3(5) is clause 18 of the Bill.

AIL submits that the insertion of an equivalent to section 3(3) would provide additional certainty on how compliance with the duty is to be determined – ie, that it is determined objectively unless clause 16 or clause 18 applies.

It would enhance the Bill's readability if clauses 16 and 18 were contained in clause 14 and followed the section 3(3) equivalent (like they do in the UK Act).

Clause 16 should provide greater clarity as to the meaning of "ought reasonably to have been aware"

Clause 16 provides that any particular characteristics or circumstances of the policyholder of which the insurer was aware, or ought reasonably to have been aware, must be had regard to in determining whether a policyholder has taken reasonable care not to make a misrepresentation.

AIL is broadly supportive of this because it recognises the potential impact of customer vulnerability. However, AIL submits that clause 16 should be amended to qualify the words "ought reasonably to have been aware" by inserting the following "when the information was provided by the policyholder".

As noted by the UK Law Commission with respect to the equivalent provision in the UK legislation (at [5.80]):

"The ABI has queried how the phrase "ought to have been aware" would be interpreted. We intend it to focus in a practical way on the understanding of the relevant staff at the time the reply is received. We do not intend that the insurer should be deemed to know information held by other departments, which is not available to the staff at the time. For example, the ABI asked about the situation where a customer applies for house insurance with a poor knowledge of English and is helped through the process, and then later applies for car insurance with the same insurer over the internet. We accept that internet sales are an automatic process. We do not think that there should be any obligation on an insurer to check previous records in these circumstances"

Subparts 1 and 3 of Part 2 should be clearer on the treatment of joint policies

AIL provides joint life insurance policies for partners and spouses. During the application process for these policies, both policyholders are required to provide information.

AIL submits that the Bill should be clearer on how subparts 1 and 3 of Part 2 apply to joint policies where one policyholder breaches their subpart 1 duty but the other does not.

One reading of the Bill is that each joint policyholder would themselves be regarded as a "policyholder" and, accordingly, the insurer would have a remedy against the policyholder who makes a qualifying misrepresentation, but would not have a remedy against the other policyholder.

However, in its *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation*, the UK Law Commission stated (at [6.52] – [6.53]) that:

(a) where one policyholder made a deliberate misrepresentation but the other policyholder acts honestly and reasonably, if it is a joint policy (as opposed to a composite policy), the UK law approach that the insurer may refuse all claims under the policy should be retained; and

(b) in the case of joint lives policies, because the premiums may have been paid over many years, if the other policyholder had contributed to the premiums and had not colluded in the dishonesty, it would be fair to repay (at least to the extent of his or her own contribution) the premiums to that policyholder, but the UK Law Commission did not recommend that this approach be required by law.

AIL agrees with the UK Commission's view – insurers should be able to cancel joint life policies where only one policyholder makes a deliberate or reckless qualifying misrepresentation.

Group insurance

AIL provides group insurance through unions, employers and other organisations. Subject to the changes suggested above being made to the Bill, AIL agrees with the Bill's provisions to applying the subpart 1 duty to group insurance.

3

Do you have any feedback on the Bill's provisions in relation to remedies for breach of the consumer duty?

AIL does not expect that proposed move to a proportionate approach to remedies would have a material impact on its New Zealand business.

All AIL's insurance products have a two year non-contestability period in their master policies, which means that AIL will not seek to avoid those insurance policies where a misrepresentation is discovered later than two years after the policy is taken out, provided the misrepresentation is not fraudulent.

Where the misrepresentation is discovered before two years has elapsed, AIL's practice is to seek to preserve that policy as much as possible by varying the policy terms or, where this is not possible, cancelling the policy and returning premiums paid.

AIL supports the approach in clause 29(1) of placing the onus on insurers to prove that the misrepresentation was deliberate or reckless (as defined in clause 28), and providing insurers with the benefit of the rebuttable presumptions in clause 29(2). The same approach is taken in the UK and Australian legislation, and should ensure that the burden on insurers is not unduly onerous or require an exceptionally high standard of proof.

Bill should adopt the UK approach of permitting proportionate claims reductions for qualifying misrepresentations

AIL submits that the Schedule 2 should adopt the UK approach of permitting insurers to proportionately reduce the claims paid where there is a qualifying misrepresentation that is neither deliberate nor reckless.

With respect to the Bill's proposed approach of permitting insurers to reduce the claim amount by the difference in the premium that would have been charged, the Consultation Paper states that this approach "more equitably puts the parties back in the position they would have been absent the misrepresentation", but does not explain how this view was reached.

This view appears to be based on the assumption that the insurers would be adequately compensated by being able to recoup the premiums they would have been able to charge.

However, this assumption is not correct because it does not reflect the time value of the additional premiums to insurers if those premiums had been received at the time the contract was entered into or the variation agreed. That loss of the time value of the premiums can be considerable where the insurance contract was entered into, or the variation agreed, some decades earlier. In addition, insurers will incur administration costs as a result of dealing with the policyholders' qualifying misrepresentations or breaches. However, more importantly, the insurer would not be compensated for the higher level of cover provided for all policies where claims are not made which have qualifying misrepresentations that is neither deliberate nor reckless.

A failure to adequately compensate insurers for the loss of the time value of the premiums is not equitable. Nor is it equitable from the perspective of the insurer's other policyholders. Only permitting the insurers to deduct the difference in premiums that would have been paid means that the policyholder who has made a qualifying misrepresentation obtains the same level of cover that the other policyholders are entitled, but without incurring the same opportunity costs that those policyholders incurred in paying the premiums from the time that the insurance contract was entered into or the variation agreed.

Such a result does not properly incentivise policyholders to comply with the applicable disclosure duty. Nor is the Bill's approach consistent with the UK Law Commission's view that insurers should be given a "compensatory remedy" where there are qualifying misrepresentations – ie, that insurers should be put into the position that they would have been had the qualifying misrepresentation not happened.

In its *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation*, the UK Law Commission stated:

"6.72 Although compensatory remedies are now a recognised part of consumer insurance practice, misunderstandings about them persist. They are not simply doing whatever is fair and reasonable in the circumstances. As we explore below, they look at the loss to the insurer, not at the degree of fault shown by the consumer. Nor do compensatory remedies consider whether there is a causal connection between the misrepresentation and the claim. And in some cases it is necessary to explore a chain of questions, asking what the results of a test might have been and how the insurer would have reacted to them.

…

	6.74 The aim of a compensatory remedy is to put the insurer in the position in which it would have been had the consumer fulfilled his or her duty. It does not relate to the degree of carelessness. In some cases a minor degree of fault may lead to a relatively large change in the contract. In personal injury claims it is generally understood that, where a driver's moment of minor inadvertence leads to a large loss, the size of the claim should reflect the loss, not the fault. The same principle applies here." Schedule 2's purpose is to ensure that insurers do not disproportionately respond to qualifying misrepresentations, but that purpose does not require that policyholders are put back in the position that they would have been if they had not made the misrepresentation. Questions of what is an equitable remedy must take adequate account of the perspectives of the insurers and the insurers' other policyholders, that the policyholder has breached their duty in making the qualifying misrepresentation, and that the policyholder has already received statutory relief in the form of the insurer being prevented from cancelling the insurance contract and retaining the premiums. Accordingly, AIL submits that the UK approach of permitting insurers to proportionately reduce claims is to be preferred. Alternatively, at the very least, the premium amount deducted from the claims amount should include an interest element to ensure adequate compensation for the insurers and equitable treatment for those policyholders who complied with their duties, but this would be inadequate to address the fact that the insured would receive cover it never paid for. **Schedule 2 should adopt the UK approach to variation remedies** AIL submits that Schedule 2 should reproduce the UK approach with respect to remedies where the qualifying misrepresentation occurs before a variation is agreed. The UK legislation simply provides that: (a) If the subject-matter of a variation can reasonably be treated separately from the subject-matter of the rest of the contract, the provisions relating to remedies Part 1 of this Schedule applies (with any necessary modifications) in relation to the variation as it applies in relation to a contract. (b) Otherwise, Part 1 applies (with any necessary modifications) as if the qualifying misrepresentation had been made in relation to the whole contract (for this purpose treated as including the variation) rather than merely in relation to the variation. It is not apparent why Schedule 2 adopts a different approach by providing separate remedy provisions for variations. In doing so, Schedule 2 is unnecessarily and substantially lengthened and the Consultation Paper does not identify the benefits that are derived from this approach. AIL submits that the UK approach is to be preferred for its conciseness and simplicity.
4	*Do you have any feedback on the Bill's provisions on remedies for breach of the consumer duty in relation to life insurance policies where the misrepresentation was not fraudulent and more than three years ago?*
	AIL has no feedback on this provisions. As noted in the response to question 3 above, AIL has a two year contestability period (except in cases of fraud) across its main insurance policies, so the retention or otherwise of these restrictions would have no material impact for AIL.
5	*Do you have any feedback on the Bill's provisions in relation to the disclosure duty for non-consumers?*
	AIL has no feedback on the Bill's provisions relating to non-consumer insurance contracts, because it provides only consumer insurance contracts.

6	*Do you have any feedback on the Bill's provisions in relation to remedies for breach of the non-consumer duty?*
	AIL has no feedback on the Bill's provisions relating to non-consumer insurance contracts, because it provides only consumer insurance contracts.
7	*Do you have any feedback on the provisions in relation to the insurer's duties to inform policyholders of the disclosure duties, and insurer access to third party information, including how the duties apply for variations of insurance contracts?*
	As noted above in the response to Q 2 above, the Bill should be amended to specify what policyholders are required to do in practice to comply with the subpart 1 duty. Having clarity on this matter would assist insurers in providing consistent and meaningful disclosures to policyholders as to the "general nature and effect" of the policyholders' duty under subpart 1. However, if the Bill is not be amended as suggested, regulations should prescribe the content of the duty disclosure and that disclosure should specify what policyholders are required to do in practice to meet their duty. Not only would this ensure that policyholders have sufficient guidance, but also provide desirable clarity to insurers as to what they need to disclose to avoid the non-disclosure consequences specified in clause 58. Because insurers are likely to rely on brokers to provide policyholders with the required disclosures (as brokers would often be the point of first contact), the duty could be amended so it is to take 'all reasonable steps' to inform policyholders of their disclosure duties and that the insurer may access and take into account to accessed information (and on what terms). It would also be helpful if the Bill expressly states that insurers can arrange for specified intermediaries to make disclosures on the insurer's behalf, even if the specified intermediary is not an agent for the insurer. AIL submits that clause 57 needs to be drafted so that it applies only to consumer insurance contracts as Cabinet agreed. The Cabinet Minute Paper states: *"agreed that if an insurer seeks permission to access medical or other third party records about a consumer, the insurer must inform consumers of the types of third party information they are likely to access and when this is likely to happen"* As currently drafted, clause 57 appears to apply to both consumer and non-consumer insurance contracts.
8	*Do you have any feedback on the consequences in the Bill if an insurer breaches duties to inform policyholders of the disclosure duties, and insurer access to third party information?*
	No.
9	*Do you have any feedback on how the Bill codifies the duty of utmost good faith?*
	AIL submits that clause 59 should be amended as follows: *"A contract of insurance is a contract based on the utmost good faith <u>and, in every contract of insurance, there is an implied term requiring each party to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith."</u>* Similar words are contained in section 13(1) of the Insurance Contracts Act 1984 (Cth) and are desirable to specify the practical consequence of clause 59 recognising the utmost good faith duty. AIL does not support the inclusion of a penalty provision for insurers who breach the duty of utmost good faith, as is provided in the Australian legislation. Any remedies for the breach of this duty should be developed by the courts.

10	*Do you have any feedback on the Bill's provisions relating to information provided by a policyholder to a specified intermediary?*
	AIL submits that intermediaries' obligations as to what information they must pass on to the insurer should be governed by the terms of any agreement they have with the insurers. What information insurers require intermediaries to pass on to them will depend on the insurers' risk assessment. Insurers may have more confidence in some intermediaries making decisions about what representations are material or not than compared to other intermediaries. Insurers may want intermediaries to pass on misrepresentations, because they may regard them as relevant or material – for example, as to the extent to which they should verify the information provided by the policyholder, or the insurer's assessment of the policyholder's veracity and whether it wishes to insure the policyholder. If insurers cannot obtain from the intermediaries the contractual obligations to pass on information that they consider required to protect their interests, insurers should have the choice not to engage these intermediaries or permit their products to be distributed through them. Accordingly, clause 63 should be amended to provide that it is subject to contrary terms contained in any agreement between the specified intermediary and the relevant insurer. It is also unnecessary and unusual to have statutory penalties for breaches on the intermediaries' duty to pass on material information to insurers. Such matters can be dealt with adequately through remedies for breach of contractual obligations.
11	*Do you have any other feedback on the drafting of Part 2 of the Bill?*
	No.
Part 3: terms of insurance contracts	
12	*For claims-made policies, do you consider that 60 days after the end of the policy term is an appropriate period for allowing the policyholder to notify relevant claims or circumstances that might give rise to a claim?*
	AIL does not have any feedback on this proposal, as it does not offer claims-made liability insurance policies.
13	*Do you consider that insurers should be required to notify policyholders in writing no later than 14 days after the end of the policy term of the effect of failing to notify a claim or circumstances that might give rise to a claim before the end of the 60 day period?*
	AIL does not have any feedback on this proposal, as it does not offer claims-made liability insurance policies.
14	*Do you have any other comments on clause 69 of the Bill (Time limits for making claims under claims-made liability policies)?*
	AIL does not have any feedback on this proposal, as it does not offer claims-made liability insurance policies.
15	*Do you have any feedback on the exclusions listed in clause 71(3), which are not subject to the rule for increased risk exclusions in clause 71(1)?*
	AIL has no feedback on the exclusions, as they do not appear relevant to life policies.

16	*Do you have any other feedback on Subpart 4 of Part 3 of the Bill (Third party claims for liability insurance money)?*
	AIL does not have any feedback on this matter as it does not provide liability insurance.
17	*Do you have any feedback on Schedule 3 of the Bill (Information and disclosure for third party claimants)?*
	AIL does not have any feedback on this matter, as it does not provide liability insurance.
18	*Do you have any comments on not carrying over section 10(1) of the ILRA 1977?*
	AIL agrees that there is no need to carry over section 10(1). Section 10(1) appears to merely state the effect of a relevant person being contractually engaged to act on the insurer's behalf during negotiations for insurance (which is implicit in the proposed "specified intermediary" definition) and its drafting is confusing and prolix.
19	*Do you have any other feedback on the drafting in Part 3 of the Bill?*
	No.
Part 4: payment of monies to insurance intermediaries	
20	*Do you consider that changes should be made to requirements for how insurance brokers must hold premium money such as restrictions on brokers' ability to invest or more stringent requirements in line with the client money and property rules in the FMC Act?*
	AIL has no comments to make on Part 4, because AIL does not receive premiums on its insurance products through brokers.
21	*Do you have any feedback on the proposed penalties for non-compliance with Part 4 of the Bill?*
	AIL submits that brokers should not be penalised for non-compliance with Part 4.
22	*Is it necessary to retain clause 102 (broker to notify insurer within 7 days if a premium has not been received by the broker), and if so, what should be the consequence for breach of clause 102?*
	No
23	*Do you have any other feedback on Part 4 of the Bill?*
	AIL has no other comments to make on Part 4, because AIL does not receive premiums on its insurance products through brokers.
Part 5: contracts of life insurance	
24	*If you consider that change needs to be made regarding interest payable from 91st day after date of death, please provide any further reasons and provide feedback on whether interest should only begin accruing after 90 days if the insurer has been notified of the death claim and (where relevant) letters of administration or probate have been obtained.*
	AIL submits that life insurers should not be required to pay interest from the 91st day after the date of death where there are reasonable grounds for the insurer not paying the claim by the

	90th day after the date of death, including delays in providing the insurer with reasonable evidence of the claim being made, including letters of administration or probate. While incentivising life insurers to process death claims expediently is a relevant policy consideration, so too is the need for insurers to ensure that they pay only valid claims and that the payments are made to persons entitled to receive them. Accordingly, the Bill should provide that, for the purposes of calculating when the 90 day period ends, the period should run from the date the insurer is notified of the death and exclude the period after the insurer gives notice of the information that the insurer reasonably requires to determine the claimant's right to receive the sum insured and ending on the day all the requested information is provided. This approach would achieve a better balance between the competing policy considerations. The interest rate should also should be set a commercial call deposit rate which the insurer can earn on the amount due after tax.
25	*Do you have any feedback on the proposal that any mortgaging of life insurance policies under new policies be dealt with under the Personal Property and Securities Act 2009?*
	AIL has no comments on this matter, because its policies cannot be mortgaged.
26	*Do you have any feedback on the Bill's requirements relating to assignments and registrations generally?*
	The Bill should deal with the situation where a joint policy owner refuses to sign the transfer, particularly in matrimonial separations. Registers of assigned life insurance policies (clause 126) are no longer necessary now that paper based systems have been replaced with electronic systems.
27	*Are section 75A of the LIA (relating to a policy entered into by a person for the benefit of the person's spouse, partner or children) or section 2(1) of the Life Insurance Amendment Act 1920 (relating to the reversion or vesting of life policy assigned to a spouse or partner) still necessary?*
	AIL has not needed to rely on section 75A. When applying for AIL insurance, applicants are asked to name the beneficiaries. The policy documentation issued records these beneficiaries. Insureds are able to change the beneficiaries subsequently and the policy documentation is amended accordingly and AIL pays the claims amounts to the specified beneficiaries. AIL has no comment on whether section 2(1) is still necessary.
28	*Do you have any other feedback on Part 5 of the Bill?*
	AIL submits that there should be no limit on benefits paid on the death of a minor (clause clause 146 of the Bill).
Part 6: regulation making powers and miscellaneous provisions	
29	*Do you have any feedback on Part 6 of the Bill?*
	No.
Part 7: unfair contract terms and presentation of consumer policies	

30	*Do you see any unintended consequences from removing sections 18-20, 34-39 and 42 from the MIA?*
	AIL has no comments.
31	*In relation to unfair contract terms: which option do you prefer and why?*

Option B preferred

AIL prefers Option B, subject to the amendments suggested below.

Option A is too narrow in specifying that a term of a contract of insurance defines the main subject matter of the contract "only to the extent that the term describes what is being insured".

The subject matter of an insurance contract is not just "what" is insured – it is the transfer of risk from the policyholder to the insurer in return for the policyholder paying the premiums. Accordingly, the main subject matter of an insurance contract must include **all** terms that define the risk that is (or is not) transferred and, as such, includes the terms that:

(a) identify the individual or property covered by the insurance contract;

(b) specify the scope of the risks covered, including the main insuring clause, the policy definitions, coverage extensions, and any exclusions or limitations; and

(c) specify the nature and extent of the insurer's liability, including any no-claims or stand-down periods, excess, instalment payments, loadings, discounts, premium adjustments for changes in cover, and in-built fees and charges.

This is recognised by the European Council in its *Unfair Terms in Consumer Contracts Directive* (93/12/EEC), which states in the preamble:

"Whereas, for the purposes of this Directive, assessment of unfair character shall not be made of terms which describe the main subject matter of the contract nor the quality/price ratio of the goods or services supplied; ... whereas it follows, inter alia, that in insurance contracts, the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;"

In AIL's view, if Option A was adopted, it would create undesirable uncertainty because it increases the risks to insurers that they cannot rely on the terms contained in the insurance contracts. Premiums are priced on the basis of the terms of the insurance contract. If any of those terms are subsequently deemed to be unfair, this may mean that the premiums are no longer sufficient or appropriate. Accordingly, insurers may cease to offer cover or increase premiums to cover the risk that they may not be entitled to reply on the terms of cover.

The uncertainty for insurers will have implications for their reinsurance arrangements. New Zealand insurers are reliant on overseas reinsurers to provide the reinsurance required to provide insurance products to New Zealand consumers. Reinsurance treaties normally require insurers to obtain the reinsurers' prior approval to the terms of their policies and, in some cases, the reinsurers are not obligated to meet claims where the insurer provides insurance on terms that have not been previously approved by the reinsurers.

Any uncertainty as to whether insurers can rely on the terms of their insurance contracts decreases the commercial appeal of New Zealand to reinsurers. Reinsurers' willingness to provide reinsurance is mobile and sensitive to risk and return. Reinsurers already have some hesitance with respect to covering New Zealand risks, because New Zealand has been rated as the second-riskiest country (after Bangladesh) for expected losses from natural catastrophes by Lloyd's (*A world at risk, Closing the insurance gap*).

Further, any resulting premium increases and/or reduction in cover would exacerbate New Zealand's considerable underinsurance. A 2014 Massey University study (M.J Naylor, C.

Matthews and S. Birks, *The Extent of Underinsurance: New Zealand evidence,* October 2014) concluded that over half of New Zealanders have inadequate life insurance, with certain ethnicities having significantly greater levels of underinsurance, and the majority of families would suffer a 40% income drop due to underinsurance if the primary earner died, and there is likely to be an even large impact if either parent suffers permanent disability or medium term illness.

Finally, the proposed COFI regime makes it unnecessary to extend the unfair contract terms provisions to insurance contracts to the extent proposed by Option A.

COFI will require insurers to comply with the fair conduct principle, which includes paying due regard to consumers' interests and ensuring that the relevant services and associated products that the financial institution provides are likely to meet the requirements and objectives of likely consumers. The obligation to comply with the fair conduct principle applies at all stages of the product lifecycle, including when the relevant service or associated product is designed, offered and provided, and in any dealings or interactions with consumers in connection with the relevant service or associated product (including claims handling).

Accordingly, COFI will provide an avenue through which the FMA can address, and take appropriate action against, unfair terms in insurance contracts and to do so without undertaking litigation. That would permit a more nuanced approach to addressing fairness concerns than is possible through seeking a court declaration.

Accordingly, AIL prefers Option B on the basis that it better covers the subject matter of an insurance contract compared to Option A (but as noted below, AIL submits amendments should be made to improve Option B). AIL considers that Option B better ensures that policyholders can challenge terms that unfairly prevent them from receiving the cover they thought they had purchased, while giving insurers sufficient certainty that the commercial and actuarial basis on their insurance contracts will not be undermined.

Nevertheless, amendments are required to improve Option B, which are set out below.

Amendments to clarify scope of the "upfront price" to insurance contracts

AIL submits it would be desirable for section 46K to be further amended to specify that "upfront price payable under the contract" (section 46K(1)(b)) for contracts of insurance includes:

(a) premiums;

(b) premium adjustments for changes in cover or increased risk;

(c) instalment payments;

(d) discounts and loadings;

(e) excess;

(f) no-claim and stand-down periods; and

(g) other built-in costs (eg, cancellation fees),

provided that these are set out in a term that transparent as required by section 46K(2).

So too no-claim or stand-down periods should not be within the scope of the unfair contract terms provisions.

If the amount of the excess, or the length of the no-claims or stand-down period, were within the scope of the unfair contract terms provisions, this could result in insurers ceasing to provide these options to policyholders so as to reduce the risk of them being challenged. This would be expected to make insurance less affordable for some policyholders, thereby exacerbating New Zealanders' underinsurance noted above.

32	*Do you have any feedback on the drafting of either of the options?*
	Yes, see the amendments specified in the response to Q.31.
33	*Do you have any comments on the obligation that consumer insurance contracts be worded and presented in a clear, concise and effective manner?*
	AIL submits that the proposed section 447A should be removed. AIL agrees generally that it is desirable that insurance contracts are worded and presented in a clear, concise and effective manner, however that expression lacks the certainty required to be adopted in law. As part of its Conduct and Culture Review Action Plan, AIL has re-drafted its policy documentation to improve their wording and presentation so that they more appropriate and readable for New Zealand audiences. AIL prepared summaries of the policies, which are provided to policyholders to assist them to understand their policies – these have been translated into the main non-English languages of AIL's New Zealand policyholders. However, AIL does not think that an obligation to ensure that contracts are worded and presented in a "clear, concise and effective manner" would be good law. Two of Lord Bingham's eight Rule of Law principles are that: (a) the law must be accessible and so far as possible intelligible, clear and predictable; and (b) questions of legal right and liability should ordinarily be resolved by application of the law and not the exercise of discretion. The proposed section 447A is not consistent with these two principles. The "clear, concise and effective manner" criterion is impractical and can be internally inconsistent. Clarity may conflict with conciseness. Effectiveness and conciseness may require the use of technical terms, particularly when medical terms are used, which for some affects clarity. Whether contracts are worded and presented in a "clear, concise and effective manner" is a judgement call that must take account of a wide range of factors, such as: (a) the subject matter, including the relevant exclusions, limitations or conditions that must be described; (b) the medium in which policyholders access the contracts; (c) the sales channel, including the circumstances in which policyholders are provided with the policy documentation; (d) the assumptions that can reasonably be made about their target market's reading and comprehension levels ; and (e) what assistance policyholders have available if to explain the contracts and to answer any questions they may have. Because it is a judgement call, reasonable minds can reach different conclusions on the same set of facts. Accordingly, insurers would not have sufficient certainty as to what the proposed section 447A requires them to do. The proposed section 447A creates the risk that the FMA may seek to substitute its judgement call for the judgement call that the insurers were reasonably entitled to make. The wording and presentation of insurance documentation is a complex exercise that requires insurers to navigate between competing considerations – on one hand, avoiding unnecessary complexity and, on the other, ensuring that the contract comprehensively defines the risk that

the insurers have assumed (or not assumed) having regard to the wide range of factual permutations that can be expected to be encountered.

Drafting/amending insurance contracts is a time-consuming and iterative process involving input from legal counsel, actuarial staff, and customer facing staff (including financial advice providers and financial advisers). Even comparatively minor changes to contractual wording must be subject to actuarial review to ensure that they do not materially affect the risk the insurer has assumed and the appropriateness of the premiums – this may require actuarial staff to carry out premium modelling.

Finally, AIL submits that the proposed section 447A is unnecessary.

New Zealand insurers have made considerable efforts to ensure that their policy documentation is clear and accessible as possible to customers. This development reflects market demand and, more recently, the FMA and RBNZ's Conduct and Culture review expectations.

New Zealand customers expect policy documentation and collateral that they can easily understand, and their decision as to which insurer they will select can be expected to be influenced by their assessment of whether the policy documentation and collateral is clear and accessible. Accordingly, insurers already have sufficient incentive to ensure that their contracts are worded and presented in a clear, concise and effective manner.

Finally, since 15 March 2021, insurance contracts have been regarded as financial advice products under the FMCA. For insurance products (such as AIL's) that are distributed through financial advice providers, customers will receive financial advice on the products. This financial advice will assist to ensure that customers understand their policies and, in particular, provide them with an opportunity to seek clarification about any aspects of their policy documentation that they do not understand.

In light of the above, there does not appear to be a compelling policy need for the proposed section 447A that outweighs the concerns about it not being good law noted above.

34 *Do you have any comments on the regulation-making powers in clause 184?*

It is difficult to meaningfully comment on this matter without a clearer understanding of what regulations are proposed.

As part of its consultations on the Bill, MBIE should release a paper setting out the options for the proposed regulations and ask for submissions.

Any regulations need to ensure that the value to policyholders of the information required to be disclosed or made publicly available demonstrably justifies the increased costs that insurers would incur in meeting the disclosure/publication obligations.

35 *Do you think regulations specifying form and presentation requirements for consumer, life and health insurance contracts (eg a statement on the front page that refers to where policy exclusions can be found) would be helpful? If so, please explain.*

As noted in the response to Q.34, it is difficult to meaningfully comment on this matter without a clearer understanding of what regulations are proposed.

As part of its consultations on the Bill, MBIE should release a paper setting out the options for the proposed regulations and ask for submissions.

For the same reasons specified in the response to Q.33, AIL does not consider that any such regulations are required.

AIL is concerned at the prospect that regulations may result in insurers having to needlessly revise the work they have already undertaken to improve the wording and presentation of their policy documentation and collateral. That would be a waste of the significant resources that insurers have invested into this work.

Further, any such regulations should avoid adopting a "one-size fits all" approach. Insurers should have sufficient flexibility to word and present their policy documentation and collateral in a manner that reflects their judgement as to the best balance between protecting their interests in adequately defining the risks they have and have not assumed, and meeting the needs of their policyholders (these needs may be different depending on the insurer's target market).

36

Do you think regulations specifying publication requirements for insurers would help consumers to make decisions about insurance products? If so, please explain.

As noted in the response to Q.34, it is difficult to meaningfully comment on this matter without a clearer understanding of what regulations are proposed.

As part of its consultations on the Bill, MBIE should release a paper setting out the options for the proposed regulations and ask for submissions.

AIL has concerns about the proposed section 447C example stating that the regulations may require an insurer to disclose information about "claim acceptance rates, the length of time to settle claims, contract cancellations, complaints made against the insurer, and disputes the insurer is or has been involved in."

This type of information is dynamic so would need to be updated on a regular basis and that would have operational and cost implications for insurers.

Further, it is not apparent that this information would necessarily assist consumers. Providing consumers with total or average numbers or percentages over a given period with respect to each of these types of information does not enable them to reliably assess the significance of that information. Without relevant contextual information being provided, or benchmarking against comparable insurers, there is the risk that consumers may draw simplistic and inaccurate conclusions about the insurer, its reliability and performance.

For example:

(a) With respect to claim acceptance rates, consumers would need to know the reasons for any claims declinations to assess the significance of the rates. Higher decline rates over a period may be attributable to the declined policyholders failing to provide sufficient evidence to establish their claim, or seeking to claim for matters that are not covered, or increased fraudulent activity, rather than being indicative of the insurer being unwilling to pay claims or problems in how the insurance policies are designed.

(b) The significance of the number or percentage of policy cancellations can be reliably assessed only if information is provided about the cancellation reasons. An insurer may have a higher rate of policy cancellations as a result of its competitors recruiting its distributors and specifically targeting its policyholders, rather than because cancelling policyholders found their policies, or the insurer's service, unsatisfactory. Even where the policyholder cancels because they considered that the policies were unsatisfactory, this may be attributable to their changed needs or priorities rather than to some inherent problem with the policies.

(c) To assess the significance of complaint/dispute numbers, policyholders would need to know the insurer's total number of policies and policyholders, the complaint/dispute reasons and the outcomes. Insurers should not need to include complaints/disputes that were found to lack substance or where the complainant was at fault. The inclusion of such complaints/disputes in the published numbers could give a misleading impression.

AIL submits that requiring insurers to provide relevant contextual material to better ensure that consumers can assess the significance of the numbers or percentages would significantly increase insurers' compliance costs. Because this will invariably increase the amount of

information provided, there is the risk that consumers may not take account of the information if they consider it too complex or lengthy to understand.

Further, cancellation information can be commercially sensitive and insurers may not have reliable information because policyholders may not wish to disclose why they cancelled, and privacy and confidentiality restraints would limit how much detail insurers can disclose about complaints and disputes.

Finally, requiring insurers to provide complaints information may create an incentive on insurers to interpret "complaint" narrowly, and not include informal expressions of dissatisfaction, so as to avoid needing to publicly disclose these.

Timing and transitional arrangements

37 *Do you have any initial feedback on when the Bill's provisions should come into effect?*

The Bill's commencement needs to take adequate account of the fact that insurers and their intermediaries have had to undertake major changes as a result of the new financial advice regime coming into force. Those changes are continuing with the transition to full licencing and will continue for some period after as they refine their policies, processes, systems and controls.

Further major changes will occur when the proposed COFI regime is enacted and comes into force, and many insurers and intermediaries are already taking steps to ensure compliance with COFI when it comes into force.

When the Bill is enacted, insurers and insurers will need to review their operations and design and implement action plans to ensure they comply with the Bill's new requirements. That will take time and resources, and the impact of "change fatigue" should not be underestimated.

Accordingly, the Bill should commence after sufficient time has elapsed for insurers to embed the changes resulting from the new financial advice regime and the COFI regime. Only then will insurers and intermediaries be in a position to identify and implement the changes necessary to comply with the Bill in the context of their by then substantially changed operations and compliance frameworks.

Commencement should be staggered so that insurers have more time to implement the more far-reaching changes that will be enacted by the Bill.

For insurers that provide consumer insurance, these changes include the new subpart 1 duty and the unfair contract terms amendments. These will require insurers to review their policy documentation and collateral and, if changes are required:

(a) undertake actuarial reviews (including modelling of premiums);

(b) decide whether consequential changes to premiums or cover are necessary (including withdrawing products);

(c) amending and reissuing policy documentation and collateral;

(d) communicate the changes to policyholders and intermediaries;

(e) make required changes to systems programming; and

(f) provide additional training to staff and intermediaries.

38 *Do you have any feedback on the transitional provisions in Schedules 1 or 4, or other proposed transitional arrangements?*

No.

Do you have any feedback on Schedule 5 of the Bill?

No.

Other comments

None.

Respectfully yours,

AMERICAN INCOME LIFE INSURANCE COMPANY

Privacy of natural persons

Joel Scarborough
Divisional Senior Vice President, General Counsel and Secretary