

Submission on *Exposure draft Insurance Contracts Bill*

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Submission on the Exposure draft Insurance Contracts Bill

MAY 2022

JESSICA DOWNWARD

I Introduction

1. I support the enactment and policy decisions of the Insurance Contracts Bill (the Bill). Insurance law has been long overdue for a makeover.¹ It was developed in a very different time and has become scattered across a multitude of Acts.² The Insurance Contracts Bill consolidates, modernises, and remedies several concerns with the current law. The areas of the exposure draft I would like to comment on are the changes to the insured's duties of disclosure and the remedies for breach of this duty.

II Consumer vs non-consumer insurance contracts

2. *I support the intent of cl 10, 11 which define consumer insurance contracts and non-consumer insurance contracts.*
 - 2.1. Defining these distinct categories of policyholders reflects the bargaining power of the relative parties and recognises that consumers are in a relatively uninformed and under-resourced position compared to businesses.³ Therefore, it should follow that consumer policyholders should not be held to as high a standard when it comes to their disclosure duty.
 - 2.2. The previous duty of disclosure was developed at a very different time. Where the insurer was vulnerable to the insured's honesty and the disclosure of facts was crucial to their operations.⁴ Insurers now have access to massive amounts of information on the internet and have developed sophisticated methods of assessing risk.
 - 2.3. Classification of the contract will be key as it determines the policyholder's rights and obligations.

¹ Law Commission *Some Insurance Law Problems* (NZLC R46, 1998); Ministry of Business, Innovation and Employment *Review of Contract Law: Issues Paper*, (May 2018).

² The Insurance Intermediaries Act 1994 (1994 No 41); The Insurance Law Reform Act 1977 (1977 No 14); The Insurance Law Reform Act 1985 (1985 No 117); The Life Insurance Act 1908 (1908 No 105); Part 3 of The Law Reform Act 1936; Marine Insurance Act 1908.

³ Ministry of Business, Innovation and Employment *Impact Statement: Insurance Contract Law Reforms* (December 2019) at 5.

⁴ *Carter v Boehm* (1766) 3 Burr 1905.

2.4. Clause 11 supports the intention of cl 10 by creating the default position that insurance contracts will be consumer unless proven otherwise.

3. *I support cl 19 which clarifies where the current disclosure duties stand in the law.*

3.1. Clause 19 asserts the replacement of the current duties with the new duties and that this duty shall not be widened by the duty of utmost good faith.

4. *I would like to propose a change to the use of the term “disclosure duty” used throughout the Bill concerning consumer insurance contracts.*

4.1. The proposed duty in the bill is to “take reasonable care not to make a misrepresentation to the insurer”.⁵ This does not impose a duty to disclose information. Instead, it creates a duty to present information with reasonable care. Using the term “disclosure duty” is not an accurate representation of what is being proposed as it conflates it with the current duty. We can see from cl 19 that this is not the Bill’s intention. It is also an unnecessary reference to what would become an outdated concept for consumer insurance contracts.

4.2. For greater clarity I suggest that the instances referring to a “disclosure duty for consumer insurance”⁶ are replaced with “duty of reasonable care” or “insured’s duty” or an alternative of similar effect. This would be a similar approach to Australia and the UK.⁷

III Duty for consumers to take reasonable care

5. *I support the intention of cl 14 to promote consumer-friendly insurance contracts by addressing the power imbalance between the insurer and a consumer insured.*

5.1. This clause will replace the duty of disclosure for consumer policyholders with a duty to “take reasonable care not to make a misrepresentation to the insurer before

⁵ Ministry of Business, Innovation and Employment *Draft for Consultation: Insurance Contracts Bill* (2022), cl 14.

⁶ For instance - pt 2 heading, subpart 1 heading and subpart 3 heading.

⁷ Insurance Contracts Act 1984 (Cth); Consumer Insurance (Disclosure and Representations) Act 2012 (UK) (CIDRA).

the consumer insurance contract is entered into or varied.”⁸ Effectively, to answer any questions asked by the insurer truthfully and accurately.

5.2. Policyholders are not always sure what information an insurer considers material.⁹ Clause 14 will put the onus on the insurer to state what they need to know. This makes sense as the insurer has advanced industry knowledge. Therefore, they know what information they require to make a risk assessment, unlike your average consumer policyholder. Clause 14 should help reduce the number of claims involving misrepresentations and therefore, should result in fewer cases of policyholders having their insurance contracts voided.¹⁰

5.3. Although not all insurers are in favour of this approach¹¹ we can see that many insurers are happy to decrease the burden on insureds¹² and have been doing so by asking specific questions or by limiting/waiving the duty in other ways.¹³ Therefore, aspects of cl 14 have already been implemented in the industry and further adoption should not be overly burdensome.

5.4. This approach was implemented successfully in the UK¹⁴ and has recently been adopted in Australia under the Financial Sector Reform (Hayne Royal Commission Response) Act 2020.¹⁵

5.5. Despite the anticipated drawbacks of this decision, such as, the time and costs associated with insurers changing their policies, opening themselves to greater risk and the long documents with pages of questions to answer. I believe it is the best way forward as it is anticipated to be a one-off cost, spread across consumers and will bring insureds greater certainty that their contract will be upheld.¹⁶

⁸ Clause 14.

⁹ Impact Statement, above n 3, at 11.

¹⁰ Impact Statement, above n 3, at 16.

¹¹ IAG “Submission on the Insurance Contracts Review Issues Paper” at [12].

¹² Tower Insurance “Submission on Insurance Contract Law Review Options Paper” at [2].

¹³ *State Insurance v Fry, State Insurance v Peake* [1991] 2 NZLR 287.

¹⁴ David Hertzell *Reforms to UK insurance law: overview of key changes* (Thomas Reuters, March 2016); CIDRA, s 2.

¹⁵ ICA 1984 (Cth), above n 7, s 20B.

¹⁶ Impact Statement, above n 3, at 16.

A The matters to be taken into account when determining whether a consumer has taken reasonable care

6. I support clause 15 of the Bill which guides the judge's factual analysis.

6.1. Clause 15 builds on the UK and Australian Acts regarding the matters to be considered when determining whether a policyholder has taken reasonable care not to make a misrepresentation. The matters provide some guidance to the judge but do not limit their inquiry.¹⁷ This allows for a thorough factual analysis to be conducted.

6.2. Clause 15(1)(c) provides further clarity as to the expectations for the insurer. It will be important for the insurer to ask clear and specific questions in order to claim the insured has taken reasonable care not to make a representation, broad questions may not be sufficient. This supports the intention of the bill to make insurance contracts more consumer-friendly.

7. I support the intention of the mandatory matter to be considered in clause 16.

7.1. Clause 16 creates a mandatory consideration for the judge. It states that “any particular characteristics or circumstances of the policyholder of which the insurer is aware, or ought reasonably to have been aware” *must* be taken into account.

7.2. This may help protect vulnerable insureds while placing a higher expectation on more experienced insureds. This clause is also present in the Australian Act.¹⁸

8. I suggest that clause 16 is clarified by explaining how this clause is to be used by the judge.

8.1. The way the clause is currently drafted it is fairly ambiguous as to how it would work in practice. This could be resolved by providing a list of sub-sections that describe how their characteristics or circumstances should be considered. Alternatively, a phrase such as “which might impact their ability to answer the

¹⁷ Clause 15(3).

¹⁸ Section 4.

insurer’s questions with reasonable care” after the word “aware” could be included in the descriptive text.

9. *I support the policy decisions behind clauses 17 and 18.*

9.1. Clause 17 recognises that it can be difficult and confusing to answer the questionnaires set by insurers.

9.2. Clause 18 clarifies that cl 17 does not extend to fraudulent behaviour.

IV Breach of consumer duty

B Qualifying breach of consumer duty

10. *I support the purpose of clauses 26, 27, 28 and 29 which determine when an insurer has a remedy for a breach of duty by a consumer policyholder.*

10.1. Clause 26 proposes that insurers will no longer have a remedy where a misrepresentation would not have changed the terms of the contract. There have been many cases where claims have been denied due to a misrepresentation despite it not having any influence on the insurer’s decision to enter the contract.¹⁹ The enactment of this clause will help provide better outcomes for consumer policyholders.

10.2. *Jones v Zurich Insurance Plc* gives insight as to the nature and extent of evidence that would be required for an insurer to prove they would not have entered the contract.²⁰ *Jones* shows that it is a high bar and the unique facts of the case will determine whether the remedy of avoidance applies.

10.3. Clause 27 defines a qualifying breach. This sets up the framework for proportionate remedies in schedule 2, based on whether the breach is, deliberate or reckless, or neither deliberate nor reckless. This recognises that fraudulent breaches deserve a greater punishment than accidental breaches. This distinction is helpfully clarified by cl 28 which defines the meaning of deliberate or reckless.

¹⁹ Impact Statement, above n 3, at 13.

²⁰ *Jones v Zurich Insurance* [2021] EWHC 1320 (Comm).

Any breach which does not fit the definition in cl 28 will be treated as neither deliberate nor reckless,²¹ opening up a greater range of remedies for the insured.

10.4. Clause 29 puts the burden of proof on the insurer to prove the breach was deliberate or reckless. Clause 28(a) will likely be where most contention lies as it can be assumed in most cases that the insured would know the questions asked by the insurer in the questionnaire are relevant.²²

C Remedies for breach of consumer duty

11. I support the policy decisions behind schedule 2, clauses 2, 3, 4 and 5.

11.1. These clauses create proportionate remedies for qualifying misrepresentations. Total avoidance is a disproportionate response in situations where a policyholder has made an accidental misrepresentation or was unaware of what an insurer considers material. It takes away the policyholder's ability to be compensated for the financial loss that they had prudently prepared for and believed they were entitled to. It also impacts their ability to be covered in the future.²³ Proportionate remedies recognise that some misrepresentations would have had no effect on the contract and those which do will be dealt with accordingly.

11.2. In practice many insurers use a range of proportionate remedies, including the proposed approach under schedule 2, clause 5(1).²⁴ Insurers also claim they are reluctant to avoid contracts except in exceptional cases.²⁵ If this is the case then the Bill will codify what is already occurring as current best practice and ensure consistency throughout the industry. This recognises that in a situation where the majority of insurers would not avoid the contract there will always be one who will.

²¹ Clause 27(b).

²² Clause 28(b).

²³ Impact Statement, above n 3, at 12.

²⁴ Partners Life "Response to Review of insurance contract law comprehensive form" at 4.

²⁵ IAG, above n 11, at 14.

- 11.3. Deliberate and reckless misrepresentations result in the punitive approach of withholding the premiums paid and avoiding all claims.²⁶ Punishment for a breach of contract is a unique feature of insurance law that is not present in general contract law. This reflects the special relationship of trust between the parties. A careless misrepresentation adjusts the response according to whether the insurer would have entered the contract at all or would have done so on different terms.²⁷
- 11.4. Clause 5(2) provides a remedy when there is a qualifying misrepresentation because the insured was careless, and the insurer would have entered the contract on different terms relating to the premium. The remedy for this is to reduce the amount paid on a claim by the difference in premiums that would have been charged under the contract and what was charged. By recovering the cost of the premiums, they are being put in the same situation that they would have been if the misrepresentation had not been made.
- 11.5. The UK provides a slightly different remedy in this situation. This is to “reduce proportionately the amount to be paid on a claim”.²⁸ This is calculated by charging X% of the claim to the insurer. Where X is; the premium charged, divided by the premium which would have been charged, multiplied by one hundred.²⁹ This method results in a greater loss to the insured. The proposed New Zealand approach calculates a more accurate representation of the loss to the insurer, it also minimises the loss suffered to the insured. Therefore, creating a fair result for both parties.
- 11.6. The Australian approach is to reduce the claim to put the insurer in the position they would have been in had the relevant failure not occurred.³⁰

V Duty for non-consumers to make a fair presentation of the risk

12. *I support the enactment of clauses 31, 32, 33, 34, 35, 36, 37, 39, 40, 41, 43 and 48 which set out the duty for non-consumers to make a fair presentation of the risk.*

²⁶ Schedule 2, cl 2.

²⁷ Schedule 2, cls 3, 4 and 5

²⁸ CIDRA, above n 7, sch 1, pt 1, s 7.

²⁹ CIDRA, above n 7, sch 1, pt 1, s 8.

³⁰ Section 28(3).

- 12.1. The proposed duty for non-consumer policyholders is to make a fair presentation of the risk.³¹ This is the same approach as the UK³² and is similar to the old approach for the consumer duty of disclosure in Australia.³³
- 12.2. This approach retains elements of the duty of disclosure, however, is less onerous on the insured and focuses more on the overall presentation of the risk.
- 12.3. Clause 32 defines “fair presentation of the risk”. It requires a disclosure as described in clause 33 and for that disclosure to be reasonably clear, accessible, substantially correct and made in good faith.³⁴ This definition allows the insured to describe their perspective on a situation without claiming it is a fact.
- 12.4. Clause 33 requires every material circumstance that the policyholder knows or ought to know to be disclosed. A material circumstance is one that influences the judgment of a prudent insurer in determining whether to take on the risk and, if so, on what terms.³⁵ This approach doesn’t deviate too far from the current disclosure duty.
- 12.5. I support this approach because a business will have the best understanding and experience of the risks they run in their operations. Therefore, the onus should remain on them to disclose every material circumstance they know or ought to know,³⁶ or, at least provide sufficient information to put a prudent underwriter on notice to make further enquiries.³⁷
- 12.6. When the UK adopted this duty they retained the common law as to what was considered material.³⁸ Therefore, it is likely much of New Zealand’s common law will remain relevant.

³¹ Clause 31.

³² Insurance Act 2015 (UK), pt 2, s 3.

³³ Insurance Contracts Act 1984 (Cth) 26, s 21.

³⁴ Clause 32(1)(b) and (c).

³⁵ Clause 34.

³⁶ Clause 33(a).

³⁷ Clause 33(b).

³⁸ *Versloot Dredging v HDI Gerling Industrie Versicherung (The DC Merwestone)* [2017] AC 1, per Lord Sumption at para 32; *The Dora* [1989] 1 Lloyd’s Rep. 69, per Phillips J at 93; *Berkshire Assets (West London) Limited v Axa Insurance UK Plc* [2021] EWHC 2689 (Comm).

12.7. *Jones v Zurich Insurance Plc* gives insight as to the nature and extent of evidence that would be required for an insurer to be entitled to avoid a policy for breach of the duty of fair presentation.³⁹ *Jones* shows that the burden of proof is high and that the unique facts of the case will determine the outcome

13. *I support the enactment of clauses 44, 45, 46 and 47.*

13.1. These clauses limit the disclosure duty by stating what should already be known to the insurer.

VI Breach of non-consumer duty

D Qualifying breach

14. *I support the enactment of clauses 51, 52, 53 and 54 which decide when an insurer has a remedy for a breach of duty by a non-consumer policyholder.*

14.1. These clauses have essentially the same effect as clauses 26, 27, 28 and 29 which set out the rules for a qualifying breach of a consumer insurance contract. I believe they are just as suitable for non-consumer insurance contracts for similar policy reasons. Particularly regarding the need for proportionate remedies.

E Remedies for a qualifying breach

15. *I support the decision to provide the same remedies to insurers in both consumer and non-consumer cases.*

15.1. This is the same approach that is taken in the UK and Australia.⁴⁰ It means all policyholders will have their contracts responded to proportionately to the breach. This is just as important for non-consumers as it is for consumers.

VII Summary of feedback and recommendations

³⁹ *Jones v Zurich Insurance* [2021] EWHC 1320 (Comm).

⁴⁰ Insurance Act 2015, sch 1, s 6(1) and (2); ICA 1984 (Cth), above n 7, s 28(3).

16. In summary I support the changes to the insured's duties of disclosure and the insurer's remedies for breach of this duty.
17. I propose a change to the use of the term "disclosure duty" used throughout the Bill concerning consumer insurance contracts.
18. I suggest that clause 16 is clarified by explaining how this clause is to be used by the judge.