Submission on discussion document: Insurance contract law review

Name	Dr Michael Naylor
Organisation	Massey University

School of Economics & Finance
Massey Business School
Palmerston North
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I am available to discuss technological transformation issues further if useful.

I have taught insurance to financial advisers since 1995, and was headed the Massey Insurance Diploma from 1999-2006. I have been lobbying for a disclosure law change since 2004. I am the author of the only book on insurance advice in NZ 'Risk Management and Insurance in NZ', (2010 2nd Ed, Dunmore Press) and of the premier book on the impact of technological change on the insurance sector, 'Insurance Transformed' (2017, Palgrave-Macmillan). I have been leading a Massey team researching the response of insurers to Canterbury quake claims. I have also been/ are involved in other financial advice/ insurance research on the adviser/ consumer interaction.

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Responses to discussion document questions

Regarding disclosure obligations and remedies for non-disclosure

3	Are consumers aware of their duty of disclosure?
	Our research indicates strongly that consumers have little awareness of their disclosure duties and just intuitively rely on the advertising promise to 'look after you'. There are no other areas of consumer purchase where a similar disclosure requirement is imposed with nil guidance. In general consumers think that only fraudulent answers would be a problem. *When informed of what the law actually is, the normal consumer responds with shock and distain for insurers. This is a major factor in the general low, in crating distrust, and the low opinion of insurance and consequent under-insurance.*
4	Do consumers understand that their duty of disclosure goes beyond the questions that an insurer may ask?
	Our research indicates strongly that consumers have nearly zero awareness that their duty of disclosure goes beyond answering questions asked by the insurer honestly.
5	Can consumers accurately assess what a prudent underwriter considers to be a material risk?

	Our research indicates strongly that consumers have nearly zero awareness that their duty of disclosure knowing what a prudent underwriter considers important, and in general have a very limited understanding of what such an underwriter would consider material.
6	Do consumers understand the potential consequences of breaching their duty of disclosure?
	Our research indicates strongly that consumers have nearly in general very limited awareness that their duty of disclosure has serious consequences. Their understanding is that they should answer questions honestly and conscientiously and that there may be adverse consequences if they answer fraudulently.
7	Does the consumer always know more about their own risks than the insurer? In what circumstances might they not? How might advances in technology affect this?
	See detailed notes below
8	.
9	Should unintentional non-disclosure (i.e. a mistake or ignorance) be treated differently from intentional non-disclosure (i.e. fraud)? If so, how could this practically be done?
	Yes. Research shows that the current consumer understanding is that their obligation is to answer questions asked by the insurer honestly. They have no understanding that mistakes in answers will be treated as fraudulent. They regard this result as being opposed to the principles of natural justice. *See detailed notes below.*
10	Should the remedy available to the insurer be more proportionate to the harm suffered by the insurer?
	It is widely acknowledged that the binary outcome of cover/ no cover is far too limited. The range of options offered by the 2007 or the UK law is a good starting point. See point (9) below.
11	Should non-disclosure be treated differently from misrepresentation?
	Yes. See detailed notes.
12	Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not?
	Yes, the UK approach is preferred for the reasons which were extensively covered in the English/ Scottish Law Commission reports. Basically, current law evolved from commercial insurance contracts where both sides had expert knowledge and skill. This was then haphazardly extended to household contracts. Consumers do not have the skill or expertise to disclose correctly. Insurance law for consumers needs to be recreated on a different basis. *The UK approach is to be preferred, whereby consumers and small business only have a requirement to answer all questions asked as accurately and honestly as would be expected of a reasonable respondent. Commercial and Marine can use a higher standard.* *See detailed notes below.*

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13	In your experience, do insurers typically choose to avoid claims when they discover that an insured has not disclosed something? Or do they treat non-disclosure on a case-by-case basis?
	Massey's Canterbury quake research is still being processed, but initial indications are of major and sustained instances of poor responses to some claims. Whether this is due to deliberate insurer actions or poor insurer claims procedures is still being ascertained. *In general, the current law of disclosure allows insurers to ask very few questions and accept most clients on standard terms. Very little underwriting is done at policy inception, and very few non-disclosures are bought to the potential customers attention at that time. It is at claim time when analysis of the customer is undertaken and non-disclosure issues are raised. At this stage, even if non-disclosure is indisputable, it is too late for the customer to make other insurance arrangements. As a principle, risk-ranking of customers should occur at policy inception and not at claim time.*
14	.

General Comments on Technology and the Law of Disclosure

The review of disclosure law needs to carefully consider looming technological issues. When the Law Commission wrote their 1998 report or when the 2007 Cabinet Paper was written, technology meant that insurers had very limited capacity to ascertain what risk factors clients were affected by and could only obtain that information by asking clients at application or claim time.

It has been costly to ask consumers questions, it has been expensive to underwrite each customer, it has been expensive /infeasible to offer customised terms or conditions, and communications with customers has been very limited. This has meant that in cost terms it was expensive to ask potential customers a long list of questions and risk-rank customers into a large number of risk buckets with differing premiums. It was not possible to modify questions asked based on responses. Thus, at policy inception a small number of set questions was asked, with a catch-all final question. It was more efficient to ask detailed questions of the far smaller number of customers who claim. Underwriting thus occurs at claim time not policy inception.

Insurers have traditionally been very focused on cost control and avoiding unlimited loss situations. They have known very little about their customers and have placed very little focus on customer interactions. A consequence of this has been a low level of insurer-insured engagement, a high level of customer mistrust of insurers, and a high level of public general ignorance of insurance issues.

Within this cost/economic framework the 2007 suggestions around relaxing the duties of consumer disclosure was a feasible option, as it required insurers to ask positive questions at policy inception, even though that substantially added to cost. However, the world has moved on technologically, so the 2007 suggested reforms are no longer suitable. The UK and Aust reforms are also becoming out-dated.

A range of things are about to change in insurance:

(1) End-to-end software will allow the automation of most administrative processes and reduce the cost of transactions from tens of dollars to less than a cent. This will apply initial potential customer enquiry, to application, to policy creation, to underwriting, to renewal, to claims assessment, to claims payment, to policy termination. As all data, regardless of channel, will be inputted into one system there will be no issues with cost of paperwork.

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On a cost basis it will be feasible for all customers will be able to be underwritten at policy inception. Individualized policy customisation will also be feasible.

(2) Most customers will initially interact with insurers via online systems, either PC, of Tablet, or Mobile Phone. This could be webpage based or video. Most all centre contacts will be replaced by audio chatbots or video avatars. Customers will interact via a range of options, called 'omnichannel', even within the same enquiry. This means that policy search, policy comparison, policy condition confirmation and disclosure, and therefore related insurance law, will have to confirm that the requirements of omnichannel interactions.

a. An important aspect of this is that the disclosure questionnaire can be dynamic rather than static. This works on an online form by responses to initial questions creating additional questions or eliminating questions. This reduces reasons for insurers not to be able to ask additional questions.

b. It is difficult to read detailed conditions and to answer detailed questionnaires on a mobile phone due to screen size. Consideration needs to be made as to an insurer duty to ensure the questionnaire style is suitable to the channel used, so that the awkwardness of the sales channel does not hinder customer compliance.

c. Questions should not be repeated just because a customer uses a different format. Any modern insurer will integrate answers from a range of response channels so questions do not have to be asked multiple times just because the customer changes the channel.

(3) An increasing amount of customer interaction with their insurer will be via linked telematics. These are devices like car 'white-boxes' or fitbits which can be used to provide customer data on metrics are used in setting premiums. There will also be data integration with external parties within the linked ecosystem, like doctors, health boards, MOT, etc, who may be holding relevant information. Customers will not have to ask those providers for information when insurer software can link directly.

This means that premiums can be dynamic, so that they can be adjusted as the insurer gains more information about the client.

a. This allows the insurer to instead of underwriting at policy inception, to offer a set premium at inception, then adjust it over time as customer characteristics reveal themselves. Thus, client disclosure may not only occur at inception as current law assumes but may be ongoing. Client disclosure may not, in fact, be required at inception.

b. Premiums may be adjustable on a time basis or state basis, e.g; car premiums may differ depending on whether the car is being driven or is parked, or if the driver drives faster or slower. Policy cover maty therefore switch back and forth between an insurer who covers a car while driving and an insurer who covers a car will parked.

c. Minimal costs will allow insurers to offer short-term specials, e.g.; low car driving premiums just prior to a vacation is you switch. Consumers may therefore switch insurers for periods as short as week or even a day.

d. 'Disclosure' may occur from telematic device to insurer algorithm without the knowledge of the insured. The algorithm may adjust premiums without any human involvement within the insurer. They can only give general permission for this interaction to occur. Regulation will need to be written to oversee this insurer-insured interaction, in terms of style, data privacy and security, algorithm modelling, etc.

e. Claims may be paid by insurer software based on telematic feedback and assessment, e.g.; if two net-linked cars crash the insurer software can obtain all required info from the car software, decide on blame, and arrange payments.

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Within this looming software driven world complex disclosure requirements have no part to play. There will need to regulation covering ease of policy switching. There may be a need for a centralized consumer data holding agency similar to that in the electricity market.

(4) Insurers will increasingly underwrite via software algorithms based on telematic feedback, with little direct human involvement. The law needs to allow for this. There will be a need of regulation around algorithms to avoid biases created by inadequate data training.

(5) As telematic feedback provides a transformed style, size, and scope of data on customers, insurers will start to understand individual customer preferences and risk factors in greater detail than the customers do about themselves. By combining data from thousands of customers insurers will obtain a very detailed and individualized understanding of individual customer risk, with little need to ask customers. There will need to for law relating to requiring insurers to provide customers with the insurer's risk assessment rather than the insured providing the insurer with information.

I have not seen this in the scope of the review.

(6) Overall what this means is that as technological advances transform the insurance sector over the next decade, the concept of requiring customers to comprehensively disclose all relevant risk factors at policy inception will be increasingly archaic.

The burden should be placed entirely on insurers to underwrite customers at policy inception if they desire, though the likelihood of this occurring will decrease over time. Whether they obtain required data from customers at policy inception/renewal or whether the customer allows the insurer to obtain the required data from linked telematics can be a mutually agreed negotiation, under a legal framework.

Therefore, a good argument can be made for a UK style disclosure law which covers customers who ask for inception disclosure, and a different law with no inception disclosure required for those customers who ask for telematic based policies. There may be scope for a clause requiring a consumer to disclose facts which are exceptional and unlikely to be asked by an insurer and which a reasonable person would know that should disclose

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General Comments on Misrepresentation

(7) Customer expectations have moved on since the NZLC wrote their 1998 report. Customers are used to ignoring online forms which have terms and conditions, so that we all just click to agree and never read. Expecting the modern customer to read, understand, and fill out detailed online forms does not fit current or future culture. Many insurance disclosure questions can be extremely general and unanswerable, e.g.; 'Give details of all doctor, psychiatrist, consultant, clinic, etc visits over the past seven years'.

(8) A suitable data link to a centralised data store will increasingly provide an insurer with all that information, so all that is needed is for the insured to allow the insurer to access their records. Legislation and regulation may be required around central storage of data and how insurers can access it.

If the insurer can obtain data from a third party and informs the insured of that, then there needs to be a legal presumption that the insurer has indeed done so at policy inception. It should not be permissible to only access that information at claim time, then then use it to deny the claim. All warnings that the insured needs to obtain any relevant information should be banned as archaic.

(9) In the long-term, for consumers, this implies that there should be no requirement for disclosure at policy inception, just an agreement to allow dynamic telematic or external ecosystem data

linkages. The UK principle of only requiring consumers (households or small business) to only take reasonable care not to make a misrepresentation is a future-proved law.

The concept of inducement needs to be used rather than materiality. There are three parts to this, (i) the policy creation was induced by the misrepresentation, (ii) that a reasonable person would know they have committed a misrepresentation, (iii) the fact would have been known by a reasonable person in the insured's shoes at the time of the fact occurring. The later point is important as it is common in health issues for symptoms to not seem relevant until a diagnosis is made. Assessment of misrepresentation needs to be per reasonable knowledge at policy creation/renewal not at claim time.

Consideration needs to be applied to limiting the requirement to volunteer information about topics which the insurer does not ask about. This can be covered by a UK style duty 'to take care not to misrepresent'.

The UK Act does not define a misrepresentation, as this is complex, e.g.; an omission can be misrepresentation. However, it should be defined and can be by skilful legal writing. If an insurer accepts the proposal then the omission should be ignored, unless a reasonable person would know the omission was a misrepresentation.

Misstatement needs to take account of insured specific issues such as lack of English or age if these are known to the insurer. The insured needs to have the opportunity to show that they had less knowledge than expected and did not the fact was relevant. There needs to be provision for consumer specific issues, e.g.; where the insured has very limited English/Maori ability and the insurer is aware of this, or ought to be aware of it, and did not adjust their procedures adequately. The standard of care required by a consumer can vary depending the manner and the situation in which the information is provided by the insurer to the insured, e.g.; the care expected will differ from an online transaction vs an adviser facilitated transaction. e.g.; If during a distance style application, the consumer is not asked to check figures then the insurer should not later be allowed to claim that due care was not taken.

To protect insurer interests there needs to be a presumption that a consumer (a) had the knowledge of a reasonable consumer, (b) knew that the matter was relevant if the insurer asked a clear and specific question. It would then be up to specific consumer to show that in their case, it was not reasonable to make this assumption.

There needs to be a time restriction on ability of the insurer to ask further questions and clarify risk consumer characteristics. If answers are incomplete or inadequate and the insurer does not follow up after a reasonable time, then it should be presumed that the insurer has accepted that statement. This non-misrepresentation duty needs to be extended to renewals and claims times. Open-ended questions should be invalid. The burden of proof that a misrepresentation has been made should rest on the insurer, on the basis that a reasonable person would have been aware that a misrepresentation has occurred, rather than a prudent underwriter.

Basis of contract clauses should be banned and restrictions placed on the inclusion of specific warranties. Contracting out should be banned.

(10) Insurance law for commercial, marine, or larger businesses needs separate consideration. The UK law is a good template here. Consumer insurance tends to occur on standardized terms and without sufficient knowledge by the insured and without advice. These aspects do not occur with commercial or marine insurance. The test for 'small business' could use the UK micro-business standard of less than 9 employees, thus excluding the majority of NZ firms from more onerous disclosure requirements. A filter may be needed to exclude Special Purpose Vehicles.

(11) The use of underwriting algorithms based on a wide range of big data sources raises a complex 'materiality test' question. Currently underwriters use a statistical connection between some

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aspect of the customer and the risk level to understand the determinates of the rate setting. The causal link is normally clear and understandable, e.g.; being female lowers driving risk. However, bringing in a far wider array of telematic derived data and assessing it via a multi-layered AI system often does not provide a clear causal link, e.g.; There may be a strongly proven link between buying red meat on a Friday afternoon/ driving red wine/ owning a SUV and driving risk but it is not easily understandable for a customer. Is 'materiality' to be set based on a level of strength in a specific algorithm process? How is a customer supposed to know that it is a material fact to be disclosed?

(12) The remedy for misrepresentation needs to differ depending on whether it is (a) deliberate/ reckless, (b) careless, (c) reasonable. The UK Act is an ideal template, with (a) rendering the policy void, (b) allowing a proportional claim, and (c) having no impact. Life cover should always be noncancelable even for misrepresentation, but continue on amended terms.

(13) There needs to be no legal requirement for an insurable interest. This should remain an underwriting issue. Experience from Canterbury quakes claims has shown that loss can arise because of damage to property or people which the insured has no direct link to, but which creates a condition whereby a loss occurs to the insured, e.g.; loss of access to insured's property or supplier/purchaser disruption. The reform process needs to encourage policy innovation.

(14) Consideration needs to be given to time limitations on claims. The complexity of the Canterbury quake sequence and the extraordinary length of claim resolution demonstrate that flexibility of needed in applying the normal cut-off law.

Comments on UK Law of Disclosure Reforms

I strongly argue that in most cases the UK law is superior and more future-proof than the Australian law. The UK law does not address a series of contentious issues, which should be addressed including;

- The definition of 'fraudulent claim' is left for judicial decision. That is of particular significance for one contentious and recently recognised class of fraudulent claim; being the use of fraudulent means and devices to promote a perfectly genuine loss (e.g. immaterial misdescription of how the loss occurred, or the creation of documents of title to the lost subject matter where the insurer insists upon such documentation). The existence of this head of fraudulent claim is being challenged in an English decision heard by the Court of Appeal in July 2014. The Law Commissions thought it sensible not to pre-empt any judicial ruling.
- The law provides no guidelines on whether a specific fraud taints unconnected losses. For example, if the insured's building and contents are insured under separate sections in a single policy following a fire, a fraudulent claim for contents also affects the claim for damage to the building. The Act is silent.
- There is no mention of the problem of fraud committed by one of the joint holders of a policy, particularly husband and wife cases.
- The Act does not provide for the recovery by the insurer, by way of damages, of the costs of investigating a fraudulent claim. Recent authority in England suggests that such costs are recoverable.

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Regarding conduct and supervision

15	What do you think fair treatment looks like from both an insurer's and consumer's perspective? What behaviours and obligations should each party have during the lifecycle of an insurance contract that would constitute fair treatment?
	Fair Treatment can be described as making decisions which would be regarded as reasonable, given the circumstances, by an independent reasonable person. This can be defined as good faith by both parties.
16	To what extent is the gap between ICP 19 and the status quo in New Zealand (as identified by the IMF) a concern?
	The ICP19 framework is a good basis for policy. This is a long way from current NZ legislation. One issue with ICP19 is that it needs to be updated to allow insurance processes to occur within the framework I have outlined above, where interactions are software rather than human based. This means that the processes built both into the software and into the algorithms have to have Fair Treatment coded into them, with suitable fall-back to human supervisors if appropriate.
17	Does the lack of oversight over the full insurance policy 'lifecycle' pose a significant risk to purchasers of insurance?
	Research indicate that insurer responses to claimants in NZ can at times be inconsistent in quality and variable over time and state. NZ needs to have an Insurance Conduct Act similar to that in the UK. Neither the RBNZ nor the FMA has any oversight of insurer-insured interactions and there is no overall framework setting out good conduct expectations, with regard to external circumstances. There needs to be regulation around the legibility of policy terms so they are more understandable by the average person. There will need to be substantial remedies for breach of Good Conduct regulation, including areas like faulty assessment, undue delays in assessment or payment, etc, as long as consideration is made of exceptional circumstances. There should be a provision for punitive damage payments to insureds in cases of serious breaches by the insurer, e.g.; dishonesty, malicious conduct, or maladministration. There should be provision for group actions as a major limitation of dispute resolution is the inability of claimants to afford legal advice. *The ICNZ Fair Insurance Code' has had a positive impact on insurer behaviour in normal circumstances, but does not deal effectively with circumstances where insurer capacity is overwhelmed, as occurred in Canterbury. Research indicates that the ICNZ disputes resolution process did not achieve any significant level of public support for quake disputes. As the UK report points out, consumer acceptance is better for a declined claim if the claimant is told that 'the law disallows it' rather than 'the industry code' disallows it.* *A simple process of settling time limits on various insurer processes would have a positive impact but to be modifiable for extreme circumstances.* *The issues raised in the Technological Note also have to be considered, as software only processes raise additional issues.*
18	What has your experience been of the claims handling process? Please comment particularly on: • timeliness the information from the claims handler about:

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	○ timeframes and updates on timeframes ○ reasons for declining the claim (if relevant) ○ how you can complain if declined • The handling of complaints (if relevant)
	Massey's research relating to quake claims is still incomplete but had so far raised many issues relating to either bad faith on some claims settlements or very poor communications. It needs to be emphasised that often the claim was being settled as fast as it could be, but poor insurer administrative processes and old-fashioned client communication procedures made it seem to claimants that the insurer was acting in bad faith. The insurer not only has to demonstrate good faith, they also have to be seen by claimants as visibly possessing that. *The ISO service is very restricted as it has a claims cap and cannot cross-examine witnesses. These issues were examined in detail in the UK reports and the many issues pointed out.*
19	.
20	.
21	.
22	Are sales incentives causing poor outcomes for purchasers of insurance? Please provide examples if possible.
	Within the life/ personal insurance - financial advice industry there is only limited evidence of incentives causing mis-selling, though anecdotal evidence is frequently cited. The balance of high up-front commissions and low trail commissions, however, does provide perverse incentives for agents to miss-sell and churn. Because of competition law, insurers do need govt guidance to be able to overcome this issue. Within that it is vital that total long-cycle commission does not reduce as there are already inadequate financial advisers, so incentives to enter the profession cannot be reduced. *The use of conferences or travel as sales incentives needs to be banned. However, there needs to be the ability to retain insurer spending on education conferences.*
23	Does the insurance industry appropriately manage the conflicts of interest and possible flow on consequences that can be associated with sales incentives?
	No. The life industry framework is well aware of the adverse incentive structure but has proved unable to amend it.

Regarding exceptions from the Fair Trading Act's unfair contract terms provisions

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27	.

Regarding difficulties comparing and changing providers and policies

28	Is it difficult for consumers to find, understand and compare information about insurance policies and premiums? If so, why?
	Research shows that consumers have very limited understanding of insurance, especially personal/life insurance. Very few customers read policies or understand trigger clauses or conditions/exemptions. This leads to consumers mainly comparing policies on year One premiums.
29	Does the level of information about insurance policies and premiums that consumers are able to access and assess differ depending on the type of insurance? E.g. life, health, house and contents, car insurance etc.
30	What barriers exist that make it difficult for consumers to switch between providers?
	Consumers find insurance confusing and troublesome to think about. Level of distrust of insurers leads to poor purchase decisions. Comparison of premiums past year one and of policy quality is not provided by any existing website. There are no websites which offer consumers the opportunity to give feedback on quality. Comparison websites only provide year one premiums and these are normally discounted leading to false conclusions about longer term cost.
31	Do these barriers to switching differ depending on the type of insurance? E.g. life, health, house and contents, car insurance etc.
32	What, if anything, should the government do to make it easier for consumers to access information on insurance policies, compare policies, make informed decisions and switch between providers?
	There is need to support/ regulation relating to a web-based comparison tool. This needs to provide basic insurance advice, basic insurance sum calculation engines, an ability to compare policy quality for differing consumer types, and an ability to compare premiums over at least 10 years on a PV basis. The information provided by insurers should cover all insurers and policy quality be independently assessed. Statements made on aggregator websites, questions formats, question answers, need to be bought into the law of disclosure. If errors occur in the transmission of entered insured data between the aggregator and the insurer, then the insurer should be liable as the aggregator is acting as their agent, unless it is made to the consumer that this is not the case. *The creation of a centralised data store of client linked information would greatly ease switching. This should be government guided, not necessarily owned.*

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Regarding responsibility for intermediaries' actions

45	Do you consider there to be problems with the current position in relation to whether an insurer or consumer bears the responsibility for an intermediary's failures? If possible, please give examples of situations where this has caused problems.
	From a consumer viewpoint current law is correct and needs to be retained. It is reasonable to expect any intermediary to be able to bind the insurer wrt consumer actions or disclosures. However, the suggested 2007 reforms would provide needed clarity.
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47	.

Other comments

	We welcome any other comments that you may have.
	[Insert response here]

Comments on Insurance Disputes Resolution

Massey's research into insurer responses to the Canterbury quakes indicates that there needs to be substantial changes to insurance dispute resolution, as the current arrangements have failed significantly in some cases. One of the major issues that consumers are often unaware of what their does and does not cover, so there is a gap between expectations and contractual clauses. These issues will be covered in detail in our forthcoming quake report.

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