

# Submission on discussion document: Insurance contract law review

Your name and organisation

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Responses to discussion document questions

Regarding the objectives of the review

1 Are these the right objectives to have in mind?

**PLEASE NOTE:** This submission focuses exclusively on property & contents insurance.

## Emerging Issues

As noted in the Issues Paper the "current legislation is fragmented across six different Acts, some of which are over 100 years old." (Issues Paper p. 7)

Insurance law is only reviewed once every few decades. Consequently any review of insurance law needs to consider emerging issues such as the impact climate change will have on the affordability and availability of home & contents insurance.

Furthermore, the review understandably focuses on issues which already have some prominence in the public arena. For example, the Issues Paper addresses issues where dispute resolution providers have commented on a high volume of complaints (Issues Paper p.20).

The review does not address issues where directly interested parties are motivated to hide an issue and do not currently have formal mechanisms to even raise, let alone resolve, disputes. For example, homeowner who have been unable to renew their insurance policies are reluctant to report this as it may limit the pool of potential buyers for their homes and therefore reduce the value of their property. Insurers are not willing to provide information on the locations where they no longer offer insurance for fear that this could harm their reputation with all consumers. Local governments are reluctant to publish information on the availability of insurance for certain locations for fear of a backlash from affected ratepayers.

## Post-contract Issues

The Issues Paper also noted "... it is in the public interest to ensure that insurance provides

the compensation that it is intended and expected, to provide." {Issues Page p. 8}

The review focuses primarily on issues which arise during the term of the insurance contract. There is some discussion of the relationship between the consumer and the insurer prior to the sale of a contract. There is no discussion of the relationship between the consumer and the insurer once insurance is no longer available (i.e. post-contract).

Almost every homeowner we have spoken with expressed an expectation that, provided they met their obligations as a responsible and honest consumer (i.e. they pay their insurance premiums on time and do not engage in fraudulent insurance activity), they will be able to renew their home & contents insurance for as long as they own their property and, at the very least, for the term of their mortgage.

Homeowners accept that insurance premiums will increase each year but appear to expect that those increases will be modest (i.e. approximately equal to CPI inflation). Few homeowners (or policy makers) recognise that property insurance premiums could increase dramatically with rapidly escalating climate hazards. Consumers have been so shocked when insurance premiums in high-risk locations have been adjusted to reflect that risk that they have contacted national news outlets to express their dismay.

For example, after extra-tropical Cyclone Debbie devastated Edgecumbe in April 2017, a local resident s 9(2)(a) was shocked to discover his insurance premiums had increased from s 9(2)(a) and that a s 9(2)(a) for flood damage had been added to his policy. s 9(2)(a) explained to Radio New Zealand that as a pensioner paying more than \$100 a week for insurance was unaffordable.

s 9(2)(a)

No homeowner we have spoken to recognises that with escalating hazards under climate change their insurance premiums could double or triple (or more) from one year to the next and that insurance may become unavailable during term of their mortgage.

#### Lack of Disclosure Requirements on Insurers

The Issues Paper also noted "*disclosure obligations for policyholders and remedies for non-disclosure are seen as onerous*" {Issues Paper p.8} however the review does not comment on the lack of disclosure requirements placed on insurers. There are many obligations on policyholders to disclosure and significant penalties if they fail to disclose but there are effectively no obligations on insurers to disclose. Consequently there are no penalties for insurers' failure to disclose even though this lack of information can have significant financial consequences for homeowners. This imbalance in disclosure between consumers and insurers is particularly concerning in the face of escalating hazards under climate change.

There are two possible avenues for disclosure: disclosure to a regulator and disclosure to consumers. This is addressed in questions Q.3, Q.18, and Q.32 below.

2

Do you have alternative or additional suggestions?

#### Escalating Hazards under Climate Change

Climate change is going to increase the frequency of devastating storms and will make the

rarest events more destructive. This will dramatically increase the cost of insurance in many locations in New Zealand and will make some properties uninsurable within the next 20 years.

*Insurance retreat* occurs when a private or public insurer declines an application for insurance coverage, or ceases to offer renewal of existing coverage, based on the characteristics of the property and its location. *Partial insurance retreat* refers to situations where an insurer introduces terms which transfer a significant proportion of a property's risk back onto the policyholder, such as the introduction of extraordinarily high excesses.

The review should consider introducing disclosure requirements for insurers on how escalating hazards under climate change is, and will, impact the affordability and availability of home & contents insurance.

USEFUL REFERENCE: The following is a recent interview by one of the authors, Belinda Storey, on Radio New Zealand on insurance retreat from coastal properties under climate change.

[www.radionz.co.nz/national/programmes/afternoons/audio/2018628974/coastal-properties-may-lose-insurance](http://www.radionz.co.nz/national/programmes/afternoons/audio/2018628974/coastal-properties-may-lose-insurance)

## Regarding disclosure obligations and remedies for non-disclosure

### 3 Are consumers aware of their duty of disclosure?

The Issues Paper notes *'The duty of disclosure has its origins in the reciprocal duty of utmost good faith owed by and to each party to a contract of insurance.'* The Paper notes that the duty is established to ensure that the insured (one party to the contract) does not "deliberately withhold information" that the insurer (the other party to the contract) would have used when deciding whether or not to enter into the contract *{Issues Paper p.18}*.

However, all of the obligations are on the consumer to disclose. There are no obligations on the insurer to disclose - even of information that could be material to a *consumer's* decision to enter into a contract with an insurer.

Insurers should be required to disclose information that a reasonable consumer would consider to be material to *their* decision to enter into the contract.

For example, if a consumer was aware that an insurer has assessed escalating hazards at a particular location and has either:

- refused to renew policies for a number of nearby properties; or
- expects to stop renewing policies in within the next 5 or 10 years,

a consumer may be less likely to enter into an insurance contract with that insurer and may even decide not to purchase a house in that location.

### 4 Do consumers understand that their duty of disclosure goes beyond the questions that an insurer may ask?

No. Nor should they. Insurers should be required to specify the information they need from consumers as they are in the UK and in Australia *(Issues Paper p. 19)*.

When it comes to natural hazards, any information provided by consumers is already secondary to the increasingly sophisticated information available to insurers through data

science (i.e. Big Data analysis of aggregated consumer data) and the outputs from climate and seismic models.

Consumers should only be accountable for the disclosure of information explicitly sought by an insurer and which is not otherwise available through industry best practice data analysis and modelling.

5

Can consumers accurately assess what a prudent underwriter considers to be a material risk?

No. Objective 1 of the review notes that "*insureds can access and understand the information they need to make informed decisions.*" {Issues Paper p.12) and notes that "*some consumers may find it hard to find and compare prices and policies.*" {Issues Paper p. 8) but does not recognise how difficult it is for consumers to understand low probability risk high consequence risk especially when it comes to natural hazards.

Publically available information on natural hazards is rarely accessible for consumers. Even with good information, consumers often make poor decisions under uncertainty. They over-react to recent events (*availability bias*), ignore long term consequences (*myopia bias*), and quickly forget major events (*amnesia bias*). Consumers assume catastrophic events won't happen to them (*optimism bias*) and ignore risks if their neighbours (or peers) do not appear to be reducing their risk (*herding bias*).

Insurance underwriting is a highly skilled activity requiring specialised qualifications and significant institutional resources. Furthermore, the nuances of what one insurer defines as material can differ to that defined by another insurer because of each insurer's strategic appetite for risk. Consumers cannot be expected to understand what an underwriter might consider to be material.

USEFUL REFERENCES: The Ostrich Paradox, Why We Underprepare for Disasters, Robert Meyer & Howard Kunreuther, 2017.

Insurance, Housing and Climate Adaptation, Motu Note #27, Belinda Storey, Ilan Noy, et al. 2017. [motu.nz/assets/Documents/our-work/environment-and-resources/climate-change-impacts/Insurance-Housing-and-Climate-Adaptation2.pdf](https://www.motu.nz/assets/Documents/our-work/environment-and-resources/climate-change-impacts/Insurance-Housing-and-Climate-Adaptation2.pdf)

6

Do consumers understand the potential consequences of breaching their duty of disclosure?

N/A

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?

No. Insurers (and other market participants) are increasingly using data science to analyse consumer behaviour. This is enabling some providers of goods and services to understand more about consumer demand than consumers do themselves.

Further, the sophistication of predictions of climate and seismic models is now such that insurers now know far more about a location's risk from natural hazards than an individual homeowner.

As data science and climate and seismic models advance, the insurer's need for information provided by the consumer is dramatically reduced. Consequently, at least with regard to natural hazards, the obligation on consumers to disclose information that could otherwise be provided by best practice data analysis and natural hazard modelling should be removed.

	<p>The Issues Paper notes that the New Zealand Treasury's principles for best practice regulation expect regulations to be <i>flexible</i> and <i>durable</i> and that the "regulatory system has the capacity to evolve in response to changing circumstances." {Issues Paper p.10} As data science advances and climate and seismic models become increasingly sophisticated the information advantage enjoyed by insurers relative to homeowners will increase. As a result any insurance law should include a mechanism to periodically review (and potentially increase) the disclosure obligations of insurers.</p>
8	<p>Are there examples where breach of the duty of disclosure has led to disproportionate consequences for the consumer? Please give specific examples if you are aware of them.</p>
	N/A
9	<p>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?</p>
	N/A
10	<p>Should the remedy available to the insurer be more proportionate to the harm suffered by the insurer?</p>
	<p>Again, penalties for failure to disclose a material risk currently only applies to consumers even though homeowners can suffer significant financial consequences if their insurance policy is not renewed and they do not have the means to self-insure, and may experience a loss on their primary financial asset if potential homebuyers are not able use the property as collateral to secure a mortgage.</p>
11	<p>Should non-disclosure be treated differently from misrepresentation?</p>
	N/A
12	<p>Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not?</p>
	<p>Yes. The primary duty of a regulator should be to protect consumers. In some cases, the imbalances experienced by small and medium businesses are similar to those experienced by consumers. Therefore some disclosure requirements should be placed on the insurers of small to medium businesses.</p>
13	<p>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?</p>
	N/A
14	<p>What factors does an insurer take into account when responding to instances of non-disclosure? Does this process vary to that taken in response to instances where the insurer discovers the insured has misrepresented information?</p>
	N/A

## 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?

N/A

16

To what extent is the gap between ICP 19 and the status quo in New Zealand (as identified by the IMF) a concern?

We agree with the IMF that in New Zealand "no regulator has oversight of insurers' and insurance intermediaries' conduct during the full insurance policy "lifecycle" (Issues Paper p. 25)

In addition to the issues noted in the Issue Paper, we note that the absence of a regulator exposes the insurance industry to the entrance of unreliable, and potentially insolvent, insurance providers. This problem will worsen when large insurers elect to withdraw from certain locations.

For example, when Tower Insurance increased the house insurance for Wellington homeowner s 9(2)(a) from just over s 9(2)(a) (to better reflect s 9(2) home's seismic risk), s 9(2)(a) noted that Tower had referred her to an insurance broker who had found her an insurance quote for "around \$3,000" but that the insurer which had provided the quote "wasn't a big company, [and that she] hadn't heard of it before..."

[www.radionz.co.nz/national/programmes/morningreport/audio/2018649892/wellington-couple-in-shock-over-massive-insurance-hike](http://www.radionz.co.nz/national/programmes/morningreport/audio/2018649892/wellington-couple-in-shock-over-massive-insurance-hike)

The Issues Paper notes that the "Insurance Council of New Zealand (ICNZ) has developed a Fair Insurance Code that sets minimum standards for ICNZ members.. " and notes that "ICNZ's current members represent more than 95 percent of all fire and general insurance policies written in New Zealand. {Issues Paper p.26}

However, as the example above suggests, when large insurers elect to withdraw from certain locations, there will be an incentive for the insurers who are not ICNZ members (i.e. those who represent the remaining 5% of fire and general insurance policies) to offer insurance policies which do not meet this Fair Insurance Code to affected locations.

17

Does the lack of oversight over the full insurance policy 'lifecycle' pose a significant risk to purchasers of insurance?

Yes. See Question 1.

18

What has your experience been of the claims handling process? Please comment particularly on:

- timeliness the information from the claims handler about:
  - o timeframes and updates on timeframes
  - o reasons for declining the claim (if relevant)
  - o how you can complain if declined
- The handling of complaints (if relevant)

The review currently focuses on disputes that occur prior to sale and during the term of the insurance policy specifically with regard to *claims* however as insurance becomes less affordable and eventually unavailable in some locations there are no current mechanisms to address disputes of the availability of *coverage*.

Consumers should be entitled to know the reasons for declining coverage including situations where an existing homeowner's policy is not renewed and where a homebuyer seeks insurance in the process of purchasing a new home. This will help encourage risk reduction by informing consumers of the relative risk of particular locations.

Consumers should also be provided with an internal mechanism to complain to their insurer when coverage is denied. There will be situations where an insurer may decide to decline cover rather than offer a risk-adjusted premium on a high-risk property (where the insurance premium - even though fairly priced - might nonetheless be perceived to be exorbitant). The consumer be provided with a mechanism to enter into a good faith debate with their insurer on the reasons why coverage has been declined.

19

Have you ever felt pressured to accept an offer of settlement from an insurance company? If so, please provide specific examples.

N/A

20

When purchasing (or considering the purchase of) insurance, have you been subject to 'pressure sales' tactics?

N/A

21

What evidence is there of insurers or insurance intermediaries mis-selling unsuitable insurance products in New Zealand?

N/A

22

Are sales incentives causing poor outcomes for purchasers of insurance? Please provide examples if possible.

N/A

23

Does the insurance industry appropriately manage the conflicts of interest and possible flow on consequences that can be associated with sales incentives?

N/A

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

24

Are you aware of instances where the current exceptions for insurance contracts from the unfair contract terms provisions under the Fair Trading Act are causing problems for consumers? If so, please give examples.

N/A

25	More generally, are there terms in insurance contracts that you consider to be unfair? If so, why do you consider them to be unfair?
	N/A
26	Why are each of the specific exceptions outlined in the Fair Trading Act needed in order to protect the "legitimate interests of the insurer"?
	N/A
27	What would the effect be if there were no exceptions? Please support your answer with evidence.
	N/A

### 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?
	Yes. Most consumers can and will process only a limited amount of information prior to making a decision on a financial product. It is therefore important that information provided on insurance policies are short, standardised, and clearly communicate financial and legal terms.
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? Eg. life, health, house and contents, car insurance etc.
	No, but it should. Consumers do not know how much of their home and contents premium is allocated to each peril. For example, a consumer in Wellington does not know how much of their insurance premium covers earthquake risk vs fire risk.  This makes it difficult for homeowners to compare coverage between different insurers and makes it next to impossible for homebuyers to compare current and expected future insurance costs of different locations.
30	What barriers exist that make it difficult for consumers to switch between providers?
	N/A
31	Do these barriers to switching differ depending on the type of insurance? Eg. life, health, house and contents, car insurance etc.
	N/A
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?
	Information to the Regulator and Intermediaries



The New Zealand regulator, once established, should require insurers to report on how often the insurer denies or delays claims, refuses to renew policies to existing policyholders, and refuses new policies to homes that were insured by the previous homeowner.

This information should be made available to intermediaries in an aggregated and anonymised basis to intermediaries including journalists, consumer advocates, academics, and policymakers. These intermediaries are best placed to translate aggregated data into insights easily digested by consumers.

Provision of this information can enhance the disciplining force of firm reputation and can strengthen the ability of regulators to proactively identify and address market failures. It is next to impossible to address a market failure if data on that failure is not accessible to policymakers. Aggregated information can also enhance risk reduction for catastrophes caused by natural hazards by strengthening the pricing signal in high-risk locations.

#### Information to the Consumer

To facilitate transparency, price comparisons, and competition within the sector, any proposed insurance contract should be accompanied with a one-page easy-to-understand document that described the broad outline of the insurance contract proposed (what risks are covered and excluded, what is the excess associated with each risk, what are the premiums, for how long is the contract, what are the conditions for renewal, etc.). This can be modelled, for example, after the United States Consumer Financial Protection Bureau's disclosure requirements for credit card companies to report their contracts in an easy-to-understand format. There is ample evidence that consumers do not understand their insurance contracts, and what they are or are not insured for. Markets do not seem to provide strong enough incentives for this information to be provided in easily digestible format by consumers, so that this may have to be regulated.

USEFUL REFERENCE: Transparently Opaque: Understanding the Lack of Transparency in Insurance Protection, Daniel Schwarcz, UCLA Law Review, 2014.

### Regarding third party access to liability insurance monies

33 Do you agree that the operation of section 9 of the Law Reform Act 1936 (LRA) has caused problems in New Zealand?

N/A

34 What are the most significant problems with the operation of section 9 of the LRA that any reform should address?

N/A

35 What has been the consequence of the problems with section 9 of the LRA?

N/A

36 If you agree that there are problems with section 9 of the LRA, what options should be considered to address them?

N/A

### Regarding failure to notify claims within time limits

37 Do you agree that the operation of section 9 of the Insurance Law Reform Act 1977 (ILRA) has caused problems for "claims made" policies in New Zealand?

N/A

38 What has been the consequence of the problems with section 9 of the ILRA?

N/A

39 If you agree that there are problems with section 9 of the ILRA, what options should be considered to address them?

N/A

### Regarding exclusions that have no causal link to loss

40 Do you consider the operation of section 11 of the Insurance Law Reform Act 1977 (ILRA) to be problematic? If so, why and what has been the consequence of this?

N/A

41 The Law Commission proposed reform in relation to exclusions relating to the characteristics of the operator of a vehicle, aircraft or chattel; the geographic area in which the loss must occur; and whether a vehicle, aircraft or chattel was used for a commercial purpose. Do you agree that these are the areas where the operation of section 11 of the ILRA is problematic? Do you consider it to be problematic in any other areas?

N/A

42 If you agree that there are problems with section 11 of the ILRA, what options should be considered to address them?

N/A

### Regarding registration of assignments of life insurance policies

43 Do you agree that the registration system for assignment of life insurance policies still requires reform?

N/A

44 If you agree that there are problems with the registration system for assignment of life insurance policies, what options should be considered to address them?

N/A

## 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.

N/A

46 If you consider there to be problems, are they related to who the intermediary is deemed to be an agent of? Or the lack of a requirement for the intermediary to disclose their agency status to the consumer? Or both?

N/A

47 If you consider there to be problems, what options should be considered to address them?

N/A

## Regarding insurance intermediaries - Deferral of payments/ investment of money

48 Do you agree that the current position in relation to the deferral of payments of premiums by intermediaries has caused problems?

N/A

49 If you agree that there are problems, what options should be considered to address them?

N/A

## Other miscellaneous questions

50 Are there any provisions in the six Acts under consideration that are redundant and should be repealed outright? If so, please explain why.

N/A

51 Are there elements of the common law that would be useful to codify? If so, what are these and what are the pros and cons of codifying them?

N/A

52 Are there other areas of law where the interface with insurance contract law needs to be considered? If so, please outline what these are and what the issues are.

	N/A
53	Is there anything further the government should consider when seeking to consolidate the six Acts into one?
	N/A

## Other comments

	<p>We welcome any other comments that you may have.</p> <p>We would welcome an opportunity to answer any questions and provide more detail on any part of our submission - in person or by email.</p> <p>We would also value the opportunity to contribute policy options as part of the second consultation document scheduled for release at the end of 2018.</p> <p>Belinda Storey is a Principal Investigator with the Deep South National Science Challenge and is a professional member of the Royal Society of New Zealand. She is Managing Director of Climate Sigma which provides scenario analysis and asset valuation on the physical and transition risk from climate change. Belinda serves as a director on the boards of Landcorp Farming and 350 Aotearoa and is a member of the New Zealand Institute of Directors and Risk New Zealand.</p> <p>Ilan Noy is a Professor of Economics at Victoria University and the Chair in the Economics of Disasters, a position supported by the New Zealand Earthquake Commission. His research and teaching focus on the economic aspects of natural hazards and disasters, and other related topics in environmental, development, and international economics. He is also the founding Editor-in-Chief of <i>Economics of Disasters and Climate Change</i>, a journal published by SpringerNature. He previously worked at the University of Hawaii, and consulted for the World Bank, the Asian Development Bank, the Inter-American Development Bank, UNISDR, the International Monetary Fund, ASEAN, the Japanese Government, and the Chilean Central Bank.</p> <p>Samuel Becher has earned his LLM and JSD from Yale Law School, and his LLB (magna cum laude) from Tel Aviv University. He specializes in economic and behavioral analysis of law. His research has been widely published in journals such as American Business Law Journal, Law &amp; Contemporary Problems, Cardozo Law Review, Connecticut Law Review, Tulane Law Review, San Diego Law Review, University of Michigan Journal of Law Reform and Michigan Telecommunications and Technology Law Review. Samuel served as a member of the Israeli Form Contract Tribunal (Jerusalem district court) and as the head of the Dispute Resolution Institute of the "Public Trust" organization - an Israeli non-profit organization that works to promote a fair consumer-business environment.</p>
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