Submission on discussion document: Insurance contract law review

Your name and organisation

Name	Adrian Tulloch
Organisation	Vero Liability Insurance Limited

Responses to discussion document questions

Regarding the objectives of the review

1	Are these the right objectives to have in mind?
	We agree in general terms with Objectives 1 and 2. *Any amendments to the current regulatory framework should only be made in response to evidence that these Objectives are not being met currently and a conclusion that legislative amendment is the appropriate method to remedy that. It will also be appropriate for MBIE to consider other solutions to any identified failures to meet the Objectives, eg education or enforcement.*
2	Do you have alternative or additional suggestions?
	Objective 1 must also encompass insurers and their stakeholders having certainty that the insurance policy will respond as expected in the event of loss. *Insurance in New Zealand ultimately depends on the willingness of foreign re-insurers to support it. Generally, it is desirable for New Zealand law to remain in step with that prevailing in the major overseas markets with which those re-insurers and their investors are most familiar. This assists in investors' perception of the stability and predictability of outcomes in the New Zealand market.*

Regarding disclosure obligations and remedies for non-disclosure

3	Are consumers aware of their duty of disclosure?
	We believe our customers are aware of their duty of disclosure. We generally do not sell to "consumers" (other than our LawSafe product). *Anyone applying for insurance cover with Vero Liability must complete a proposal form. The first item on the proposal form is an explanation of the duty of disclosure and the consequences of non-compliance with it. We have embedded below an example proposal form for a professional indemnity policy.*

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	professional-indemnity-proposal.pdf
	We distribute our insurance policies to customers who are advised by intermediaries. Anyone who takes out a policy with us has had access to assistance from an expert intermediary in completing their proposal form. These intermediaries understand the legal framework both in terms of what is required to be disclosed and the consequences of failing to do so. *We generally find that our policyholders comply with their duty of disclosure. It is very uncommon for us to have situations where we later conclude that customers failed to disclose material information to us at the time we wrote their policy. We estimate that we have avoided fewer than 10 insurance policies in the last decade, across a live client base of about 14,000 customers, 30,000 policies and 3,000 claims at any one time. We take that as a good sign that customers, assisted by brokers, understand and comply with what is required of them.*
4	Do consumers understand that their duty of disclosure goes beyond the questions that an insurer may ask?
	We believe our customers understand this. We generally do not sell to "consumers" (other than our LawSafe product). See our answer to Q3 above.
5	Can consumers accurately assess what a prudent underwriter considers to be a material risk?
	We believe our customers are capable of assessing this. We generally do not sell to "consumers" (other than our LawSafe product). See our answer to Q3 above.
6	Do consumers understand the potential consequences of breaching their duty of disclosure?
	We believe our customers understand this. We generally do not sell to "consumers" (other than our LawSafe product). See our answer to Q3 above.
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?
	We believe our customers do know more about their own risks than we do. It is impossible to get past the reality that the policyholder knows all the facts about their business and we have to rely on them to tell us what we need to know. We generally do not sell to "consumers" (other than our LawSafe product). *For a liability insurer, the specific characteristics of each particular business are relevant to risk acceptance and underwriting. We do not rely on a set of fixed questions derived from actuarial models to determine whether and on what terms we will write a risk. We instead continue to rely on individual underwriting of risks by human underwriters. Our underwriters are experienced and ask intelligent questions designed to elicit the information we require to assess the risk. But good disclosure requires co-operation from both sides. An efficient process also needs to encompass a duty on the policyholder to disclose information they know or should know would be material to us in assessing the risk of loss associated with their business.* *Our underwriters already use the internet in appropriate cases to gather publicly available information about policyholders. However, we cannot see advances in technology affecting*

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	the basic dynamic that the customer has access to the information about their business, and we do not.
8	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.
	No, in respect of our customers. We estimate we have avoided fewer than 10 policies in the last decade. All those were cases where we considered avoidance to be a proportionate remedy.
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?
	In our experience, the current law is working adequately. *If reform is considered desirable, then we strongly advocate retaining the existing avoidance remedy for any intentional or fraudulent non-disclosure. It would be totally inappropriate for us to be required to continue to insure anyone who has intentionally attempted to deceive us.* *The existing avoidance remedy should also remain available, at the least, in any case where the insurer would not have written the risk with full disclosure.*
10	Should the remedy available to the insurer be more proportionate to the harm suffered by the insurer?
	In our experience, the current law is working adequately. As with any business, we do not insist on our strict legal rights in every situation. *A stricter legal remedial framework would reduce insurer discretion. This is only necessary if there is evidence insurers are not currently making appropriate decisions. We are not aware of any such contention within our area of business.*
11	Should non-disclosure be treated differently from misrepresentation?
	No. *If reform is considered desirable, the culpability of the policyholder's conduct and the effect on the insurer's risk acceptance decision and premium calculation should be the guiding factors. The distinction between non-disclosure and misrepresentation breaks down at the margins in any case, eg is a "half truth" a misrepresentation or a non-disclosure?*
12	Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not?
	In our experience, the current law is working adequately in the part of the market in which we operate. This typically involves the sale of business insurance products, with insurance brokers involved. Any reform should not affect this well-functioning sector of the market. *We apprehend from the Issues Paper that MBIE has concerns about the operation of the duty of disclosure and the remedy of avoidance in the "consumer" sector. Any reform should be limited to this sector.* *The distinction between consumers and non-consumers is one that is drawn in other legal contexts, and that has been introduced in the UK and Australian insurance legislation in recent years. In addition to the factors taken into account in the Australian and UK legislation,*

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	we consider that the involvement of an expert insurance broker is another factor which ought to lead to the customer being treated as a "non-consumer".
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?
	We always treat non-disclosure on a case-by-case basis. As noted in our answers above, we estimate that we have avoided fewer than 10 policies in the last decade. In all those instances we considered avoidance to be a proportionate remedy.
14	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?
	Our process is the same for non-disclosure and for misrepresentation. *Most commonly, any issue emerges in the course of response to a claim. We do not go looking for such issues, so any issues we encounter tend to be directly related to the subject matter of the claim.* *We take into account the materiality of the issue and what we would have done had we known about the issue at inception. We also take into account the culpability of the policyholder in the non-disclosure and more general factors such as the length of their relationship with us.* *It is common for us to consider we have a right to avoid, but not to exercise it, where we are satisfied that is the appropriate response in the circumstances.* *On the other hand, we can also foresee situations where, notwithstanding that we would have written the risk had full disclosure been made at the time, the circumstances in which we have become aware of the issue have undermined our trust and confidence in the policyholder to the extent that we do not wish to continue our relationship.*

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?
	[Insert response here]
16	To what extent is the gap between ICP 19 and the status quo in New Zealand (as identified by the IMF) a concern?
	[Insert response here]
17	Does the lack of oversight over the full insurance policy 'lifecycle' pose a significant risk to purchasers of insurance?
	[Insert response here]

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18	What has your experience been of the claims handling process? Please comment particularly on:
	• timeliness the information from the claims handler about:
	  ○ timeframes and updates on timeframes
	  ○ reasons for declining the claim (if relevant)
	  ○ how you can complain if declined
	• The handling of complaints (if relevant)

	[Insert response here]
19	Have you ever felt pressured to accept an offer of settlement from an insurance company? If so, please provide specific examples.
	[Insert response here]
20	When purchasing (or considering the purchase of) insurance, have you been subject to 'pressure sales' tactics?
	[Insert response here]
21	What evidence is there of insurers or insurance intermediaries mis-selling unsuitable insurance products in New Zealand?
	[Insert response here]
22	Are sales incentives causing poor outcomes for purchasers of insurance? Please provide examples if possible.
	[Insert response here]
23	Does the insurance industry appropriately manage the conflicts of interest and possible flow on consequences that can be associated with sales incentives?
	[Insert response here]

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.
	[Insert response here]
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?

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	[Insert response here]
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"?
	[Insert response here]
27	What would the effect be if there were no exceptions? Please support your answer with evidence.
	[Insert response here]

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?
	[Insert response here]
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.
	[Insert response here]
30	What barriers exist that make it difficult for consumers to switch between providers?
	[Insert response here]
31	Do these barriers to switching differ depending on the type of insurance? E.g. life, health, house and contents, car insurance etc.
	[Insert response here]
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?
	[Insert response here]

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?
	Yes. This should be a priority for reform. *The statutory charge was originally introduced as part of a package which also required compulsory third party motor vehicle insurance (the Motor Vehicles Insurance (Third-party Risks) Act 1928). In that context, it made some sense for a mechanism to be created to allow*

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the third party to obtain the benefit of the compulsory insurance.

That rationale no longer applies. Liability insurance is not compulsory. Liability insurance is taken out by policyholders voluntarily for their own benefit. In the first instance, it is a product that is intended to fund the defence of a claim against them. The statutory charge, as interpreted by the Supreme Court in BFSL 2007 Ltd v Steigrad [2014] 1 NZLR 304, *frustrates this primary purpose of the policy. If the defence costs cover does not operate effectively, the policy simply becomes a "deep pocket" making the policyholder a more attractive target for claims which they are – by virtue of the* Steigrad *charge – unable to defend effectively. In a real, practical sense the policyholder would be better off had they not taken out the insurance policy and could plead poverty.*

More generally, there is no sensible reason why a third party claimant, a contingent creditor, should be given greater rights over insurance proceeds than they have over other assets of the debtor.

This is not a hypothetical concern. For example, we are currently acting for a policyholder who is facing multiple claims across two policy years. Individually and together the claims exceed the limit of indemnity in either year meaning that the limit of indemnity is "fully charged" in each year. The effect is that, despite paying premiums over a number of years, the policyholder has been deprived of funding for its defence. By contrast, had the policyholder self-insured by banking its premiums it would be able to spend the fund defending the claims.

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

There are three significant problems with the way the charge operates, even accepting the premise that the law should include a mechanism by which third party claimants can have direct access to liability insurance proceeds.

First, the charge as interpreted in Steigrad prevents the insurer meeting defence costs where a claim is received exceeding the limit of indemnity. This frustrates the first purpose of the insurance policy which is to fund the defence of the claim. It also puts the third party claimant in a better position than it could ever have been in without the existence of the charge. In the ordinary course, a defendant is entitled to fund a good faith defence to a claim from its available assets (either its personal assets or an insurance policy). A successful claimant has access to the remaining assets after the failure of the defence, including the remaining limit of indemnity under the insurance policy.. By contrast, under Steigrad*, the claimant has access to the full limit of indemnity at the expense of the ability of the insured to fund a defence.*

Second, the charge is expressed to arise on the occurrence of the event giving rise to the claim. This makes it notoriously difficult to determine priority between claims where more than one claim arises in a policy year. Each claim may involve multiple events that could be occurrences for the purposes of the section 9 charge. Even if priority can be determined, resolution of later claims is made hostage to resolution of claims arising from earlier occurrences that have priority. The priority granted to claims by section 9 has no necessary relation to the order in which the claims were made, or the order in which the indemnifiable liabilities covered by the policy arise.

*Third, because the courts have determined that the charge does not apply to overseas insurers (*Ludgater Holdings Ltd v Gerling Australia Co Pty Ltd *[2010] 3 NZLR 713 (SC);* Bridgecorp Ltd (in rec & in liq) v Certain Lloyd's Underwriters *[2015] 2 NZLR 285 (CA);* Body Corporate 326421 v Auckland Council *[2013] NZHC 753;* McCullagh v Underwriters *[2015] NZHC 1384), the existence of the charge gives overseas insurers an unfair competitive advantage over local*

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	insurers.
35	What has been the consequence of the problems with section 9 of the LRA?
	Liability policies in force at the time of the Steigrad *decision commonly provided for defence costs and liability to be met out of a single limit of indemnity. For policyholders covered by such policies, the effect of the* Steigrad *decision was to deprive them of an insurer-funded defence if they faced claims for which their potential liability exceeded the limit of indemnity. This was surprising and unsettling to our policyholders, who found their insurance did not deliver them the primary benefit which they thought they had purchased, ie funding of their defence. This is an obvious example of the law not responding in a way consistent with the Objectives of this review.* *The effective removal of defence costs funding means that the policyholders' defence to the claim is compromised. The operation of the charge gives claimants an unfair advantage over defendants. Claims cannot be properly investigated and interrogated, leading to third party claimants potentially recovering more than their true entitlements.* *Insurers, including Vero Liability, have subsequently implemented work around solutions for new policies entered into post* Steigrad*. The details vary but typically involve the creation of a separate, ring-fenced defence costs limit of indemnity. This introduces unnecessary complication, additional costs for policyholders and is only required to address the consequences of the section 9 Law Reform Act charge, as interpreted in* Steigrad*.*
36	If you agree that there are problems with section 9 of the LRA, what options should be considered to address them?
	For the reasons set out in response to Q33 above, there is no justification for any mechanism giving third party claimants direct access to the proceeds of an insurance policy to which they are not party and did not fund. *Alternatively, Vero Liability supports repeal of section 9 and its replacement with a more fit for purpose mechanism. Any mechanism should address the three major issues identified in our response to Q34 above: it should allow the insurer to fund a good faith defence; not interfere with the default order in which claims would fall for payment under the insurance policy; and put overseas and local insurers on a level playing field.* *The NSW Civil Liability (Third Party Claims Against Insurers) Act 2017 and UK Third Parties (Rights against Insurers) Act 2010 are examples of ways other comparable jurisdictions have dealt with these issues. The reforms in both NSW and the UK were each based on substantial law reform commission reports evaluating the pros and cons of various reform options.*

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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?

Yes. This should be a priority for reform.

The problem was lucidly explained by the New Zealand Law Commission in its previous commentary recommending reform.

"Claims made" policies are designed to avoid the underwriting problems that arise from "occurrence" policies in situations where there may be a long period of time between an occurrence and the subsequent claim. Common examples are professional indemnity and directors' and officers' liability policies where there may be a period of years between an alleged act of negligence and a claim being pursued to recover loss. There are two main, related issues.

First, the use of an "occurrence" policy in that context leads to a "long tail", ie a long period following the close of a policy year in which unknown claims may still emerge that are covered in that policy year.

Second, claims often relate to multiple occurrences across different years that combine to create loss to claimants. That leads to difficulties in allocating claims across policy years and also to the possibility of multiple annual limits "stacking" for the same loss. There is a particular scope for dispute where the identity of the insurers has changed between policy years creating scope for dispute between the insurers about allocation between the policy years.

Both these issues make adequate reserving and fixing of premiums for future years very difficult. This led insurers and their re-insurers and investors to become increasingly unwilling to offer such products.

"Claims made and notified" policies address the above issues by tying policy coverage to the making and notification of a claim within the policy year, rather than to the underlying occurrence. Tying coverage to a claim addresses the second issue identified above, ie allocation. Tying coverage to prompt notification of a claim addresses the first issue, ie the long tail.

The application of section 9 to the notification element of claims made policies re-introduces the "long tail" problem that these policies were designed to eliminate. It is now possible for a claim – or even more problematically circumstances known to the policyholder that may give rise to a claim – to be notified years after the relevant policy year has closed but covered in that much earlier policy. The insurer has to show specific "prejudice" to the standard required by the courts under section 9 in order to avoid this result. Even if this can be done, the statutory process has the effect of undermining one of the core economic premises on which the coverage is able to be offered, ie that the insurer will be able to assess its likely exposure promptly following the closure of the policy year. This in turn undermines contractual certainty and makes adequate reserving and fixing of premiums very difficult.

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

See our answer to Q37 above.

We are currently involved in a dispute where an attempt is being made to move a claim from the policy year in which the claim was made and notified to an earlier policy year, after the claim has already been settled, on the basis that the claim arose from circumstances known to

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	the policyholder in the earlier policy year that could have been (but were not) notified at that time.
39	If you agree that there are problems with section 9 of the ILRA, what options should be considered to address them?
	Notification requirements included in claims made and notified policies should be excluded from the application of section 9 of the ILRA. At the least, a proviso should be introduced that section 9 does not apply where a notification under a claims made and notified policy is purported to be made more than, eg, 30 days after the close of the policy year.

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?
	We are aware that general property insurers have concerns about the operation of section 11. However, it arises only very rarely in the course of our business.
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?
	[Insert response here]
42	If you agree that there are problems with section 11 of the ILRA, what options should be considered to address them?
	[Insert response here]

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?
	[Insert response here]
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?
	[Insert response here]

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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.
	Yes. The deeming provision in section 10(3) of the Insurance Law Reform Act 1977 by which a person receiving commission from the insurer is deemed to be a representative of the insurer is arbitrary and often does not conform to the reality of the position. *Some types of intermediary, eg an insurance broker, owe their legal duties to the policyholder, rather than the insurer. There is no justification for making their failures the responsibility of the insurer. They are responsible to the policyholder and it is the policyholder which will have the legal right of action against them in relation to any failure.*
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?
	The primary problem we are concerned about is the intermediary being deemed to be the agent of the insurer where that does not reflect the reality of the position. *We agree that whatever solution is adopted, it should be clearly understood by clients whether an intermediary is their agent or the agent of the insurer.*
47	If you consider there to be problems, what options should be considered to address them?
	Vero Liability supports the suggestion in the Issues Paper that intermediaries be required to have a written authorisation from the customer appointing them as their agent. *The deemed agency provision in section 10(3) of the Insurance Law Reform Act 1977 should be repealed, or at least reduced to a default provision in the absence of a written authorisation.*

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?
	[Insert response here]
49	If you agree that there are problems, what options should be considered to address them?
	[Insert response here]

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.

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	[Insert response here]
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?
	[Insert response here]
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.
	The rule providing for joint and several liability of defendants. Vero Liability supports reform of the law to provide for proportionate liability. *The existing rule places the risk of insolvency or lack of insurance of one defendant onto the other defendants. This can have the effect of arbitrarily increasing the liability of the remaining defendants above their proportionate responsibility. This risk is not something that can readily be assessed when underwriting a policyholder as the risk is entirely external to the insured business and unpredictable in its manifestation. This dilutes the extent to which the insurance market, through premiums, can operate to discourage risky behaviour.* *An example of the negative effects of the joint and several liability rule is in leaky building litigation. One of the factors (although not the only factor) in the substantial withdrawal of leaky building insurance cover was that defendants could, in an unpredictable way, find themselves legally responsible for a substantial share of a large loss that bore no resemblance to their actual culpability. The joint and several liability rule, combined with the courts' decisions expanding the scope of a council's duty of care, has made ratepayers the underwriters of building code compliance in New Zealand. This has stunted the development of a mature market for direct building defects insurance. Purchasers do not need to insist on developers and builders standing behind projects, either directly or through insurance. This indirectly lessens incentives on developers and builders to build properly in the first place.* *The leaky building experience ought to be taken as a lesson. The regime for defendants' liability ought to place the risk of insolvency of individual defendants on the claimant, who will usually be the party who is contracting with each defendant. It is the claimant that has the greatest ability to manage the risk through insisting on quality of performance and appropriate financial backing.*
53	Is there anything further the government should consider when seeking to consolidate the six Acts into one?
	[Insert response here]

Other comments

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

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