



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
HIKINA WHAKATUTUKI

Issues Paper



Review of Insurance Contract Law

May 2018

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How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by 5pm on Friday 13 July 2018.

Your submission may respond to any or all of these issues. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please use the submission template provided at: <http://www.mbie.govt.nz/info-services/business/business-law/insurance-contract-law-review>. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission:

- By sending your submission as a Microsoft Word document to insurancereview@mbie.govt.nz
- By mailing your submission to:

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Please direct any questions that you have in relation to the submissions process to insurancereview@mbie.govt.nz

Use of information

The information provided in submissions will be used to inform MBIE's policy development process, and will inform advice to Ministers on this review of insurance contract law. We may contact submitters directly if we require clarification of any matters in submissions.

Release of information

MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission.

If your submission contains any information that is confidential or you otherwise wish us not to publish, please:

- indicate this on the front of the submission, with any confidential information clearly marked within the text
- provide a separate version excluding the relevant information for publication on our website.

Submissions remain subject to request under the Official Information Act 1982. Please set out clearly in the cover letter or e-mail accompanying your submission if you have any objection to the release of any information in the submission, and in particular, which parts you consider should be withheld, together with the reasons for withholding the information. MBIE will take such objections into account and will consult with submitters when responding to requests under the Official Information Act 1982.

Private information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review. Please clearly indicate in the cover letter or e-mail accompanying your submission if you do not wish your name, or any other personal information, to be included in any summary of submissions that MBIE may publish.

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List of Acronyms

| | |
|---------|--|
| ASIC | Australian Securities and Investments Commission's |
| EQC | Earthquake Commission |
| FMA | Financial Markets Authority |
| FMC Act | Financial Markets Conduct Act 2013 |
| GST | Goods and Services Tax |
| IAIS | International Association of Insurance Supervisors |
| ICP | Insurance Core Principle |
| ICNZ | Insurance Council of New Zealand |
| ILRA | Insurance Law Reform Act 1977 |
| IMF | International Monetary Fund |
| LRA | Law Reform Act 1936 |
| MBIE | Ministry of Business, Innovation and Employment |
| UK | United Kingdom |

1 Foreword



Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

Insurance plays an important role in the lives of New Zealanders, helping us cope with unforeseen life events and providing businesses with greater certainty. A well-functioning insurance system is integral to ensuring insurance continues to serve all New Zealanders. We need all parties (insurers and consumers) to be able to transact with confidence and we need these interactions to be fair, efficient and transparent.

Our insurance contract law plays a key part in this well-functioning system. However, it is clear that our current law is outdated – current legislation is fragmented across six different Acts, some of which are over 100 years old. There are a number of issues that need addressing, including the onerous nature of disclosure obligations on consumers and technical issues that insurers claim make it difficult for them to price risk. A review is well overdue, a sentiment echoed by both industry and consumers.

In addition to the issues with insurance contract law, the experiences following the Christchurch earthquakes have highlighted the need to review whether greater regulation of insurers' conduct is required. This review will proceed in parallel with, and complement, the Government's inquiry into the Earthquake Commission. The concurrent nature of the review and the inquiry will create an opportunity to share findings and make sure that everyone is able to have their earthquake-related insurance experiences heard.

I also see great benefit in thinking about how best to reduce the complexity of insurance more generally to improve the experience of the average consumer. I look forward to how these conversations will take shape as this review progresses.

I welcome the release of this issues paper and am keen for an open and transparent discussion with all stakeholders. Insurance affects nearly everyone, so I look forward to wide engagement with the review.

It is important to this Government that the review progresses as quickly as possible. Provided that consultation confirms the need for change we aim to get new legislation introduced by the end of this term.

A handwritten signature in blue ink, appearing to read 'Kris Faafoi'. The signature is fluid and stylized, with a large initial 'K'.

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

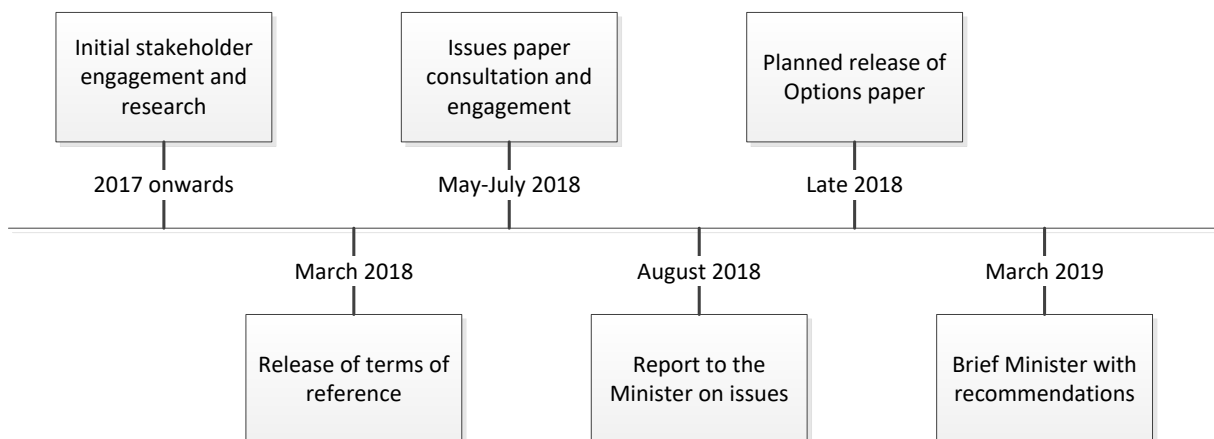
2 Introduction

Scope and context of this review

1. Insurance plays an important social and economic role. Insurance provides compensation for the losses that consumers and businesses can face when an unexpected, harmful event occurs. Insurance also encourages innovation and supports productivity by transferring the risk of loss from one business to another. Having insurance also means that consumers and businesses have less need to hold reserve funds for dealing with emergencies, thereby freeing up money for more productive uses.
2. Given the importance of insurance, it is in the public interest to ensure that insurance provides the compensation that it is intended and expected, to provide. Insurance contract law is the law that governs insurance contracts. It consists of various pieces of legislation and case law.
3. The Ministry of Business, Innovation and Employment (MBIE) is reviewing New Zealand's insurance contract law with input from the Financial Markets Authority (FMA), the Treasury, the Commerce Commission and the Reserve Bank of New Zealand. The terms of reference for the review are available at <http://www.mbie.govt.nz/info-services/business/business-law/insurance-contract-law-review>.
4. A number of previous reviews have identified issues with insurance contract law that have not yet been addressed. The review will focus on these discrete issues and a number of other ones that have subsequently been raised. The issues within the review's scope include:
 - The law is fragmented and would benefit from consolidation
 - disclosure obligations for policyholders and remedies for non-disclosure are seen as onerous
 - there are a range of technical issues that have been identified by the Law Commission and industry
 - the International Monetary Fund's Financial Sector Assessment Programme has identified areas where there is inadequate conduct regulation of insurers and intermediaries
 - the precise scope of those terms defined to be not "unfair contract terms" under the Fair Trading Act 1986 may need to be considered and whether these could be moved to insurance specific legislation
 - some consumers may find it hard to find and compare prices and policies.
5. The review will cover all types of insurance, as many of the issues raised will be common to many forms of insurance products.

6. The review is being scoped relatively tightly to ensure that progress can be made on the issues that have already been identified. The following areas are out of scope for the review:
- concerns about “underinsurance” – for instance, whether consumers are underestimating the level of cover needed under “sum-insured” home insurance policies (insurers do not face an incentive to underinsure consumers and many insurance companies already provide estimation tools to help ensure that consumers accurately estimate their insurance needs)
 - any competition issues related to the structure of insurance markets, such as the number and market share of insurance companies (these issues are the responsibility of the Commerce Commission)
 - the prudential regulation of insurers (separately being considered by the Reserve Bank in its review of the Insurance (Prudential Supervision) Act 2010, although relevant findings from each review will flow into the other)
 - earthquake insurance as governed by the Earthquake Commission Act 1993 and accident compensation insurance as governed by the Accident Compensation Act 2001 (the Treasury has been reviewing the Earthquake Commission Act 1993 and an inquiry into the Earthquake Commission’s (EQC’s) claims management is in the process of being established), and
 - regulation of financial advisers and the dispute resolution regime in relation to insurance (considered in the 2017 review of the Financial Advisers Act 2008 and Financial Service Providers (Registration and Dispute Resolution) Act 2008).
7. The legislation specifically included in the review is: the Marine Insurance Act 1908, the Life Insurance Act 1908, the Law Reform Act 1936, the Insurance Law Reform Act 1977, the Insurance Law Reform Act 1985 and the Insurance Intermediaries Act 1994.

Timeline for the review



Relationship to the EQC inquiry

8. The government is in the process of establishing an independent inquiry into EQC. The concurrent nature of the insurance contract law review and the EQC inquiry will create an opportunity to share findings and steer stakeholders to the right place for their earthquake-related insurance experiences to be heard.

Treasury's Principles for Best Practice Regulation

9. The review will be informed by the New Zealand Treasury's principles for best practice regulation:
 - **Growth Compatible:** Economic objectives are given an appropriate weighting relative to other specified objectives, including other factors contributing to higher living standards.
 - **Proportionality:** The burden of rules and their enforcement should be proportional to the benefits that are expected to result.
 - **Flexible, durable:** Regulated entities have scope to adopt least cost and innovative approaches to meeting legal obligations. The regulatory system has the capacity to evolve in response to changing circumstances.
 - **Certain, predictable:** Regulated entities have certainty as to their legal obligations, and the regulatory regime provides predictability over time.
 - **Transparent, accountable:** Rules development, implementation and enforcement should be transparent.
 - **Capable regulators:** The regulator has the people and systems necessary to operate an efficient and effective regulatory regime.

Purpose of this issues paper

10. This document outlines MBIE's initial analysis of various issues that have been raised with insurance contract law. It also proposes objectives for the review.
11. It is important to understand what is working well and what isn't before considering potential solutions to any issues. Submissions on this issues paper will inform the government's understanding of the various issues. This document therefore deliberately does not propose any solutions or legislative changes. Policy options to address any issues will be the subject of a second consultation document which we plan to release toward the end of 2018.
12. This issues paper poses a number of key questions, informed by initial discussions with consumers, industry groups, dispute resolution schemes, professional advisers and other government agencies. We seek your responses to these questions and other relevant feedback to improve our understanding of the insurance sector, issues with insurance contract law and opportunities for change.

How to use this document

13. We have included suggested questions throughout the document. While we seek answers to these questions, we also welcome any other relevant information that you wish to provide. All paragraphs are numbered for ease of reference.

3 Summary of objectives and key questions

Objectives

14. The proposed objectives for the review are outlined below.

Objective 1: Insurers and insureds are able to transact with confidence at all points in the lifecycle of an insurance policy

15. Meeting this objective will mean that:
- a. Insureds have certainty that insurers will respond as expected in the event of loss.
 - b. Insurers can effectively measure and price the risk being insured.
 - c. Insureds can access and understand the information they need to make informed decisions.

Objective 2: Interactions between insurers and insureds are fair, efficient and transparent at all points in the lifecycle of an insurance policy

16. Meeting this objective will mean that:
- a. The insurance industry places a high importance on treating their customers fairly, for instance having regard to the behavioural biases and information asymmetries that customers may face.
 - b. Consequences for wrongdoing are proportional to that wrongdoing.
 - c. Consumers are responsible for their own actions.
17. The International Association of Insurance Supervisors' Insurance Core Principles state that fair treatment of customers encompasses achieving outcomes such as:
- a. developing, marketing and selling products in a way that pays due regard to the interests and needs of customers
 - b. providing customers with information before, during and after the point of sale that is accurate, clear, and not misleading
 - c. minimising the risk of sales which are not appropriate to customers' interests and needs
 - d. ensuring that any advice given is of a high quality
 - e. dealing with customer claims, complaints and disputes in a fair and timely manner; and protecting the privacy of information obtained from customers.

18. The two objectives above are modelled on the two main purposes of the Financial Markets Conduct Act 2013, which are to:
- a. promote the confident and informed participation of businesses, investors, and consumers in the financial markets
 - b. promote and facilitate the development of fair, efficient, and transparent financial markets.

Questions

- | | |
|---|--|
| 1 | Are these the right objectives to have in mind? |
| 2 | Do you have alternative or additional suggestions? |

Key questions

19. Below is a selection of key questions that we are seeking answers to. The question number corresponds to the question number in the body of the paper.

Regarding the objectives of the review

- | | |
|---|---|
| 1 | Are these the right objectives to have in mind? |
|---|---|

Regarding disclosure obligations and remedies for nondisclosure

- | | |
|----|--|
| 5 | Can consumers accurately assess what a prudent underwriter considers to be a material risk? |
| 6 | Do consumers understand the potential consequences of breaching their duty of disclosure? |
| 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? |
| 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. |
| 12 | Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not? |

Regarding insurers' conduct and supervision

- | | |
|----|---|
| 13 | 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? |
| 18 | What has your experience been of the claims handling process? Please comment particularly on: <ul style="list-style-type: none">• timeliness the information from the claims handler about:<ul style="list-style-type: none">○ timeframes and updates on timeframes○ reasons for declining the claim (if relevant)○ how you can complain if declined• The handling of complaints (if relevant) |
| 21 | What evidence is there of insurers or insurance intermediaries mis-selling unsuitable insurance products in New Zealand? |
| 22 | Are sales incentives causing poor outcomes for purchasers of insurance? Please provide examples if possible. |

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. |
| 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”?

27 What would the effect be if there were no exceptions? Please support your answer with evidence.

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?

30 What barriers exist that make it difficult for consumers to switch between providers?

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?

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?

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

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?

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

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?

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?

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.

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?

4 Background

Development of the current regime

20. New Zealand's law relating to insurance contracts is currently spread across a mix of case law and various pieces of legislation. This reflects the incremental development of insurance contract law in New Zealand.
21. Insurance contract law in New Zealand has developed from the principles and practices developed in the eighteenth and nineteenth centuries. Back then, insurance contracts were primarily for marine insurance and existed between insurers and shipping companies. The foundation piece of insurance contract law in New Zealand is the Marine Insurance Act 1908 which was itself based on the Marine Insurance Act 1906 (UK). Although the Marine Insurance Act 1908 appears to apply only to marine insurance, many of its principles have been applied to non-marine insurance on the basis that it accurately states the common law.
22. New Zealand's existing insurance contract-related statutes include:
 - a. the Marine Insurance Act 1908
 - b. the Life Insurance Act 1908
 - c. the Law Reform Act 1936
 - d. the Insurance Law Reform Act 1977
 - e. the Insurance Law reform Act 1985
 - f. the Insurance Intermediaries Act 1994.
23. A number of these Acts have been targeted at addressing specific issues. In some places this has resulted in inconsistent outcomes in similar scenarios.
24. A number of jurisdictions with similar laws have reformed them to reflect the changing nature of insurance and to provide more protection to consumers. This leaves the New Zealand regime out of step with what is occurring elsewhere.

Previous reviews

25. A number of previous reviews of insurance contract law have been undertaken. These include:
 - a. The 1998 report from the New Zealand Law Commission titled *Some Insurance Law Problems*. In 2004, the New Zealand Law Commission published a second report titled *Life Insurance*, which confirmed the principles set out in its 1998 report and considered applying them to life insurance.
 - b. The New Zealand Ministry of Economic Development (subsequently incorporated into MBIE) launched a broad review of financial services regulation in 2005. The *Review of Financial Products and Providers* was released in 2006 and resulted in Cabinet proposals in 2008 to reform insurance contract law in New Zealand. However, these proposals were never actioned.

International context

26. New Zealand's insurance contract law is modelled on the law that used to exist in the United Kingdom (UK). Until 1984 Australian insurance law was also by and large modelled on the law in the UK and therefore was substantially the same as that in New Zealand – with the exception of the reforms contained in New Zealand's Insurance Law Reform Act 1977.
27. Australia and the UK have both reformed their insurance contract law and have therefore already addressed a number of the issues raised in this issues paper. Given this, these two countries provide good comparators when considering the issues with New Zealand's insurance contract law.

United Kingdom reforms

28. In 2006, the Law Commissions (for England and Wales) and the Scottish Law Commission started a review of UK insurance law. This led to the adoption of three new Acts: the Third Parties (Rights against Insurers) Act 2010, the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015. In the UK, there is now a difference drawn between consumer insurance and business insurance. Some of the detail of these reforms is discussed in the body of this issues paper.

Australian reforms

29. Following an Australian Law Reform Commission report in 1982, the Australian Government passed the Insurance Contracts Act 1984. The Insurance Contracts Act 1984 was subsequently amended by the Insurance Contracts Amendment Act 2013. Some of the detail of these reforms is discussed in the body of this issues paper.

5 Issues that are likely to be of general interest

30. This section summarises those issues which are likely to be of general interest to a broad range of stakeholders. Each issue concludes by posing a number of questions that we are particularly interested in hearing your views on.

Disclosure obligations and remedies for non-disclosure

The duty of disclosure: what the law is

31. 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. This underlying duty highlights the importance of disclosure by the insured and the insurer when forming a contract for insurance. The duty is based on the fact that it is the business of the insurer to assess risk, and the insurer cannot be expected to know all circumstances affecting a risk. Without this duty, the insured could deliberately withhold information so as to qualify for a contract of insurance an insurer may not otherwise agree to, or to lower the cost of premiums.
32. As a way of mitigating this, the duty of disclosure provides an obligation, when entering into a contract for insurance, on the part of the policyholder to disclose information to the insurer which could affect the insurer's analysis of risk. The Marine Insurance Act 1908 codifies the duty of disclosure applicable to all insurance contracts in New Zealand.
33. The policyholder has a duty to make full disclosure of all "material" facts that are within the knowledge of the policyholder. Materiality is defined as a circumstance which would influence the judgment of a prudent insurer in setting the premium or deciding whether to take on the risk. The duty exists independently of any duty stipulated in the contract.

The remedy for non-disclosure

34. The remedy for the failure to disclose all material circumstances (i.e. "non-disclosure") is also provided by section 18 of the Marine Insurance Act 1908. This permits the insurer to avoid the contract and refuse all claims under it. The remedy strictly applies even if there is no connection between the facts that were not disclosed, and the claim being made by the policyholder. Use of the remedy of avoidance does not require any damages to be incurred by the insurer as a result of the non-disclosure.

The remedy for incorrect disclosure (misstatement)

35. With regards to life insurance there are differences between how the law treats non-disclosure and incorrect disclosure (misstatement) due to the Insurance Law Reform Act 1977 (ILRA). The law on misrepresentation in the ILRA limits the circumstances in which an insurer may avoid a life insurance policy based on misrepresentation by the insured. The

effect of the ILRA is that insurers cannot rely on minor errors in disclosure in order to avoid a policy.

36. Misstatement for the purposes of marine insurance policies and policies other than life insurance is dealt with by the Marine Insurance Act 1908 and the Contract and Commercial Law Act 2017 respectively. For marine insurance, an insurer can avoid the policy for misstatement and for other forms of insurance an insurer can cancel the policy.

What the law is overseas

Australia

Duty of disclosure

37. The insured's duty extends only to facts which the insured knew, or which a reasonable person in the insured's circumstances would have known, to be relevant to the insurer's assessment of the risk.
38. The insured's burden of knowing what to disclose is thus lightened, by providing that insurers are taken to have waived compliance with the duty of disclosure in consumer insurance if they have not asked specific questions of the insured. An insurer cannot rely on an incorrect answer to an open-ended or vaguely worded question if the information it wanted could have been the subject of a specific question.
39. Additionally, an insurer is required to inform the insured in writing of the nature and effect of the duty of disclosure before contract formation.

Remedies for non-disclosure

40. An insurer cannot reject a claim if the non-disclosure was innocent and the insurer would have accepted the risk with full disclosure, but it can do so if innocent non-disclosure would have caused it to reject the risk at the time of contract formation. In this instance the insurer must prove that it would have rejected the risk (e.g. based on evidence of similar rejections). An insurer can reduce the claim amount paid to the policyholder if it would have charged a higher premium or excess if the relevant information had been disclosed.
41. In instances of fraudulent non-disclosure, if only an insignificant part of the claim was fraudulent and if non-payment of the remainder of the claim would be harsh and unfair or disproportionate, the court can order the insurer to pay such amount in respect of the claim as the court considers "just and equitable" in the circumstances.

United Kingdom

Duty of disclosure

42. Insurance contract legislation in the United Kingdom treats disclosure and remedies separately for consumers and businesses. The Consumer Insurance (Disclosure and Representations) Act 2012 abolished the duty of disclosure for consumers and replaced it with a duty to take reasonable care not to make a misrepresentation.
43. The law now requires the insurer, through questioning, to identify the information it needs to underwrite risk and on what terms. The insured then has the responsibility to accurately answer the questions; any incorrect response constitutes misrepresentation.

Remedies for misrepresentation

44. If a misrepresentation was deliberate or reckless, the insurer:
 - a. may avoid the contract and reject all claims

- b. need not return any premiums paid unless it would be unfair to the consumer to retain them.
45. If a misrepresentation was careless:
- a. If the insurer would not have entered the contract, the insurer may avoid the contract and refuse all claims but must return the premiums.
 - b. If the insurer would have varied the terms of the contract (excluding terms relating to a premium), the contract must be treated as if it were entered into on those terms.
 - c. If the insurer would have charged a higher premium, the insurer may reduce the claim amount paid by that amount.

Why is New Zealand's current treatment of disclosure a problem?

46. In the past twenty years, many stakeholders, including dispute resolution providers that deal with insurance-related complaints, have commented on the high volume of complaints related to disclosure in insurance contracts, and have highlighted the need for reform in the law.
47. The Law Commission's 1998 report *Some Insurance Law Problems* identified several issues with the duty of disclosure. The issues identified were that:
- a. what the insured must disclose is uncertain – the law does not provide clarity to policyholders about what information they must disclose
 - b. ignorance is no excuse for breach of duty to disclose
 - c. specific questions do not relieve the insured of the duty to disclose
 - d. the law imposes disproportionate consequences on policyholders for the breach of the duty to disclose.
48. We have categorised the problems with the broad issue of disclosure into the following related problems:
- a. Consumers don't understand what needs to be disclosed.
 - b. Consumers may not be aware of the duty of disclosure.
 - c. The consequences for breaching disclosure obligations can be disproportionate.

Consumers don't understand what needs to be disclosed

49. The test in the law for what a purchaser of insurance needs to disclose requires disclosure of information that is material, which would influence the judgement of a prudent underwriter. This test is not easy for the average consumer to understand. The test of materiality is subjective; what may be considered "material" to a prudent underwriter may not be to the policyholder, and vice versa. An ordinary consumer cannot be expected to know what circumstances would influence a prudent underwriter.
50. In some cases, it is fairly obvious to the insured what type of information needs to be disclosed, but there is plenty of room for genuine misunderstanding. For example, when a consumer takes out health insurance, it may be obvious that they need to disclose prior physical health conditions, but they may not know whether any previous mental health conditions are likely to be material in influencing the insurer's analysis of risk. This may be obvious to the insurer, but not necessarily to the insured.
51. If consumers are required by law to disclose information that an insurer would consider material, but they do not understand what information is material and fail to make correct

disclosure, then by law the insurer has the right to deny the claim or avoid the policy, leaving the consumer without cover.

52. Our initial position is that the duty to interpret what is meant by material in influencing the judgement of a prudent insurer is overly onerous on the consumer.
53. Related to the lack of understanding about what is material and what needs to be disclosed, is the fact that consumers may not understand that what is “material” goes beyond specific questions which may be asked by the insurer. Insurers typically ask insureds questions as part of accepting a proposal for insurance. However, even if insurers do ask specific questions, this does not relieve the policyholder of the duty to disclose other facts which may be considered “material” by a prudent underwriter; if there were other material facts which were not disclosed, the fact that specific questions were asked which did not target those facts is not an excuse for breaching the duty to disclose. Insureds may not know, and may not have been warned, that they have a residual duty to disclose any material facts that are out of scope of any specific questions that are asked.

Consumers may not be aware of the duty of disclosure

54. Insureds will not always be aware of their general duty of disclosure and insurers are not under a positive duty to bring this to their attention. Ignorance on the part of the policyholder, or the fact that the policyholder was not warned by their insurer, cannot be taken as an excuse for the breach of the duty of disclosure.
55. In fact, the legal remedies for breaching disclosure obligations (i.e. avoidance of contract or the ability to deny the claim) mean that insurers may lack incentives to inform policyholders of the extent of the duty and the potential consequences.
56. This is a problem because if consumers are not aware that they have a duty to disclose, and they fail to make full disclosure, the insurer’s remedies can kick in and the consumer may not be covered for a loss.

The consequences for breaching disclosure obligations can be disproportionate

57. Failure to disclose a material circumstance allows an insurer to treat the contract of insurance as void (i.e. as if it never existed) from the start. Insurers have the ability to avoid a claim even if the disclosure of the relevant facts would not have made them decline cover.
58. This is a problem because it can have serious consequences for the policyholder: it can impact their ability to obtain cover in the present and in the future due to a history of having a previous contract voided or a claim denied. Therefore, breaches of disclosure obligations can have disproportionate, long-term consequences for the insured. It can affect their ability to be protected against economic loss both in the short term and in the future, to the detriment of their wellbeing.

Questions

| | |
|---|--|
| 3 | Are consumers aware of their duty of disclosure? |
| 4 | Do consumers understand that their duty of disclosure goes beyond the questions that an insurer may ask? |
| 5 | Can consumers accurately assess what a prudent underwriter considers to be a material risk? |

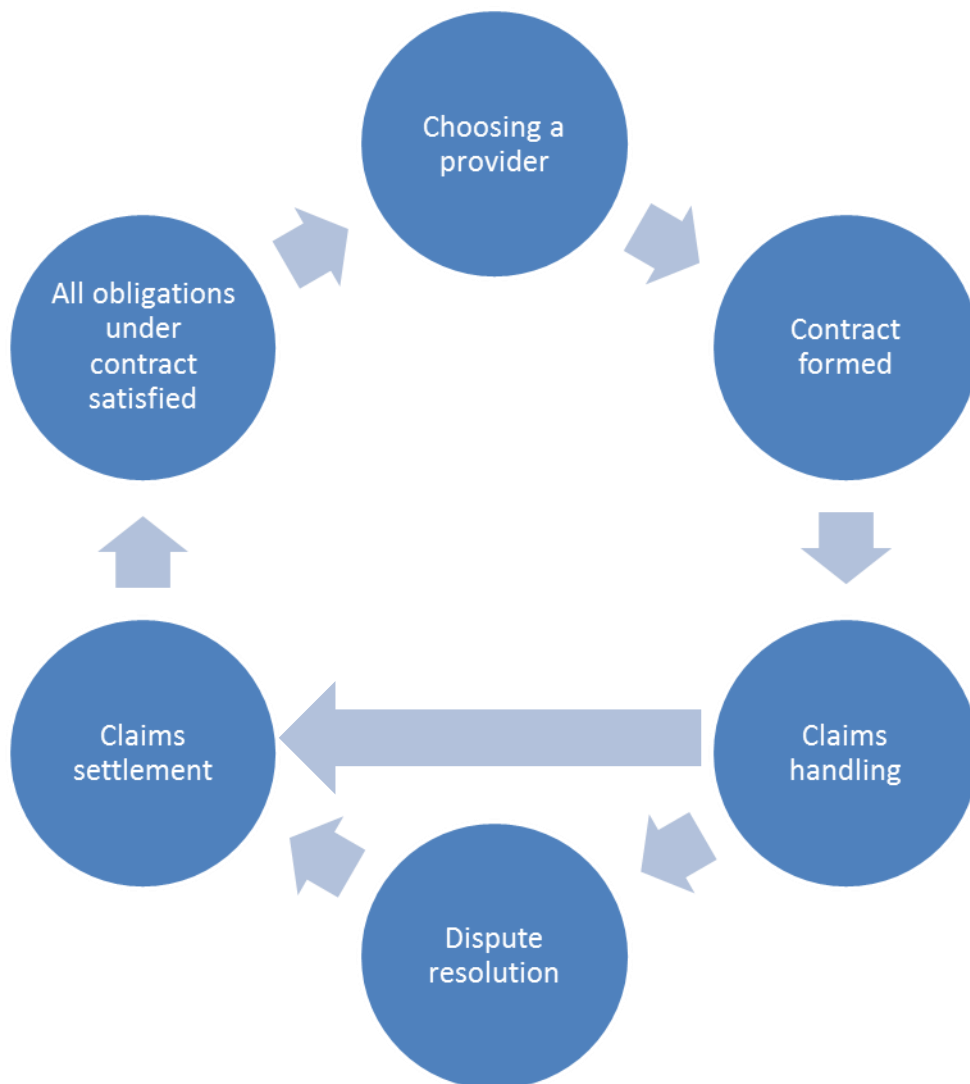
| | |
|----|--|
| 6 | Do consumers understand the potential consequences of breaching their duty of disclosure? |
| 7 | Does the consumer always know more about their own risks than the insurer? In what circumstances might they not? How might advances in technology affect this? |
| 8 | Are there examples 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. |
| 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? |
| 10 | Should the remedy available to the insurer be more proportionate to the harm suffered by the insurer? |
| 11 | Should non-disclosure be treated differently from misrepresentation? |
| 12 | Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not? |
| 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? |
| 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? |

Conduct and supervision

What do we mean when we talk about insurers' conduct?

- 59. The conduct of insurers and associated intermediaries involved in selling insurance can significantly influence the outcomes for policyholders during the lifecycle of a contract (involving all stages of the contract, from choosing a provider, claims handling, dispute resolution, settlement of a claim and through to the point at which all obligations under the contract have been satisfied). We are therefore also considering any issues relating to the broader question of insurers' conduct.

Diagram: Stylised lifecycle of an insurance policy



60. The International Association of Insurance Supervisors (IAIS) has taken responsibility for setting a globally-accepted framework for the supervision of the insurance sector. IAIS has established a set of core principles designed to maintain a “fair, safe and stable insurance sector”. Insurance core principle 19 – Conduct of Business (ICP 19) specifically relates to the conduct of insurers and states that:

“insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.”

61. More detail on ICP 19 is included in the box below. The IAIS envisages that the requirements set out in ICP 19 would be overseen and enforceable by an industry supervisor or regulator.

The International Association of Insurance Supervisors’ Insurance Core Principle 19 – Conduct of Business¹

The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.

Fair treatment of customers

- 19.1 The supervisor requires insurers and intermediaries to act with due skill, care and diligence when dealing with customers.
- 19.2 The supervisor requires insurers and intermediaries to establish and implement policies and procedures on the fair treatment of customers, as an integral part of their business culture.
- 19.3 The supervisor requires insurers and intermediaries to avoid or properly manage any potential conflicts of interest.
- 19.4 The supervisor requires insurers and intermediaries to have arrangements in place in dealing with each other to ensure the fair treatment of customers.

Product development and pre-contractual stage

- 19.5 The supervisor requires insurers to take into account the interests of different types of consumers when developing and distributing insurance products.
- 19.6 The supervisor requires insurers and intermediaries to promote products and services in a manner that is clear, fair and not misleading.
- 19.7 The supervisor requires insurers and intermediaries to provide timely, clear and adequate pre-contractual and contractual information to customers.
- 19.8 Where customers receive advice before concluding an insurance contract the supervisor requires that the advice provided by insurers and intermediaries takes into account the customer’s disclosed circumstances.

Policy servicing

- 19.9 The supervisor requires insurers to: service policies appropriately through to the point at which all obligations under the policy have been satisfied; disclose to the policyholder information on any contractual changes during the life of the contract; and disclose to the policyholder further relevant information depending on the type of insurance product.
- 19.10 The supervisor requires insurers to handle claims in a timely, fair and transparent manner.

¹ The content of this box is drawn from the IAIS website <https://www.iaisweb.org/page/supervisory-material/insurance-core-principles/file/70028/all-adopted-icps-updated-november-2017>

19.11 The supervisor requires insurers and intermediaries to handle complaints in a timely and fair manner.

19.12 The supervisor requires insurers and intermediaries to have policies and procedures for the protection and use of information on customers.

Information supporting fair treatment

19.13 The supervisor publicly discloses information that supports the fair treatment of customers.

Status quo of insurers' conduct regulation in New Zealand

62. New Zealand's regulation of insurers against the IAIS principles was examined during the International Monetary Fund's (IMF) Financial Sector Assessment Program. In its report² the IMF noted there are gaps in the regulation of insurers' conduct. Specifically, in relation to ICP 19, the IMF found that the principle of 'Conduct of Business' (ICP 19) was only partly fulfilled in New Zealand. The IMF stated: "...aspects of the insurer's relationship with customers where there may be misconduct, including the handling of claims and complaints, and advice on (nominally) simpler products provided by registered advisers (RFAs), are effectively unregulated or reliant on industry self-regulation and dispute resolution processes."³
63. The IAIS principles envisage a regulator or supervisor who can monitor and enforce conduct requirements. In New Zealand the following entities have regulatory/supervisory powers over the insurance industry:
- Prudential regulation (typically relating to financial soundness and good governance requirements) is overseen by the Reserve Bank.
 - The Financial Markets Authority has powers in relation to insurers' and insurance intermediaries' conduct through the regulation of financial advice and through powers relating to 'misleading and deceptive' conduct under Part Two of the Financial Markets Conduct Act 2013 (FMC Act).
 - The Commerce Commission can enforce the provisions of the Fair Trading Act 1986.
64. Taken together, the Reserve Bank, the FMA and the Commerce Commission regulate parts of the insurance sector, but no regulator has oversight of insurers' and insurance intermediaries' conduct during the full insurance policy 'lifecycle'.
65. The IMF found that the regulation of insurers' conduct is largely delivered through the regulation of financial advice in New Zealand (regulated by the FMA). The law deals with the improper provision of financial advice through its care, diligence and skill requirements and the ban on misleading/deceptive conduct.
66. There are changes being made to the financial advice regime in New Zealand that will make improvements to how insurance products are sold through financial advice channels. However, these improvements will not change the regulation of insurance products that are sold without financial advice (i.e. when a consumer makes the decision themselves about the insurance product they want and the insurer or their intermediary only executes the contract rather than giving financial advice). Sales conduct in relation to insurance (where it does not involve financial advice), whether by insurance providers or others, is

² <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/FSAP/Detailed-assessment-of-observance-Insurance-core-principles.pdf>

³ <https://www.imf.org/en/Publications/CR/Issues/2017/05/10/New-Zealand-Financial-Sector-Assessment-Program-Detailed-Assessment-of-Observance-Insurance-44904>

subject to fair dealing laws only (Part Two of the FMC Act), and is not covered by financial advice legislation.

67. If a dispute over an insurance contract arises, conduct during the dispute resolution process is governed by the requirement for all insurers to belong to an external dispute resolution scheme.

Some insurers have adopted a 'Fair Insurance Code' and the 'duty of utmost good faith' has been clarified in a 2016 court case

68. The Insurance Council of New Zealand (ICNZ) has developed a Fair Insurance Code that sets minimum standards for ICNZ's members in regards to general responsibilities, claims handling and resolution of complaints. It also sets out the areas of responsibility for the insured during the lifecycle of an insurance contract (for example, acting honestly when making a claim).
69. ICNZ represents the fire and general insurance industry only, and whilst membership is voluntary, ICNZ's current members represent more than 95 percent of all fire and general insurance policies written in New Zealand.
70. When a dispute arises over a possible breach of the Fair Insurance Code, an insurers' external resolution scheme can take this breach into account in its decision. The consequence for a significant breach of the Code is a reprimand, fine or expulsion from ICNZ.
71. There is evidence to suggest that, in most cases, insurers who have subscribed to the Fair Insurance Code are honouring standards set out in the Code. During 2016 only 0.3 percent of all claims resulted in complaints to insurers' internal dispute resolution services, and, 95 percent of those claims were resolved internally. Of the disputes that were considered by external dispute resolution schemes, 14 were upheld.
72. However, as stated above, the Fair Insurance Code only applies to fire and general insurance. Other types of insurance products are not covered by the Code, including life insurance and health insurance.

Duty of 'utmost good faith'

73. As outlined above, there are no specific duties in New Zealand law that cover the conduct of insurers during the full lifecycle of an insurance policy. However in 2016 the High Court found that a mutual duty of utmost good faith was implied in every insurance contract.⁴ The Court found that the duty was a reciprocal obligation between the insurer and the insured. Both insurers and insureds are therefore expected to act in good faith towards one another at all points throughout the lifecycle of an insurance policy. This implies full disclosure by both parties and no deliberate withholding of information or passing of misinformation.

⁴ Young v Tower Insurance Ltd [2016] NZHC 2956

Consumer complaints we have heard relating to insurers' and insurance intermediaries' conduct

Claims handling

74. Notwithstanding the figures outlined above in relation to ICNZ's Fair Insurance Code, we have heard from consumers who have been engaged in protracted disputes with their insurance companies in regards to claims handling. These disputes may not go through any formal internal or external dispute resolution process, but are negatively impacting consumer outcomes.
75. The disputes have particularly been in the general insurance sector and relate to the following issues:
- Lengthy timeframes to settle claims
 - particularly in the case of Christchurch earthquake claims we have heard that more complex claims have been deprioritised in favour of settling more straightforward claims
 - disputes over claims extending to a number of years without resolution.
 - In Christchurch, claimants being pressured to settle their claim or be placed at the 'bottom of the pile' of claimants.
 - Lack of transparency on the part of insurers during the claims handling process – specifically in regards to not supplying documents requested by the insured in relation to their claim.
76. We are aware that other factors and the sheer unexpected volume of claims following the Christchurch earthquakes have contributed to these issues. Moreover, as mentioned above, the High Court has found that the 'duty of utmost good faith' is reciprocal, and in the case mentioned found that the plaintiffs caused some of the delays in claims handling. The Court also referenced an earlier case where delays were due to ongoing negotiations between the parties involved, rather than a deliberate strategy by the insurer to delay payment.
77. We are also aware that in Christchurch the relationship was not solely between the customer and private insurance company. The Earthquake Commission (EQC) was also involved.

Sales and advice

78. We have heard reports of a number of conduct issues related to sales and advice, including pressure sales tactics, selling products that are unsuitable for the customer in question and deliberate churn of insurance policies.

The role of incentives in sales and advice

79. Sales incentives can take a number of forms, including: commissions (for example a share of the insurance premium), soft commissions (for example, using overseas trips as a reward), bonuses and sales targets.
80. In 2016 the FMA released the findings of its investigations into 'replacement life insurance' (or insurance 'churn'). The report highlighted that the commissions paid to those selling life insurance were incentivising some in the industry to replace policies for existing customers (in order to gain a renewed commission on the policy).

81. In March 2018 the FMA released a further report⁵ looking at conflicted conduct and insurance replacement business practices among financial advisers. The 2018 report found that most of the advisers reviewed failed to recognise that incentives create a conflict with the interests of their clients.
82. We seek feedback on whether sales incentives (in all insurance sectors) are causing poor outcomes for purchasers of insurance.

Pressure sales tactics

83. The Australian Securities and Investments Commission's (ASIC) recent review of the sale of direct insurance⁶ has resulted in refunds to thousands of customers. For example, in the review of ClearView Life Assurance Limited, ASIC found that sales staff had:
 - “made misleading statements about the cover, the premiums, and the effect of any of the consumer's pre-existing medical conditions
 - did not clearly obtain consumer consent to purchase the cover before processing the premium payments, and
 - used pressure sales tactics to sell the policies.”
84. We seek evidence on whether there are similar problems in New Zealand.
85. Should similar practices be identified in New Zealand then customers' current recourse would be through either the Fair Trading Act 1986 or Part Two of the Financial Markets Conduct Act 2013. For instance, charges relating to false and misleading sales practices were upheld against insurance company Youi NZ Pty Ltd (Youi) in 2016. Youi pled guilty to charges of misleading sales techniques laid under the Fair Trading Act by the Commerce Commission.

Suitability of the product

86. The issue of whether consumers are being mis-sold insurance products that are unsuitable for them has received attention overseas. In the early 2000s in the United Kingdom it was revealed that many customers had been mis-sold payment protection insurance (PPI) alongside mortgages, loans and credit cards. The product is meant to protect individuals in the event that they become ill or lose their job and can no longer afford the loan repayments. However, PPI was being sold to people such as the self-employed, who would not be able to claim under the terms of the policy.
87. More recently the sale of 'junk insurance' has received media attention in Australia, with the Commonwealth Bank agreeing to repay 64,000 customers after it mis-sold credit card insurance to customers who would not be able to make claims under the terms of the contract (for example the elderly and unemployed).
88. We seek evidence regarding whether insurers' or insurance intermediaries' are selling unsuitable insurance products in New Zealand.

Insurance churn

89. As mentioned above, work undertaken by the FMA has raised issues with the practice of 'churning' insurance policies – particularly in the life insurance sector in New Zealand. In its 2016 report the FMA highlighted that some of those selling life insurance were actively

⁵ https://fma.govt.nz/assets/Reports/_versions/10637/180322-FMA-update-on-inquiries-into-insurance-replacement-business.2.pdf

⁶ Direct insurance is an execution only sale where the insurance company, rather than an intermediary, sells the insurance directly to the purchaser.

replacing policies for existing customers in order to gain a renewed commission on the policy. A replaced policy may be detrimental to the insured if the new policy provides less suitable cover.

90. A wider harm from insurance churn is that if larger commissions are paid by insurance providers to intermediaries for replacement business then these costs are likely passed on to all purchasers of insurance through higher premiums. Further, a focus on replacement business limits the time spent on sales to new customers, who may gain benefit from life insurance.

We are looking for evidence to assess the scale of any issues with insurers' conduct

91. Because there are gaps in regulatory oversight over insurers' conduct, there are currently limitations in our evidence base from which to identify and assess the issues in New Zealand. Our inquiry into insurers' conduct is largely driven by the findings of the IMF and the gaps in New Zealand's regulation of insurers when compared to the IAIS principles.
92. Part of this review process will be to collect evidence in order to assess, and develop appropriate solutions for, any issues found in New Zealand. Your submissions and input into the inquiry will form a crucial part of this process.

Questions

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| 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? |
| 16 | To what extent is the gap between ICP 19 and the status quo in New Zealand (as identified by the IMF) a concern? |
| 17 | Does the lack of oversight over the full insurance policy 'lifecycle' pose a significant risk to purchasers of insurance? |
| 18 | What has your experience been of the claims handling process? Please comment particularly on: <ul style="list-style-type: none"> • timeliness the information from the claims handler about: <ul style="list-style-type: none"> ○ timeframes and updates on timeframes ○ reasons for declining the claim (if relevant) ○ how you can complain if declined • The handling of complaints (if relevant) |
| 19 | Have you ever felt pressured to accept an offer of settlement from an insurance company? If so, please provide specific examples. |
| 20 | When purchasing (or considering the purchase of) insurance, have you been subject to 'pressure sales' tactics? |
| 21 | What evidence is there of insurers or insurance intermediaries mis-selling unsuitable insurance products in New Zealand? |

22

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

23

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

Unfair contract terms exceptions in the Fair Trading Act 1986

Status quo

93. The Fair Trading Act 1986 contains provisions prohibiting unfair contract terms in standard form consumer contracts. A term can only be declared unfair if it would cause an imbalance in the rights and obligations of the parties to the contract, is not reasonably necessary to protect the legitimate interests of the party who would benefit from the term, and would cause detriment to a party to the contract. For example, a term which allows one party to vary the terms of the contract without the other party's agreement can sometimes be unfair.
94. Insurance contracts *are* covered by these provisions, although there are some exceptions for particular core terms in insurance contracts that specify the risk that is being insured and limits to liability. For example, a term in an insurance contract that states the cover will not be provided where the loss is due to an invasion, war or terrorism. When the unfair contract terms provisions were drafted the terms excepted were considered reasonably necessary in order to protect the legitimate interests of insurers (and therefore not unfair), and the exception was added to provide certainty about this.
95. Section 46L of the Fair Trading Act sets out specific terms in insurance contracts that will be taken to be reasonably necessary to protect the legitimate interests of insurers, and which therefore cannot be declared to be unfair contract terms:
 - a. the subject or risk insured against
 - b. the sum insured
 - c. excluded/limited liability on the happening of certain events
 - d. the basis on which claims may be settled
 - e. payment of premiums
 - f. duty of utmost good faith that applies to both parties
 - g. requirements for disclosure.
96. Australia has a much broader exemption for insurance contracts. While New Zealand's unfair contract terms law exempts specific types of terms in insurance contracts, Australia's unfair contract terms prohibition currently has a total exemption for all contracts regulated under its Insurance Contracts Act 1984. The final report on the review of the Australian Consumer Law recently recommended that the unfair contract terms provisions be amended to include insurance contracts. The review concluded that while the Insurance Contracts Act contains insurance-specific protections for consumers (e.g. duty to act in the 'utmost good faith', disclosure requirements and rules directed at preventing insurers' reliance on specific policy terms in certain circumstances), they are not the same as the protections in generic consumer law and have not been shown to provide equal or greater consumer protection.
97. In August 2017 Australian Ministers agreed to support further analysis on the proposal, including public regulatory impact assessment, for report back in August 2018 to inform decision-making.

Problem definition

98. Consumer stakeholders have expressed concerns about the exceptions for insurance. We understand these concerns to be that action cannot be taken against unfair contract terms in insurance contracts because of the exceptions.
99. From the perspective of insurers, the exceptions serve to clarify what cannot be declared to be unfair in an insurance contract on the basis that the types of terms given in section 46L do not meet the criteria for unfair (i.e. they are reasonably necessary to protect the legitimate interests of the insurer).
100. Without the exceptions, insurers say they may face uncertainty regarding the extent of risk in the contract of insurance. This uncertainty will increase the difficulty faced by an insurer in quantifying the risk in the contract of insurance. If the risk in the contract of insurance cannot be accurately quantified it cannot be accurately priced. If it can't be accurately priced, insurers may cease offering cover or increase the premium that they require.
101. We are interested to know whether consumers are experiencing problems with terms in insurance contracts which are excepted from the unfair contract terms provisions but which consumers consider unfair.
102. We are also interested in submitters' views on whether the specific exceptions outlined in the Fair Trading Act are all needed (or needed at all) in order to protect the "legitimate interests of the insurer" as is currently outlined in the Fair Trading Act.

Questions

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| 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. |
| 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? |
| 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"? |
| 27 | What would the effect be if there were no exceptions? Please support your answer with evidence. |

Comparing and changing policies and providers

103. Confident and well-informed consumers help to drive effective competition, which in turn delivers better outcomes for consumers. The intensity of competition may be reduced where consumers find it difficult to compare and change policies and providers.
104. Difficulties finding, understanding and comparing information on insurance can also have significant consequences for consumers, as they may pay premiums for many years without realising that cover is excluded in certain situations.

What do we know about the difficulties comparing and changing policies and providers in the New Zealand insurance market?

105. There are costs associated with comparing compare providers. These costs involve the time taken to search for and understand information about insurance products (for example, contacting brokers to obtain quotes and reading policies).
106. There are also costs to change providers. These costs are factors that may prevent a consumer from changing providers (for example, loss of relationship with a previous provider, or loss of access to some benefits through a change in insurance policies).
107. We have heard anecdotally that consumers have difficulty comparing insurance providers and policies. In the home and contents market, CanStar Blue's research found that 79% of existing policyholders stayed with their provider when it came to renew or cancel their policy, implying that only 21% of policyholders either switched provider or cancelled their policy.⁷ The research indicates that it is likely that consumers in New Zealand only switch providers during key life stages, such as moving house or getting married.
108. We are seeking evidence of specific barriers to consumers finding information on, and comparing, insurance policies; and barriers to consumers switching to an alternative provider. We are also interested in your views on whether anything can or should be done to simplify the search and switching process. We have set out below the factors which may influence the level of these costs in New Zealand.

Difficulties finding and comparing information on insurance

109. To make an informed purchasing decision about insurance, consumers need information about price, insurance cover offered by the policy and the quality of service offered by the insurer:
 - Comparing insurance policies on **price** is complicated by the fact that insurance premiums vary depending on a consumer's risk profile, which is specific to the consumer and depends on their individual attributes (such as whether the consumer is a smoker or has a burglar alarm installed in their home). When consumers are considering purchasing insurance, they are generally required to contact individual insurers or brokers to provide their information and obtain quotes – something that can be quite a lot of work.
 - Consumers may also have difficulties comparing the **level of cover** offered by insurers. Policies may have different exclusions and reading the policy may be the only way to fully assess what is included. However, insurance policies tend to be long, complex and written in terms that the average consumer may not understand.

⁷ CanStar Blue, 2016

- Assessing insurance providers on **service quality** is often problematic for consumers at the time of purchasing a policy. This is true of many services, such as financial or legal services, which cannot be fully evaluated by the consumer either before or for some time after purchase. However, this may be alleviated if consumer reviews or surveys are available to provide consumers with an indication of others' experiences with the provider.
110. A lack of easily accessible information can discourage consumers from assessing options available to them and switching providers.
 111. Comparison websites can help consumers compare and evaluate insurance providers by consolidating information about a provider into an easily accessible format. In the life and health insurance market there are a number of comparison websites (e.g. Life Direct and Insure Me). These websites automatically generate quotes online after the consumer inputs their data and requirements.
 112. Consumers can also compare insurance providers on service quality by using CanStar Blue. CanStar Blue is a comparison website which provides a star rating for insurers based on an annual customer satisfaction survey, on factors such as satisfaction with claims outcome and policy clarity.

Ill-informed switching is not in the interests of consumers

113. Switching providers is positive for the consumer if the switch results in the consumer receiving better value for money. However, as with any change, ill-informed switching may make consumers worse off. The consequences of an ill-informed switch may be particularly dire in the context of life, health and disability insurance, where switching may result in consumers losing cover for pre-existing conditions.
114. Again, the extent to which the consumer can make an accurate assessment that takes into account price, cover and service quality is likely to impact whether the switch to a new insurer or a change in policy is in their best interests.

Questions

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| 28 | Is it difficult for consumers to find, understand and compare information about insurance policies and premiums? If so, why? |
| 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? |
| 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? |

6 Technical issues

Third party access to liability insurance monies

115. Under a liability insurance policy, the insured is protected against the risk of liability to third parties caused by the insured's wrongdoing.
116. Section 9 of the Law Reform Act 1936 (LRA) creates a charge over the insurance money (a claim to the insurance money) in favour of the wronged third party on the happening of the event giving rise to the claim for damages. This means that in the event of the insolvency of the insured, the wronged third party is given direct access to the insured's insurance money, and that money is not distributed amongst the insolvent insured's other creditors.
117. For example, a builder who has a liability insurance policy builds a home. The owner of the home discovers that it is defective and brings a claim against the builder but the builder has become insolvent. Section 9 of the LRA creates a charge over liability insurance monies in favour of the homeowner.
118. However, we understand that a number of problems have been identified with the operation of the charge in section 9 of the LRA. These include:
 - a. Practical issues prioritising multiple charges where the insurance policy limit is insufficient to fully satisfy each claim, particularly where the claims arise on the same day.
 - b. How the charge operates where a policy covers both liability and defence costs up to a combined limit - the position in Australia and New Zealand has differed on whether the section 9 charge applies to the full combined limit of the policy, or up to the limit minus any defence costs payable by the insurer to the insured.
 - c. What time limit should apply to a third party's claim against an insurer?
119. These issues have been considered previously in New Zealand. The Law Commission recommended that the charge in section 9 of the LRA be replaced with provisions extending privity of contract to third parties under the Contracts (Privity) Act 1984. In other words, this would give the third party the right to bring an action against the insurer in relation to the money. The Law Commission also recommended a number of changes to the operation of the regime.
120. The issues has also been considered overseas, including recently by the New South Wales Law Reform Commission in its November 2016 report *Third party claims on insurance money*, when reviewing the previous equivalent New South Wales provision.⁸ The UK and New South Wales have replaced their statutory charge provisions with provisions giving third parties the right to bring proceedings against the insurer directly.

⁸ <http://www.lawreform.justice.nsw.gov.au/Documents/Publications/Reports/Report%20143.pdf>

Questions

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| 33 | Do you agree that the operation of section 9 of the Law Reform Act 1936 (LRA) has caused problems in New Zealand? |
| 34 | What are the most significant problems with the operation of section 9 of the LRA that any reform should address? |
| 35 | What has been the consequence of the problems with section 9 of the LRA? |
| 36 | If you agree that there are problems with section 9 of the LRA, what options should be considered to address them? |

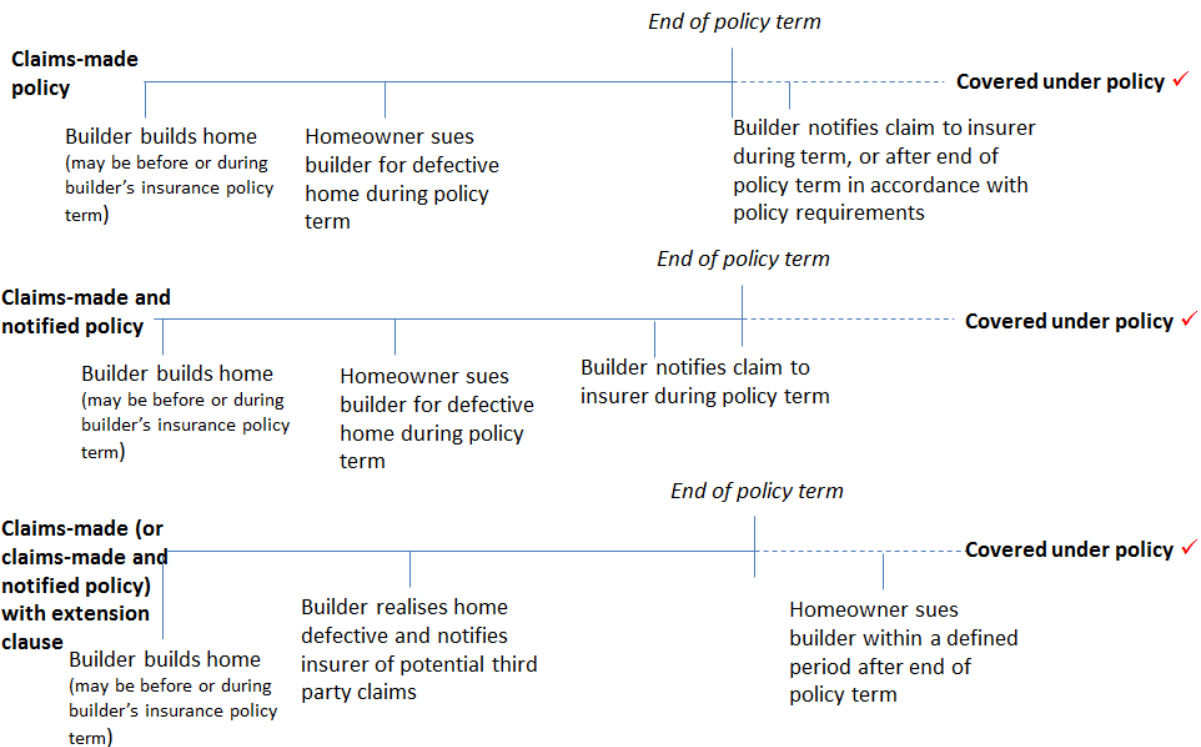
Failure to notify claims within time limits

121. Section 9 of the Insurance Law Reform Act 1977 (ILRA) relates to time limits for making claims contained in insurance policies. That section provides that a claim can be declined only if the insured's failure to comply with a policy time limit prejudiced the insurer such that it would be inequitable that the time limit did not apply.⁹ Prejudice may include for example, the insurer losing the opportunity to defend a claim.¹⁰ Increased costs of repairing or replacing property does not constitute prejudice to the insurer for the purpose of section 9 of the ILRA, but the insurer is only obliged to pay the lesser amount that would have been payable if the claim had been notified within time limits.
122. Section 9 recognises that it may be unfair for the insurer to decline a claim where the insured has merely failed to comply strictly with the policy's terms and where that failure has not caused any real prejudice to the insurer.
123. However, the operation of section 9 of the ILRA has raised issues in the context of "claims made" liability insurance policies. "Claims made" policies generally provide cover for third party claims (e.g. for negligence) made against the policyholder during the policy term (the relevant time is when a third party brings a claim against the policyholder, not when a policyholder submits an insurance claim to their insurer). There are different types of "claims made" policies as follows.

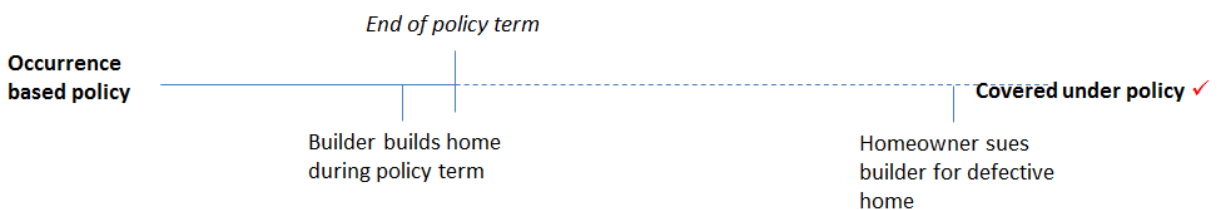
⁹ In relation to claims relating to the death of the insured under a life insurance policy, section 9 of the ILRA provides that any time limits are never binding.

¹⁰ *UEB Packaging Ltd v QBE Insurance (International) Ltd* [1998] 2 NZLR 64

For example, a builder who has a liability insurance policy builds a home. The owner of the home discovers years later that it is defective and brings a claim against the builder.



124. The above can be contrasted with an “occurrence-based” policy which covers the insured for third party claims arising out of *events* that occurred during the term of the policy.



125. The development of “claims made” policies reflects that in the case of professional liability insurance, a third party claim may be brought many years after the event giving rise to the claim e.g. after a defect in building work is discovered. This uncertainty makes it difficult for insurers to assess the level of risk and could mean setting aside large reserves for potential claims under policies that have long-expired. “Claims made” policies allow insurers to estimate risks with a greater degree of accuracy given those risks are limited to third party claims actually made and/or notified to the insurer during the term of the policy. At the end of the policy term, the insurer knows the risks that they are exposed to. Unlike an “occurrence-based” policy, the insurer is not potentially exposed to a claim many years down the track for an event that occurred during the policy term.

126. However, section 9 of the ILRA means that an insured that fails to notify the insurer of a third party claim or potential claim within time limits under a “claims made” policy is excused from that failure unless the insurer suffers prejudice. This is viewed as partly undermining the purpose behind “claims made” policies, as the insurer again faces the possibility of claims some way into the future that it can only reject if it can establish prejudice.
127. The Law Commission proposed amending section 9 so that that section did not apply in certain instances involving time limits under “claims made” policies.

Questions

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| 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? |
| 38 | What has been the consequence of the problems with section 9 of the ILRA? |
| 39 | If you agree that there are problems with section 9 of the ILRA, what options should be considered to address them? |

Exclusions that have no causal link to loss

128. Section 11 of the Insurance Law Reform Act 1977 (ILRA) provides that insurers cannot decline a claim based on a policy exclusion if:
 - a. the policy contains the exclusion because the insurer considers that the risk of loss is likely increased in the specified scenario; but
 - b. in the circumstances of the particular claim, there is no causal link between the exclusion and the loss.
129. For example, the policy may exclude cover where a vehicle is used for commercial purposes. However, a third party may cause an accident while the vehicle is being used for commercial purposes and the commercial use may not have contributed to the loss. In that scenario, section 11 of the ILRA would prevent the insurer from declining the claim based on the commercial purpose exclusion.
130. However, some circumstances may give rise to a greater statistical likelihood of loss even if they do not cause the loss. For example, a vehicle used for commercial purposes is more likely to be involved in an accident because it tends to be driven more. Section 11 has the effect of preventing insurers from excluding coverage in such circumstance where there is statistical evidence of greater loss occurring.
131. The Law Commission proposed reform by removing certain types of exclusions from the operation of section 11, being 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.

Questions

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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?

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?

42

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

Registration of assignments of life insurance policies

132. Interests in life insurance policies may be assigned to third parties such as lenders as security for a loan. This may be done by mortgage or transfer.
133. The registration system for transfers and mortgages of life insurance policies under Part 2 of the Life Insurance Act 1908 has previously been identified as out-of-date and largely unused.¹¹ It requires paper policy documents to be sent to the insurer for registration, and policy documents to be physically held by the assignee in order to make a claim under the policy.
134. When Cabinet considered the issue in 2007, it agreed to a new process whereby a notice of assignment of life insurance is sent to the insurer in order to establish the assignee's rights.

Questions

43

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

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?

Responsibility for intermediaries' actions

135. Insurance intermediaries (e.g. insurance brokers) play an important role in matching purchasers of insurance with insurers and in the formation of insurance contracts, including advising on how to complete applications for cover.
136. The Insurance Law Reform Act 1977 provides that "any person entitled to receive from the insurer commission or other valuable consideration" is the agent of the insurer. The insurer bears responsibility for the actions of those intermediaries who are agents of the insurer.

¹¹ [See 2008 Cab paper]

137. For example, a consumer may disclose information to an intermediary who is an agent of the insurer that the intermediary fails to pass onto the insurer. In those circumstances, the insurer cannot avoid that insurance policy on the basis that that matter was not disclosed to them – because the insurer is deemed to have been given notice of it through the intermediary.
138. We have heard that this position creates problems in that:
- a. it may be unreasonable that the insurer should bear the cost of an intermediary's failures on the basis of entitlement to commission alone;
 - b. consumers may not always be aware whose agent an insurance intermediary is, and may not know that they will be responsible for an intermediary's failures if the intermediary is not entitled to commission from the insurer.
139. Previous proposals have included that agency should be determined based on who the intermediary has a written authorisation from. Where there is no such authorisation, the intermediary would be deemed to be the agent of the insurer.¹²

Questions

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

Insurance intermediaries – Deferral of payments / investment of money

140. Under the Insurance Intermediaries Act 1994 insurance intermediaries are:
- a. entitled to defer the payment of premiums to insurers (the default period for this is 50 days but it is capable of being varied by arrangement between the insurer and the intermediaries)
 - b. required to establish insurance broking client accounts for the purposes of, among other things, holding premiums paid by purchaser of insurance
 - c. allowed to invest money held in their insurance broking client accounts and keep any profit they make on that investment (but must personally repay any loss).
141. This creates an incentive for insurance intermediaries to hold onto premiums for as long as possible and creates a risk to insurers where intermediaries default on their payment obligations or become insolvent. We understand that periods of 80-90 days have been negotiated.

¹² Insurance: Contracts, Agency and Assignment, January 2008. <http://www.med.govt.nz/upload/55058/insurance-contracts.pdf>.

142. In the interim, insurers remain liable for the Fire Service Levy, GST and any relevant reinsurance premiums without access to the premium paid by the insurer.

Questions

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| 48 | Do you agree that the current position in relation to the deferral of payments of premiums by intermediaries has caused problems? |
| 49 | If you agree that there are problems, what options should be considered to address them? |

Other miscellaneous questions

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| 50 | Are there any provisions in the six Acts under consideration that are redundant and should be repealed outright? If so, please explain why. |
| 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? |
| 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. |
| 53 | Is there anything further the government should consider when seeking to consolidate the six Acts into one? |

7 Recap of questions

143. For ease of reference, below is a list of all the questions asked in this issues paper.

Regarding the objectives of the review

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| 1 | Are these the right objectives to have in mind? |
| 2 | Do you have alternative or additional suggestions? |

Regarding disclosure obligations and remedies for non-disclosure

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| 3 | Are consumers aware of their duty of disclosure? |
| 4 | Do consumers understand that their duty of disclosure goes beyond the questions that an insurer may ask? |
| 5 | Can consumers accurately assess what a prudent underwriter considers to be a material risk? |
| 6 | Do consumers understand the potential consequences of breaching their duty of disclosure? |
| 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? |
| 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. |
| 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? |
| 10 | Should the remedy available to the insurer be more proportionate to the harm suffered by the insurer? |
| 11 | Should non-disclosure be treated differently from misrepresentation? |
| 12 | Should different classes of insureds (e.g. businesses, consumers, local government etc.) be treated differently? Why or why not? |
| 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? |
| 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? |

Regarding conduct and supervision

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| 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? |
| 16 | To what extent is the gap between ICP 19 and the status quo in New Zealand (as identified by the IMF) a concern? |
| 17 | Does the lack of oversight over the full insurance policy 'lifecycle' pose a significant risk to purchasers of insurance? |
| 18 | What has your experience been of the claims handling process? Please comment particularly on: <ul style="list-style-type: none">• timeliness the information from the claims handler about:<ul style="list-style-type: none">○ timeframes and updates on timeframes○ reasons for declining the claim (if relevant)○ how you can complain if declined• The handling of complaints (if relevant) |
| 19 | Have you ever felt pressured to accept an offer of settlement from an insurance company? If so, please provide specific examples. |
| 20 | When purchasing (or considering the purchase of) insurance, have you been subject to 'pressure sales' tactics? |
| 21 | What evidence is there of insurers or insurance intermediaries mis-selling unsuitable insurance products in New Zealand? |
| 22 | Are sales incentives causing poor outcomes for purchasers of insurance? Please provide examples if possible. |
| 23 | Does the insurance industry appropriately manage the conflicts of interest and possible flow on consequences that can be associated with sales incentives? |

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

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| 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. |
| 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? |
| 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"? |
| 27 | What would the effect be if there were no exceptions? Please support your answer with |

evidence.

Regarding difficulties comparing and changing providers and policies

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| 28 | Is it difficult for consumers to find, understand and compare information about insurance policies and premiums? If so, why? |
| 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? |
| 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? |

Regarding third party access to liability insurance monies

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| 33 | Do you agree that the operation of section 9 of the Law Reform Act 1936 (LRA) has caused problems in New Zealand? |
| 34 | What are the most significant problems with the operation of section 9 of the LRA that any reform should address? |
| 35 | What has been the consequence of the problems with section 9 of the LRA? |
| 36 | If you agree that there are problems with section 9 of the LRA, what options should be considered to address them? |

Regarding failure to notify claims within time limits

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| 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? |
| 38 | What has been the consequence of the problems with section 9 of the ILRA? |
| 39 | If you agree that there are problems with section 9 of the ILRA, what options should be considered to address them? |

Regarding exclusions that have no causal link to loss

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| 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? |
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- 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?
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Regarding registration of assignments of life insurance policies

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Regarding insurance intermediaries – Deferral of payments / investment of money

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Other miscellaneous questions

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- 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.

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