FSCL
FINANCIAL SERVICES COMPLAINTS LTD

Level 4, 101 Lambton Quay
Wellington 6011

PO Box 5967
Wellington 6140

Freephone 0800 347 257
Phone 04 472 3725
Fax 04 472 3728
www.fscl.org.nz

3 July 2019

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

To whom it may concern

Submissions on Insurance Contract Law Reform Options Paper

Our submissions are informed by our role as an independent dispute resolution scheme, which investigates complaints across a broad spectrum of financial advice, services, and products (except banking). In the year ended 30 June 2019, we formally investigated 112 complaints about insurers and insurance advisers, and handled approximately 360 initial complaints and enquiries about insurers and insurance advisers. If MBIE seeks any further information about our complaint statistics or trends, please contact us.

1. Objectives

Q1. ***What is your feedback regarding the objectives for the review?***

1.1. The objectives developed by MBIE appear suitable to us. As a consumer dispute resolution scheme, we are particularly concerned with objectives 1 & 4. Many of the issues we investigate arise from consumers' lack of understanding around the scope of their insurance policies and the steps they can take to minimise their risk. We are pleased to see MBIE's focus on ensuring consumers are well-informed and protected.

2. Duties to disclose information

Q2. ***What is your feedback in relation to the options for disclosure by consumers? In particular: Do you agree with the costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option (including the status quo) do you prefer and why?***

FSCL's preferred option

2.1. FSCL's preferred option would be a combination of option 1 and a reduced form of option 3.

2.2. We prefer that the duty of disclosure should be abolished and replaced with a duty to take reasonable care not to make a misrepresentation (option 1). This would bring New Zealand into line with other common law jurisdictions, and would lead to better outcomes for consumers at claim-time.

2.3. We also consider life and health insurers should be required to include specific wording in their insurance application forms, letting consumers know that they can include medical records with their application, and informing the consumer of potential effects of non-disclosure (a reduced form of option 3). We note, however, that this may not be necessary if option 1 is adopted.

2.4. We consider this combination of options 1 & 3 would inform consumers of their rights and protect consumer interests, without imposing unreasonable costs or risk on insurers.

Option 1 - insurers can mitigate risks using questionnaires

2.5. We do not consider option 1 would impose any unreasonable risk on insurers. If insurers need their customers to disclose particular facts, which consumers might not ordinarily consider relevant, the insurer can use detailed questionnaires during their application process to prompt full disclosure.

2.6. For example, if an insurer wants to ensure it does not grant cover to a consumer demonstrating symptoms of leukaemia, the insurer can prompt applicants to disclose possible symptoms with specific questions: 'have you been experiencing any unusual fatigue or weakness in the past year', 'have you experienced particularly easy bleeding or bruising over the past year' etc. If an insurer asks these questions, the applicant will know the answers are relevant to the insurer; and if the consumer fails to answer one of the questions correctly, the insurer will have the right to remedies for non-disclosure. This does not, in our opinion, seem unfair or unreasonable.

2.7. Insurers will need to balance the increased certainty provided by detailed questionnaires against consumers' desire for simple and expedient application processes. This seems fair and appropriate. Consumers may gravitate to insurers with fast and general application processes. It seems fair to allow insurers to decide the level of risk they are willing to bear in exchange for the ability to offer a quick and easy sign-up process.

Option 1 – duty to take reasonable care not to misrepresent risk would bring New Zealand in line with other jurisdictions

2.8. Adopting option 1 would bring New Zealand in line with other common law jurisdictions. Option 1 is the current position in the United Kingdom, and we understand the Australian Royal Banking Commission has recommended the duty be adopted in Australia as well.[1]

2.9. We agree with the view reached by the Australian Royal Commission, that insurers are always better placed to determine the categories of information which will be relevant to assessing a consumer's risk. Consumers are often entirely unaware of the duty of disclosure, let alone the information which will be relevant to their insurer. It follows that the insurer will be in a much better position to prompt full disclosure from consumers than a consumer will be to assess what the insurer may consider relevant.

2.10. We acknowledge that it is possible this change may have an effect on the pricing of insurance. However, we consider the benefits of the options will outweigh the costs. The provision of more effective and transparent insurance will result in considerable benefits for consumers at claim-time and should lead to a reduction in complaints about insurers.

Option 3 – requiring insurers to obtain medical records at inception may be overly expensive, and costs may outweigh benefits

2.11. We support option 3 from a consumer-protection perspective. However, a duty for insurer to obtain medical records may be costly enough that the burden of the duty will outweigh its benefits.

2.12. We believe a duty on insurers to obtain medical records at a policy's inception would lead to very good outcomes for consumers at claim-time. An issue we see regularly is a consumer applying for cover without realising the level of detail they should be providing to their insurer, and without realising they can submit their medical records to better insulate themselves from risk. Come claim-time, the consumer will often discover they have no cover for a host of medical issues, due to their non-disclosed pre-existing medical conditions. Requiring life and health insurers to obtain medical records at policy inception would remedy these issues.

2.13. Despite these benefits, we consider the costs of option 3 will likely make the option untenable.

---

[1] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry *Final Report* (1 February 2019) at 300.

2.14. As a dispute resolution scheme, we do not have any particular experience in underwriting, so we cannot authoritatively comment on the costs and difficulties involved in the process, or the potential effect of regulation on premiums. However, we have spoken to several individuals involved in the underwriting process, and they have all raised concerns about the cost of obtaining medical records.

2.15. We understand insurers often use medical record aggregation services (such as konnectNET) which make obtaining medical records less time-intensive. However, we have been informed that each use of an aggregation service comes with a considerable fee (around $150). Whether an insurer obtains medical records itself or uses an aggregation service, the insurer will clearly bear a substantial cost, and these costs will be passed on to consumers through increased premiums.

2.16. There are also costs associated with reviewing and assessing medical records. We understand this will impose additional costs on insurers if option 3 is adopted, and these costs will be incurred whether the consumer decides to purchase the insurance policy they are applying for or not. Until medical records are more easily and cheaply accessible, it seems the costs of option 3 may outweigh the option's benefits.

2.17. MBIE may wish to consider working with the Ministry of Health in future to develop a database for medical records, which could be accessed cheaply and effectively by insurers. However, this seems well outside the scope of the current law reform.

Reduced form of option 3 preferable – life and health insurers should be required give information about duty of disclosure

2.18. In our view, life and health insurers should be required to disclose to consumers the risks of non-disclosure, and the consumer's right to submit medical records as part of their application. This information should be highlighted to the consumer in some way (whether through formatting or by placing the information in a prominent position in the application form) to ensure the warnings are not lost among other information.

2.19. In our experience, the most common complaints we see regarding life and health insurance involve an alleged failure to comply with the duty of disclosure. Frequently, we find a consumer has failed to disclose a diagnosis or symptom which the insurer has discovered at claim-time, when it reviews the consumer's medical records. In these circumstances, we often find a consumer was not aware of:

- the full extent of the duty of disclosure
- the risks of non-disclosure, or
- the possibility of submitting medical records along with their application.

2.20. We consider that life and health insurance applications should make these duties, risks and options explicitly clear to consumers. We consider regulations should require life and health insurers to include a mandatory section in their insurance application forms, setting out the duty of disclosure, the risks of non-disclosure, and informing the consumer that they can include their medical records along with the application (at the consumer's cost).

2.21. This would provide many of the benefits to consumers associated with option 3, without placing the high cost of obtaining medical records on insurers. The duty may lead to more consumers submitting medical records, which will lead to increased costs for insurers at policy inception but, in our view, these costs are likely to be outweighed by the benefits associated with better-informed consumers and fewer complaints at claim-time.

2.22. This option also remedies some of the concerns raised by the Privacy Commissioner about insurers' access to medical records.[2] The Privacy Commissioner has stated that insurers should only obtain medical records where they cannot obtain sufficient information by asking the consumer questions. Giving consumers the option to provide their medical records, while ensuring they are aware of the risks if they decide not to do so, will protect consumers' privacy rights while ensuring they are fully aware of their options for making full disclosure.

2.23. We note that this option may not be necessary if option 1 is adopted, as option 1 will significantly reduce an insured's obligation to proactively disclose information. If an insured is merely required to take reasonable care when answering an insurer's questions, including medical records with an application will rarely be necessary. Nevertheless, we consider it would be beneficial to inform consumers of their right to provide medical records, to reduce the risk that an insured will inaccurately disclose a complex or technical diagnosis.

Further options – insurers should clearly disclose any information they are seeking to collect, but will not be reviewing at time of underwriting

2.24. In our view, when an insurer requests consent to obtain information from a consumer, the insurer should be required to clearly disclose the purpose of the consent, and whether the insurer will be obtaining the information before it underwrites the policy. If an insurer asks for consent to obtain medical records (for

[2] *Privacy Commissioner* "Collection of medical notes by insurers – Inquiry by the Privacy Commissioner" June 2009 <privacy.org.nz/news-and-publications/commissioner-inquiries/collection-of-medical-notes-by-insurers-inquiry-by-the-privacy-commissioner>

example), but does not obtain the medical records as a matter of course, the insurer should be required to disclose this to consumers.

2.25. We find that insurers will often request consent to obtain medical records and other information, but will not in fact request or review this information until the consumer makes a claim. In our experience, consumers often misunderstand the purpose of these consents – they usually assume that the insurer will automatically request the documents, and that they can rely on the insurer to review the documents as part of their initial disclosure. Consumers tend to assume that any information in these documents has been disclosed to the insurer, but this is clearly not the case.

3. Options in relation to disclosure remedies

Q8. ***What is your feedback in relation to the disclosure and remedy options? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other options that should be considered? Which option do you prefer and why?***

3.1. We support Option 1. We consider insurers should be entitled to avoid a contract without returning premiums for non-disclosure, but only where the non-disclosure was both deliberate or reckless and material.

Careless vs deliberate or reckless non-disclosure

3.2. We support the distinction between careless non-disclosure and deliberate or reckless non-disclosure set out in Schedule 1 to the Consumer Insurance (Disclosure and Representations) Act 2012 (UK). Our support extends to the provision requiring an insurer to refund premiums paid where it would be unfair for the insurer to retain them. In our view, these provisions provide an appropriate balance between disincentivising intentional non-disclosure and preventing unfair outcomes for consumers.

3.3. We consider there should be some distinction between intentional and innocent non-disclosure. If there were not, it could be beneficial for consumers to intentionally fail to disclose a relevant fact. The law reform should not incentivise intentional non-disclosure. We are of the view that allowing an insurer to avoid a contract without refunding premiums is a reasonable disincentive for deliberate or reckless non-disclosure.

3.4. However, we acknowledge that avoiding a contract and withholding premiums could, occasionally, produce unfair outcomes for consumers. We consider the wording in paragraph 2(b) of the UK Act is an appropriate preventative measure.

3.5. We are also of the view that the onus should be on the insurer to establish a non-disclosure was deliberate or reckless. The power to avoid a contract without refunding premiums is particularly harsh, so we consider it appropriate that an insurer wishing to exercise this power should bear the burden of proof.

Materiality

3.6. We also support the Consumer Insurance (Disclosure and Representations) Act 2012 (UK)'s approach to materiality.[3] We take the view that non-disclosure should be material to an insurer if the insurer is to have access to any of the remedies for non-disclosure.

Q9. ***Is it fair to require insurers to pay claims that are not connected to a non-disclosure or misrepresentation, even if the insurer would not have entered into the contract had they known the facts?***

3.7. No. We take the view that the proportional remedies for careless non-disclosure set out in Schedule 1 to the Consumer Insurance (Disclosure and Representations) Act 2012 (UK) are sufficient to protect consumers, provided the duty of disclosure is replaced with a duty to take reasonable care not to make a misrepresentation.

3.8. If a consumer has failed to take reasonable care when disclosing their circumstances, it does not seem unduly harsh for an insurer to avoid their policy and refund their premiums. If a consumer negligently fails to disclose a material circumstance when applying for cover, they should not, in our view, be entitled to expect their insurer to provide them with cover.

3.9. If, however, the duty of disclosure remains in its current form, or the Australian position is adopted, we consider an insurer should be required to pay claims that are unrelated to a non-disclosure or misrepresentation. The insurer should, however, be entitled to terminate the contract after paying the claim, if they would not have accepted the policy had they known the undisclosed facts.

3.10. **Q10.** ***Should insurers be able to offer reduced cover or ask the insured to cover the difference in order to recoup the amount they would have charged if they had the facts? Why/why not?***

3.11. No. If the non-disclosure is careless (rather than deliberate or reckless), it appears unfair to allow the insurer to require a lump sum payment from the consumer. Based on our experience, consumers will often struggle to make lump-sum payments, so this option could result in consumers losing their cover once a non-disclosure is

[3] Consumer Insurance (Disclosure and Representations) Act 2012 (UK), s 4(1)(b).

discovered. This seems an unfair result, especially in the context of life insurance policy, where the cover available to a consumer may have changed significantly since they took out their policy.

3.12. In our view, the protections set out in paragraph 9 of the Schedule 1 to the Consumer Insurance (Disclosure and Representations) Act 2012 (UK) are appropriate, and should be adopted.

4. Unfair contract terms

Q15. ***What is your feedback on the UCT options? In particular: Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits? Are there other impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why?***

FSCL's preferred option – exclusion for insurance contracts should be repealed

4.1. We support option 2. We consider the unfair contract law provisions of the Fair Trading Act 1986 should apply to insurance contracts. In our view, genuinely unfair terms of insurance contracts should be subject to review by the courts.

4.2. We do not consider the unfair contract terms provisions will introduce an unreasonable degree of risk for insurers. The thresholds which must be met before a term can be declared unfair are fairly high. In particular, we believe the need to establish a term is not reasonably necessary to protect an insurer's legitimate business interests will be sufficient to protect almost all terms in insurance contracts.

4.3. We agree that most of the terms discussed in the options paper are reasonably necessary for protecting an insurer's legitimate business interests. Most of the terms discussed relate to the risk insured. In our view, an insurer should be entitled to define the risk it is willing to accept in exchange for a premium, provided the risk is properly assessed, and is reasonably factored into the price of the insurance contract. We do not consider the courts would have any hesitation holding these terms are necessary to protect an insurer's legitimate business interests.

4.4. There may be some increase in premiums, to account for the uncertainty introduced by applying the unfair contract terms provisions to insurance contracts. However, we would expect this increase in premiums to be relatively minor. The 'necessary to protect legitimate business interests' test is a high threshold, so we would expect the application of the unfair contract terms provisions to introduce very little uncertainty for insurers, and result in an accordingly minor increase in premiums. Again,

however, we note that we are not well-placed to judge the effect of regulation on the underwriting process and the price of insurance.

4.5. Allowing the unfair contract terms provisions to apply to insurance contracts will mean genuinely unfair provisions in insurance contracts can be reviewed, but necessary and legitimate provisions will still be protected.

Mental health exclusions may be unfair contract terms

4.6. We have particular concerns about blanket exclusions in travel insurance policies for mental health conditions. We have seen these exclusions lead to particularly unfair results for consumers, and we consider these exclusions should be subject to review as potentially unfair contract terms. We do not consider this would impose too great a risk on insurers, as the courts are unlikely to overturn exclusions if they are adequately justified by statistical and actuarial data.

4.7. In 2015, the Victorian Civil and Administrative Tribunal held that these blanket exclusions for mental health were discriminatory and unlawful.[4] However, the relevant Australian legislation contained a protection for discrimination based on statistical or actuarial data. If the insurer in that case had been able to produce actuarial data justifying its exclusion, the Tribunal's decision likely would have been different.

4.8. A similar approach would likely apply if the unfair contract terms provisions were applied to insurance contracts in New Zealand. Exclusions for mental health conditions may be considered reasonably necessary to protect an insurer's legitimate business interests, provided the exclusions are supported by statistical data. Legitimate and fairly assessed exclusions will be protected, but poorly justified and potentially discriminatory terms run the risk of being overturned. In our view, this is appropriate and fair.

4.9. These blanket mental health exclusions may be protected in any case. A court may not declare a term to be an unfair contract term if the term defines the main subject matter of the contract.[5] Mental health exclusions do affect the risk accepted by the insurer (ie, the subject matter of the insurance contract), so they may be excluded from the application of the unfair contract terms provisions.

FSCL supports the law reform proposed by MBIE. We are pleased with MBIE's objectives targeted at ensuring consumer interests are protected and consumers are kept well-informed at all points during an insurance product's lifecycle, while maintaining an evenly

[4] *Ingram v QBE Insurance (Australia) Ltd* (Human Rights) [2015] VCAT 1936
[5] Fair Trading Act 1986, s 46K(1)(a).

balanced approach so that insurers have access to remedies where consumers have failed to frankly and honestly disclose their risk. We would be pleased to discuss any of the options or proposed reforms further.

Yours sincerely

Susan Taylor
Chief Executive Officer

Nicholas Flaws
Case Manager