IAG New Zealand submission

to the

Ministry of Business, Innovation and Employment

on the

Options Paper: Insurance Contract Law Review

2 July 2019

Contents

1. Introduction

1.1 This submission is a response by IAG New Zealand Ltd (IAG, we) to the Ministry of Business, Innovation and Employment (MBIE) on the Options Paper: Insurance Contract Law Review, April 2019 (Options Paper).

1.2 IAG is New Zealand's leading general insurer. We insure more than 1.8 million New Zealanders and protect over $650b of commercial and domestic assets across New Zealand. We receive more than 650,000 claims a year and pay $1.365b in settling them. IAG brands include State, AMI, NZI, and we also underwrite the general insurance provided by some of New Zealand's leading financial institutions, including ASB, BNZ, Westpac and The Cooperative Bank.

1.3 IAG's contact for matters relating to this submission are:

Bryce Davies, Executive Manager Corporate Relations

2. Summary of recommendations

2.1 For ease of reference, we set out our recommendations in full in this section. Additional detail, including the reasoning and background to these recommendations, is provided under the applicable section headings below.

Duties to disclose

2.2 IAG supports a duty on individuals and businesses to disclose what a reasonable person would know to be relevant. The distinction between individuals and businesses would inform what is 'reasonable'.

2.3 IAG is comfortable that the duty will be subject to the oversight of the regulator and ultimately the courts to determine what is 'reasonable' in the circumstances.

2.4 IAG supports introducing a requirement for insurers to warn customers of the duty to disclose but opposes a requirement for insurers to inform customers about whether, and when, they will access third party records.

2.5 IAG opposes businesses having the ability to contract out of disclosure duties.

2.6 IAG disagrees with the approach of treating duties and remedies in isolation and remains strongly of the view remedies should be based on intention and materiality.

Unfair contract terms

2.7 IAG's supports retention of the status quo, on the basis that any changes risk interfering with contractual terms at the core of the insurance product (which would mean insurance is treated differently from other goods/services) and introducing significant unintended consequences.

2.8 In the alternative, IAG could support tailoring generic unfair contract terms provisions to insurance, provided that any legislative response does not interfere with terms that define the risk or IAG's liability.

Understanding and comparing policies

2.9 IAG supports in principle insurers being required to present their policies in plain language, and with clearly defined core policy wording. It is important that sufficient detail on any additional obligations is given to secure support and ensure consistency across the industry.

2.10 IAG opposes any additional requirements relating to summary statements and third-party comparison platforms as this would have the effect of reducing rather than improving customer engagement and would bring about unintended consequences that would harm consumers and the markets

Miscellaneous issues

2.11 IAG supports introducing a statutory obligation on intermediaries to pass on information to insurers. We also support the principle of making intermediaries agents of the insured but consider that this should be subject to a separate inquiry or review.

2.12 IAG supports the consolidation of statues, but do not support the proposal to codify the duty of utmost good faith.

3. Context

3.1 We believe that insurance is a unique, little understood – and often misunderstood, product that brings significant economic and social benefit to New Zealand. We want to preserve those benefits and so often include in our submissions information that gives context and background to the matters hand so that properly informed decisions can be made.

3.2 Recently this has included: what insurance is (and isn't); the role that general insurance plays in New Zealand; the prerequisites for a healthy insurance market; and the challenges posed by New Zealand's unique risk environment.[1] All of which are pertinent to the topics in the Options Paper. Rather than repeat that material again, we highlight below several critical features that must be acknowledged and reflected in any reform of insurance contract law.

3.3 **Insurance is a unique service.** Insurance is like no other service and expectations that it should work in the same way as other contracts for service is misguided and potentially harmful. It is not a simple contract of supply like with a utility or a gym. It is a contract to indemnify, under certain circumstances, certain financial costs that may arise from the loss or impairment of an asset, all of which is conditional and turns on how the circumstances of the loss match the terms of the policy.

3.4 **Insurers have obligations to customers and the pool.** Insurers have both individual and collective obligations to thier customers in which the obligations to all customers (as represented by the pool) extend beyond and must come before the obligations to individual customers.

3.5 **Customers have obligations to the pool.** Customers also have obligations they must meet for the pooling of risk to work. The obligations are owed to all the other customers taking part in the pool and not the insurer, but the insurer (as custodian of the pool) must ensure they a met for the benefit of all. These obligations include:

- fully and accurately describing the pertinent characteristics of the risk being insured, and any changes to it during the life of the policy (so that it can remain properly underwritten and priced);
- paying the premiums in full and on time, so the funds are there to pay claims;
- looking after their assets so as not to worsen the risk of loss;
- acting when a loss occurs to reduce the scale of that loss; and
- accurately describing the nature and extent of losses when making a claim, so that only legitimate claims are paid.

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[1] IAG's submissions on the Insurance Contract Issues Paper and Options paper for the Conduct of Financial Institutions

3.6 **(Re)insurer confidence is vital.** New Zealand's elevated level of natural hazard risk demands a system in which everyone can be certain about the availability and affordability of insurance cover. Central to this is insurer and reinsurer confidence that they can, over the long term, make an adequate return on their exposure. In turn, this relies on them being able to accurately and reliably define the risks and liabilities taken on through their policies and treaties.

3.7 **Defining risk is essential.** New Zealand's use of 'all risk' policies for general insurance (as opposed to specified risk policies) makes the ability to circumscribe risk and liability through definitions, policy terms, exclusions, and excesses central to contractual certainty and therefore both the availability and affordability of insurance.

3.8 **Low engagement.** Consumers often do not engage in insurance but should. We do not want to create a regime which allows consumers to make no effort and face no consequences for their actions and inactions.

3.9 **Differences within insurance.** We also believe care is needed not to conflate the life and general insurance industries, as there are many crucial differences between the two that must be acknowledged and accommodated in any legislation. This includes differences in the nature, scale and volatility of the risk insured, and the nature and duration of the insurance policy.

4. Objectives

4.1 We agree that it is important to establish the objectives of the review as a first step. Each decision made on the options should be viewed through the lens of these objectives, and in light of the context set out above.

4.2 It is also imperative for new regulation to be balanced against the principle that intervention should be a proportionate and targeted response to the identified problems.

Key outcomes

4.3 The Option paper is just one of many current reforms that affect insurers, with each reform having its own set of objectives. Collectively these reforms should work together to support a well-functioning insurance market that sustainably meets the needs of all participants along with those of the economy and society. However, we do not think that this collective view is being taken, as each review appears to be considered in isolation of the whole that it is contributing to.

4.4 In our submission on the Issue Paper[2] we described the characteristic of a well-functioning and sustainable market, being:

- The market has enough scale, capability, and connectivity, so that consumers can access the insurance they need;
- The market has the support of reinsurers, so customers can access insurance for our large commercial and natural hazard risks;
- Our insurers are innovative and competitive, so that consumers can access products and services that evolve to meet their changing needs;
- The market is efficient and effective in transferring risk, so that customers are confident that insurance is good value for money and continue to buy it; and
- The market and its insurers are stable, so that consumers can be confident that their insurer is able to meet their claims.

4.5 We recommended four objectives to ensure that the insurance market effectively meets the current and future needs of its customers and delivers insurance that is available, affordable, relevant, reliable and profitable. These were to:

- maintain the attractiveness and capacity of the insurance market;

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[2] *IAG,* Submission on MBIE's Issues Paper: Review of Insurance Contract Law, 13 July 2018.

- support elevated levels of participation and confidence;
- support innovation and competition;
- support effective risk management.

4.6 In that submission we detailed what each objective required and the benefits it would bring to the market. We also noted that, while the reform of insurance contract law would not deliver against each of these directly it was vital that it considered each.

4.7 We note that some elements of this wider view of market performance and sustainability have been included in the proposed objectives, but not sufficiently in our view to ensure this reform will fully meet the insurance needs of New Zealand.

4.8 We are concerned that, with few exceptions, legislative reforms affecting the insurance industry in the last decade have solely focused on reliability and consumer confidence[3]. Aside from the recent changes to the Earthquake Commission Act, little public policy thought, or legislative reform has been given to the other outcomes and most critically the availability and affordability of insurance.

4.9 We would therefore like to see the objectives amended to ensure that insurance contract law gives balanced consideration to the sound functioning of the market as a whole and not skew towards one aspect.

Proposed objectives

4.10 The Options Paper sets out the revised objectives[4], on which IAG comments below.

4.11 As a general point, IAG considers that the objectives in the Options Paper are heavily weighted towards imposing duties on insurance providers, without recognising corresponding duties on customers, and in particular the duties owed by customers to each other as outlined above.

4.12 We agree that insurers should take steps to encourage customer participation in insurance, including by enabling their involvement to be as streamlined and as easy as possible. However, this must not be to the complete exclusion of any customer responsibility.

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[3] Including reforms to: warranties (Consumer Guarantees Act); unfair contract terms (Fair Trading Act and Unfair Business Practices Consultation); fair dealing (Financial Markets Conduct Act); financial advice (Financial Adviser Act and its review); conduct (Financial Services Conduct Consultation); and consumer dispute resolution services (Financial Service Providers Act)

[4] *Ministry of Business Innovation and Employment,* Options Paper: Conduct of Financial Institutions (Options Paper), April 2019, at [10].

4.13 Insurance is a contract, and there are two parties involved. The review should recognise the social contract in the insurance industry and be conscious that conduct in relation to that contract is both how insurers treat the insured (and vice versa) and how the insureds treat each other.

4.14 We note, for example, that the decision to insure generally corresponds to a significant risk, or a significant item. We expect that it is something our customers care about, and therefore expect them to engage with the process of protecting the value of that item. This is not always the case.

4.15 While IAG does its best to mitigate the complexities of insurance products, there are limits on its ability to ensure all customers understand their obligations. There needs be some responsibility on customers to ensure that both parties are fairly informed on matters that affect their decisions to enter the contract and make decisions under it.

4.16 A well-functioning insurance market will also have the infrastructure and resource in place to support participants. As is the case in other industries, we consider that the Government has a role to play in fostering the financial literacy of consumers, which may involve education campaigns, or increasing the funding of public-support organisations (including, for example, the Commission for Financial Capability).

Informed and confident participants

4.17 IAG supports the principle that both parties (the insured *and the insurer*) are well informed before entering into an insurance contract. This acknowledges the responsibilities of the insurer to simplify the product, and the customer to ensure that the contracts accurately reflect their individual circumstance and that they have disclosed relevant information about their risk to the insurer. This allows both parties need to be able to transact with confidence.

4.18 New Zealand currently has a very high proportion of people and businesses that buy insurance, and in the interests of financial stability and sustainability, it is important to maintain this level of participation. More informed stakeholders (particularly customers) will facilitate this.

Fair, efficient, and transparent interactions

4.19 IAG supports this objective, and the foundation it provides for the social contract that governs the insurance 'pool'. If customers do not trust their insurer, or insurers do not trust their customer, the social contract will disintegrate. Fairness, efficiency, and transparency are strong determinants in building this trust.

Lower barriers to insurer participation

4.20 We agree with the intent of this objective on the basis that the aim is to reduce barriers for insurers that can provide a high-quality service. However, we consider that this should go further, for not only barriers to be minimised, but also for participants to be incentivised to enter, and to continue to innovate.

4.21 Insurers need to be confident that they can generate a return that covers their costs, meets commitments to investors and reinsurers, and allows them to reinvest in their businesses. It is also important that, beyond participating, insurers are encouraged and supported to innovate in the market, which may be modernising and developing existing products and/or bringing new products and services to New Zealand.

4.22 In considering submissions on the Options Paper, and any additional regulation, the Government should look for opportunities to encourage and incentivise competent, ethical, and responsible insurers to participate fully in the insurance market (rather than simply removing any barriers).

Consumers' interests are recognised and protected

4.23 IAG supports this objective. As above, we understand the importance of strong participation in the market from insurers and insureds. To facilitate this, it is important insurance is affordable and good value, and that customers see insurance as being relevant to their needs on an ongoing basis.

4.24 We see overlap between this objective and others, and in particular query the difference with the second objective, set out above. We also see an overlap with the core duties outlined in the proposals on financial services conduct.

5. Duties to disclose

IAG supports a duty on individuals and businesses to disclose what a reasonable person would know to be relevant. The distinction between individuals and businesses would inform what is 'reasonable'.

IAG is comfortable that the duty will be subject to the oversight of the regulator and ultimately the courts to determine what is 'reasonable' in the circumstances.

IAG supports introducing a requirement for insurers to warn customers of the duty to disclose but opposes a requirement for insurers to inform customers about whether, and when, they will access third party records.

IAG opposes businesses having the ability to contract out of disclosure duties.

IAG disagrees with the approach of treating duties and remedies in isolation and remains strongly of the view that the extent and nature of the breach should determine the appropriate remedy. Remedies should be based on intention and materiality.

5.1 The concept of the insurance 'pool' discussed above is critical to defining the appropriate scope of an insured's duty to disclose information. IAG's customers have an obligation to other customers who also contribute to, and benefit from, the 'pool'. A breach of the duty to disclose is not only a breach of a duty to the insurer, but more so a breach of a duty to other insureds. Such breaches harm the 'pool' in two ways:

- Risks that should be excluded from access to the pool draw funds from the pool; and
- Risks are under-priced and the 'pool' is deprived of the correct amount of contribution in the form of premium.

5.2 The nature of an insurer's business is assessing and pricing risk. Inherent in this activity is an information asymmetry between the insurer and the insured.

5.3 While insurers are familiar with the technical detail of insurance and insurance policies (i.e. how to price disclosed risk), customers are inherently more familiar with their own specific circumstances, and level of risk.

5.4 The proposed duties for financial service providers focus strongly on addressing the information asymmetry that advantage the insurer. The duties to disclose should balance this, by mitigating the information asymmetry that favours the customer.

5.5 We consider that both parties to an insurance contract owe a duty of utmost good faith, to ensure the contract is a fair representation of the risk. This requires correct disclosure of all material facts.

Problem definition

5.6 IAG generally agrees with the problems identified in the Options Paper but questions the extent to which they occur within general insurance.

Customers understanding

5.7 We question the assertion that ordinary customers don't understand what needs to be disclosed.[5] This appears to us an unfounded presumption, that infantilises 'the average customer'. Our experience is that the vast majority of our customers do understand what the risks are and therefore what to disclose. It is their appreciation of the risks that prompts them to seek insurance in the first place, and to transfer that risk to the 'pool'.

5.8 We take active steps to ensure that this is the case. IAG informs its customers of their duty to disclose material information at the time they take out their policy. Details of the duty are also included in customer policy documents.

5.9 Our success in these steps is reflected in our customer data. We collect evidence on the number of times we uncover material information when managing a claim that we did not know about when the customer took out the policy. The information that is uncovered typically relates to moral or physical risk factors that IAG cannot be expected to know but is information that would be used in deciding whether to offer insurance, which is to say, 'access to the 'pool', and on what terms. For instance, concealing a criminal record involving fraud and dishonesty convictions, or concealing use of a house for 'air bnb' involving transient and anonymous occupants.

5.10 It is worth repeating some of the numbers and commentary we included in our submission on the Issues Paper to illustrate. The table below shows that in the 12 months to 31 May 2018 we referred 1,639 concerns about customers' non-disclosure to our specialist team to conduct a 'prudent underwriter test' to decide our response. This equates to about 1 in every 200 customers who lodge a claim not telling us something that is sufficiently important to warrant a review of their policy.

5.11 We think that this supports the view that while some consumers do not always understand what information we need, the vast majority do. This is not surprising given the clear requests for information we give when customers take out their policies and the warnings given about the potential consequences of non-disclosure.

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[5] Options Paper, at [16].

Table 1. Referral of policies for prudent underwriter test
(12 months to 31 May 2018)

Product	# of policies	# of Claims	# referred	% of policies	% of claims
Home	834,883	60,873	245	0.03%	0.40%
Contents	805,473	88,219	214	0.03%	0.24%
Motor	1,555,498	194,342	1,180	0.08%	0.61%
Total	**3,195,854**	**343,434**	**1,639**	**0.05%**	**0.48%**

Note that the data in the tables in this section to relates to IAG's direct consumer brands (AMI, State, Lantern, and NAC) and our bank partnerships (ASB, BNZ, Westpac, and Co-operative Bank).

Consequences for insurers

5.12 We consider the consequences of non-disclosure for insurers in New Zealand is more significant than indicated in the Options Paper. This is because New Zealand insurers typically use 'all-risks' general insurance policies, meaning that all risks are covered except those specifically excluded.

5.13 Other jurisdictions typically use 'specified risk' policies, meaning the consumer is covered only for the risks expressly listed in the policy document. The impact of non-disclosure is therefore far more significant for New Zealand insurers who are already open to substantially more risk. This is an example of why there is an inherent danger in adopting the changes of law in another country (such as the UK) without considering first whether the nature and level of risks and market practices are the same.

5.14 This, and the nature of New Zealand's risks (mentioned above), makes having all material information vital to the insurer's ability to assess the risks it is taking on and price them correctly.

Disproportionate responses

5.15 We consider that MBIE has overstated the problems in the general insurance industry associated with legal remedies for non-disclosure.

5.16 When IAG is made aware of information that was not initially disclosed, a specialist team will consider what action, if any, to take. Of the 1 in 200 customers whose claim is referred to our specialist team, much of the missing information is not material, and does not impact the customer's insurance.

5.17 While the legal remedy of avoidance for non-disclosure is available, IAG's practice is to use avoidance as a measure of last resort. Our intent is to put the customer and ourselves in the position we would have been had the information been known at the start. As such, IAG supports and actively implements a proportionate response. When we discover that a customer has unwittingly or mistakenly withheld information, we respond reasonably. We are committed to do this because we think it is the right thing to do, and because we have signed up to do so through the Fair insurance Code.

5.18 Following the principle of proportionality, deliberately withheld and deliberately inaccurate information, which raises fundamental moral hazard concerns, will trigger a different response. We note, however, that this is extremely uncommon – 32% of the time IAG will adjust its records to include the extra information, or it will not do anything. In only 9% of cases would policies be cancelled or avoided.

5.19 This means that, of the total policies in place, only 1 in 20,000 were cancelled or declared void in the 12 months to 31 May 2018. It would be extremely concerning if a regulatory solution was designed to cover for the 1 in 20,000, at the expense of the certainty and predictability of the entire insurance industry.

Table 2. Actions taken following prudent underwriter test (12 months to 31 May 2018)

Action	#	% of completed
We added terms to the customer's policy	636	39%
We took no action	457	28%
We increased the customer's excess	327	20%
We cancelled the customer's policy or policies	151	9%
We updated the customer or policy details	68	4%
Total	**1,639**	

5.20 We therefore consider it imperative that duties and remedies should be reviewed together, as this is the only way to achieve proportionality. The response to a breach of duty should be relative and be appropriate for the individual circumstances.

5.21 Considering this, IAG supports the evaluation criteria suggested in the Options Paper, but would encourage an expansion of [d]. Remedies should be proportionate to materiality and reflect the behaviour and intent of the customer that did not disclose (particularly where that non-disclosure was wilful, reckless, or intentional).

Individual (consumer) disclosure options

Analysis of the preferred option

5.22 IAG is concerned about the proposed option to abolish the duty of disclosure for consumer insureds and replace it with a duty to take reasonable care not to make a misrepresentation (Option 1).

5.23 The implication of this proposal is to introduce a corresponding duty on the insurer to ask the exact question that will draw out the specific information about the customer's circumstance. This would lead to a 'don't ask don't tell' dynamic which turns a frank disclosure of risk into the insurer needing to probe through questions like the 'Battleships' board game hoping to ask the 'right' questions', whilst all the information sits with the customer.

5.24 IAG acknowledges that there are a discrete number of specified categories of non-disclosure that are known to insurers. However, within these categories there is a lot of unknown detail that is relevant to the specific 'risk' defined in the policy.

5.25 While there is a significant amount of information that could be relevant to all insurance policies with all customers, there is a specific amount of information that is relevant to specific policies with specific customers. The customer is much better placed at understanding, and disclosing, their own situation.

5.26 In addition, the corresponding duty to ask clear and specific questions would be difficult to define, and there would be issues in using this uncertain measure to decide whether there had been a misrepresentation.

5.27 We are also concerned that, as discussed above, this risk relieving consumers of the obligations they have to their fellow participants in the pool and condones the current low engagement and low effort approach of many consumers.

5.28 The duty should instead be to disclose all information which customer has and acting reasonably, ought to know is relevant to understanding the risk to be covered and the insurer's decision to insure the customer (Option 2).

5.29 The guiding question in deciding whether there has been a breach of this duty should be whether it was reasonable that the customer did not inform IAG. Any inquiry into a breach would consider all of the circumstances of individual customers. The obligation for the average customer would therefore be less onerous than the current legal duty, which does not incorporate a 'reasonableness' test, but instead refers to what would influence the judgment of the 'prudent underwriter'.

5.30 IAG agrees with the principle of insurers being required to warn potential customers of their duty to disclose material information (Design Option 1). This warning should come with some guidance on the information required to be disclosed to meet the duty.

5.31 This is already part of IAG's practice and customer relationship protocols. As above, IAG will not cancel or avoid a contract unless we consider that we have no other option. It is in our interests (and the interests of other insurers) to do everything in our power to ensure that both parties are fully informed when they enter an insurance contract. This provides certainty and predictability to the industry and we encourage it.

5.32 In addition, this would assist insurers in determining what amounts to 'reasonable', and what amounts to a proportionate response as it would be easier to distinguish between customers based on their intent. If the warning was sufficient, all customers should be aware of the information to be disclosed, unless reckless or fraudulent.

5.33 Insurers would, however, need further direction as to what constitutes an adequate warning.

International context

5.34 We understand that regulators in New Zealand are eager to learn from international jurisdictions and we encourage this. However, we warn regulators against blindly implementing a new regime from another jurisdiction without carefully considering whether it is suitable for New Zealand's circumstances.

5.35 We recognise that the United Kingdom has recently shifted its position on non-disclosure in favour of greater obligations on the insurer. However, it important to note some key differences in their market compared to ours, including:

- The UK uses 'specified risk' policies
- A considerable proportion of policies are sold via third-party aggregator sites and other online channels where there is no opportunity for customers to disclose and have applied to their policy any specific information in advance of purchasing the product
- UK has a comparatively benign natural disaster risk profile compared to New Zealand

5.36 Combined these factors mean that there are fewer opportunities for customer to disclose information unbidden and the consequences of non-disclosure for the insurer are far smaller, making the impact of the change on the market far smaller.

5.37 The operation of New Zealand's insurance market aligns more closely with Australia. For general insurance contracts, Australia has actively retained the insured's duty of disclosure – the insured is required to disclose information that "a reasonable person in the circumstances could be expected to know".[6] This duty does not extend to matters that the 'insurer knows or in the ordinary course of the insurer's business as an insurer ought to know', and requires the insurer to inform the customer of the obligation. IAG would support this position being implemented in New Zealand.

5.38 Similarly, the position in all Canadian provinces has been to retain the traditional common law duty of disclosure, which reflects New Zealand's "prudent insurer" status quo. The Ontario Court of Appeal in *Sagl v Chubb* found that a contract of insurance requires applicants to "provide full disclosure to the insurance company of all information relevant to the nature and extent of the risk that the insurer is being asked to assume".[7] A fact is deemed to be relevant or material if it would influence a prudent insurer in deciding whether to issue the policy or in determining the amount of the premium.[8] This position was reinforced in the more recent case of *Seetaram v Allstate Insurance Company of Canada in 2019*.[9]

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6 Insurance Contracts Act 1984 (Australia), s 21(1).

7 *Sagl v Chubb Insurance Company of Canada,* 2009 ONCA 388, at [51].

8 *Pereira v Hamilton Township Farmers' Mutual Fire Insurance Co.* 2006

9 *Seetaram v Allstate Insurance Company of Canada,* [2019] ONSC 683, at [59].

5.39 The prudent insurer test is also still applied by courts in Singapore in determining the facts required to be disclosed – any fact that a prudent insurer would take into account when reaching a decision whether or not to accept that risk or what premium to charge.[10] Singapore imposes the same statutory duty on the insurer to notify the insured about their duty of disclosure, on the basis that both parties to the insurance contract owe each other the duty to act in the utmost good faith.[11]

5.40 Although the above does not purport to be a comprehensive review of international jurisdictions, it does show that there is no discernible trend towards relieving customers of their disclosure obligations.

Third party information

5.41 IAG disagrees with the proposal to require insurers to tell consumers the third-party information they will access, when they will access it, and whether they will use it to underwrite the policy (Design Option 2).

5.42 As a starting point, it is not clear what the Options Paper is referring to when it discusses 'third party information'. The broad scope of the term, and the extent of information it relates to, would make this requirement unworkable. IAG uses third party information to assist with verifying customer addresses, and valuing vehicles. However, we also use third party statistics to understand crime and inform risk.

5.43 We are concerned that some third-party data used by IAG informs our commercial strategy and amounts to trade secrets. It is information that we would not be comfortable sharing with our competitors, which would be a serious risk if this requirement was introduced.

5.44 We are also concerned about the effect that this requirement would have on customer experience. Our customer interactions are meticulously designed to ensure that the process is as swift and easy as possible, while still ensuring that all necessary information is exchanged. This requirement would add to the time spent on the phone and increase the barriers to participation.

5.45 Finally, we do not consider that there is a problem with the existing system that warrants resolving. IAG is conscious of its duties under the Privacy Act and associated legislation. We do not see the need for additional regulation in this space.

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[10] The 1991 case of *The Asia Insurance Co Ltd v Tat Hong Plant Leasing Pte Ltd* [1991] SGHC 158 applied the English common law set out in *Carter v Boehm* c 4 (UK) . This position was confirmed more recently in the case of *Everbright Commercial Enterprises Pte Ltd v AXA Insurance Singapore Pte Ltd,* [2001] 1 SLR(R) 672.

[11] Insurance Act Cap 142, 2002 Rev Ed., s 25(5).

Business disclosure options

5.46 It is not always clear to IAG which of our customers would be treated as an individual, and which would be treated as a business. We note, for example, that some of our customers would be both individuals, and businesses, depending on the product.

5.47 If there is any distinction, it is on the basis of product, rather than customer, where customers purchasing home, contents, or private motor insurance would be an individual, and customers purchasing material damage, business interruption, commercial motor, liability, or cyber insurance would be businesses. There would inevitable be some small overlap for some products.

5.48 Our position on the options in relation to disclosure by businesses, therefore reflects our position on the options in relation to disclosure by individuals (above).

5.49 IAG's preference is therefore Option 1 – a duty to disclose what a reasonable person would know to be relevant. The nature of the customer (whether an individual or a business) would go to what is 'reasonable' in a duty to disclose what a 'reasonable' person would know to be relevant. Because of the "reasonableness" criteria, there would also be no need to distinguish between small and large businesses. The size and sophistication of any particular business would determine what information it can reasonably be expected to disclose. Applying the same obligation to individuals and businesses would create a far simpler regime.

5.50 IAG does not support businesses having the ability to contract out of the duty to disclose. We understand that this could be useful to achieve efficiency in commercial interactions. However, the Options Paper correctly recognises the significant bargaining power of some businesses, and IAG is concerned that potential customers could assert significant pressure in negotiations, which may result in uninformed contracts.

Disclosure remedies options

5.51 The extent and nature of the breach should determine the appropriate remedy and as such Option 1 – that remedies should be based on intention and materiality, is therefore our strong preference.

5.52 If it is found that a customer has been fraudulent, or that there has been deliberate non-disclosure (or deliberate misrepresentation), the insurer should be entitled to avoid or cancel contracts or make retrospective adjustments to policy terms. Removing this remedy in New Zealand would bring it out of step with other jurisdictions and reward conduct that harms other customers.

5.53 In the UK and Australia, in circumstances of intentional non-disclosure or misrepresentation by an insured, extensive remedies are available to the insurer.

5.54 This is also the case in Canada, where the consequence of non-disclosure or misrepresentation of a material fact by the insured is that the insurer is entitled to void the insurance contract.[12]

5.55 Avoidance also remains an available remedy for breach of the duty of disclosure in Singapore. If the insurer can prove materiality and that the misrepresentation or non-disclosure induced them into the contract, the insurer can avoid the contract altogether.

5.56 However, we acknowledge that it would not always be the case that the non-disclosure is deliberate or fraudulent, and we support a proportionate response in the case of genuine error. As a general principle, a proportionate response in the event of a discovery of a breach of disclosure would be to put both parties back in the position they would have been in, had the breach not occurred.

5.57 We would support the position in Australia and the UK, which provides that if an insured's non-disclosure or misrepresentation was careless, the insurer is entitled to vary their obligations under the contract to reflect how they would have entered into the contract had full disclosure been made (i.e. imposing a proportionate response). There is no remedy available to insurers if there would have been no change to the terms of the policy or arrangement, if the disclosure had been made before entering the contract.

Design options

5.58 As said above, the remedy for not disclosure should be to put both parties back in the position they would have been in, had the breach not occurred. It therefore follows that, if an insurer would not have entered into the contract if it had known the facts, it should not be required to comply with its obligations under the contract. As such we don't agree with Design Option 1 as it does not adhere to this principle of proportionality. In certain instances, it may be appropriate to pay the claim, but this should be determined on a case-by-case basis, determined by a proportionate response.

5.59 Similarly, insurers should be able to offer reduced cover if this is a reasonable remedy considering the breach. Where information becomes known that means the contract does not reflect the bargain agreed between the parties, there should be provision for the contract to be varied to reflect the intent of the parties, and what was agreed. This should extend to an adjustment of the scope of what is covered, and the price agreed. We therefore agree with Design Option 2.

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12 *Sagl v Chubb Insurance Company of Canada,* 2009 ONCA 388, at [51].

Where a contract is legitimately avoided, and all claims rejected, the customer should be required to refund all claims money, even if not easily refundable. It does not follow that insurance will pursue this action in all cases (as commercial, reputational and ethical considerations will apply), but they should have the right to. IAG is concerned that, where the legislation did not provide for this, it would send a message to those who had wrongfully claimed to spend the claims money quickly, so as to avoid having to repay it. As such we don't agree with Design Option 3

6. Unfair contract terms

IAG's supports retention of the status quo, on the basis that any changes risk interfering with contractual terms at the core of the insurance product (which would mean insurance is treated differently from other goods/services) and introducing significant unintended consequences.

In the alternative, IAG could support tailoring generic unfair contract terms provisions to insurance, provided that any legislative response does not interfere with terms that define the risk or IAG's liability.

Insurance contracts are not exempt

6.1 There appears to be a common belief that insurance contracts are not subject to the prohibition of unfair contract terms. This is wrong. We believe that this comes from people conflating insurance with other services and not fully appreciating the unique characteristic of insurance and the sustainable pooling of risk.

6.2 Section 46L clarifies for the purposes of certainty the types of terms that are "reasonably necessary in order to protect the legitimate interests of the insurer". Terms in insurance contracts that fall outside of provisions of 46K and 46L can be declared unfair. Also, as we noted in our submission on the Issues Paper, IAG reviewed and amended several its policies as a result of the prohibition coming into effect.

Problem definition

6.3 We do not see any material evidence showing that change is required and are concerned about the risk of serious consequences if insurance contracts are undermined by removing the existing insurance specific provisions in section 46L (4) of the UCT regime.

6.4 We agree with the Options Paper's assessment that limited customer engagement should not influence what constitutes an 'unfair contract term' (UCT).[13] IAG can make a policy very clear, and draw a customer's attention to particular provisions, but a customer still needs to read the policy. If a customer does not read the policy, and is subsequently surprised by the terms, this should not be an indicator that the terms were unfair provided that the terms were sufficiently clear and transparent.

6.5 IAG does not intend to comment on the unfair terms identified in Table 4. Whether a term in an insurance contract is objectively 'unfair' should turn on the detail of each specific case and the broader context of the contract, rather than any broad predetermination.

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[13] Options Paper, at [73].

6.6 In any event, there is already provision for the fairness of terms to be assessed, as they directly inform whether an insurer has complied with duties to its customers.[14] It would be more effective to clarify the powers of the Commerce Commission (or similar) to consider contracts and implement change to the extent that it discovers issues with contracts under the existing regime.

Recognising the unique nature of insurance contracts

6.7 Insurance is a product like no other. The insurance contract is not contract for sale of an item, but a contract to transfer from an individual into the pool administered by the insurer the costs that arise, under specified circumstances, to repair or replace that item.

6.8 An insurance contract, in part, therefore describes both the risks and the liabilities being insured. The terms that do this are the essential feature of the contract and circumscribe the risk so that it is acceptable to the pool and can be accurately priced. Without them risks that are too certain, too large, too different, or too ill-defined would enter the pool and imperil its ability to fairly and effectively share losses.

6.9 Insurers must have the ability to accurately define these risk and liabilities without the danger that they could be deemed unfair. To expose these terms to that potential would cause harm to consumers, insurers and the market, including:

- **Inconsistent treatment of insurance contracts.** The terms that define risk and liability should be considered the main subject matter of the contract and therefore safe from the prohibition. Any other approach would result in insurance contracts being treated differently to contracts for other goods or services. We also note that other jurisdictions recognise the unique nature of the insurance contracts, including the European Union which pioneered the prohibition on unfair contract terms.[15]

- **Risk appetite and financial stability.** Insurers will have a risk appetite approved by the Board that defines and informs policy wording, underwriting, and pricing. This appetite and monitoring adherence to it forms an important part of the risk management frameworks the Reserve Bank requires of insurers. The integrity of the link between appetite and individual contracts of insurance is essential to ensuring that insurers match premium income with liabilities and goes to the heart of their financial performance and stability. Deeming terms that give effect to risk appetite would threaten this.

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[14] Existing duties are set out in the Financial Markets Conducts Act 2013, the Fair Trading Act 1986, the Consumer Guarantees Act 1993, and the Financial Service Providers Act 2008. We also expect that this consultation will factor in the effect of proposed duties under MBIE's options paper for the Conduct of Financial Institutions.

[15] Council Directive 93/13 on unfair terms in consumer contracts, 5 April 1993

- **Contractual freedom.** The ability to strike down a term or say that it no longer applies would cut across the insurers right to decide what risks they do and do not admit to the pool and would have the effect of requiring the pool to take on risks and cover losses that were not intended to be covered. This outcome is disproportionate and would create outcomes different to that which would have occurred if it was known at the start of the contract that the term could not be relied on.

- **Contractual uncertainty and customer impacts.** Insurers are uniquely dependent on the accuracy with which risk and liability are defined. The ability to challenge the fairness such terms would increase the level of underwriting risk carried by insurers and would create added liabilities without the corresponding premium if a term in a contract were to no longer apply. In the sort term this would harm the 'pool' and longer terms insurers would look reduce this risk by adding precautionary premium and or changed terms.

- **Loss of capacity.** The ability of New Zealand insurers to offer cover depends on their ability to attract capital from investors and reinsurers. Added uncertainty would raise doubts about the returns they can expect from New Zealand and could either reduce their wiliness to invest or increase their expected return, both having flow-on impacts for consumers.

6.10 The need for certainty is especially important in New Zealand because of it high natural hazard risk profile and use of 'all risk' policies (see Context for more detail), which make the financial consequences of a lack of precision in circumscribing risk and liability even more material to the financial performance and stability of the insurance pool.

Unfair contract terms options

6.11 IAG's preference is to keep the current provisions relating to insurance contracts and that these are carried over into a new insurance contracts act. For further commentary on this we refer to our submission on the Issues Paper.

6.12 IAG could work with Option 1 and expect that these tailored provisions would likely replicate those in the current Act. That said, we are concerned by the use in the Option Paper of phrases like "does not disproportionately or unreasonable disadvantage the insured" and "avoid the outcome that policyholders are not entitled to any claims", as these appear to be at odds with the points we make above and imply a willingness to set aside contractual certainty and freedom.

6.13 For the reasons set out above, IAG does not support Option 2 – to rely on generic unfair contract terms provisions. Insurance products are unique in nature, and an attempt to squeeze these products into the mould of other contract regulation comes with serious risk of adverse consequences.

Unfair business practices

6.14 MBIE recently sought feedback on a paper proposing changes to strengthen the protections for businesses and consumers against 'unfair contracts' and 'unfair conduct'. Specifically, creating a back-stop prohibition of unconscionable conduct, oppressive conduct, or unfair practices (depending on the option selected), extending the protection from unfair contract terms to business, or combinations of these options.[16]

6.15 It is not obvious to us that these have been considered in setting out the proposals for unfair contract terms in the Options Paper or how the two consultations will come together or whether there is an intention for there to be a different regime for insurers and other businesses. For example, will the provisions apply to insurance customer that are businesses and if so will the definition of business be the same as that used for the disclosure reforms (if that is needed). MBIE should clarify the joint way forward for these reforms at the earliest opportunity.

[16] Discussion paper: Protecting businesses and consumers from unfair commercial practices, December 2018

7. Understanding and comparing policies

IAG supports in principle insurers being required to present their policies in plain language, and with clearly defined core policy wording. It is important that sufficient detail on any additional obligations is given to secure support and ensure consistency across the industry.

IAG opposes any additional requirements relating to summary statements and third-party comparison platforms as this would have the effect of reducing rather than improving customer engagement and would bring about unintended consequences that would harm consumers and the markets

Problem definition

7.1 IAG supports the objective of customers making informed decisions about their insurance. Customers should be confident that they have selected an insurer that will look after their interests, and that they have a product that will meet their needs if and when they make a claim. This is the output of strong, effective, and constructive competition in the insurance market.

7.2 We are comfortable with a duty on insurers to present policy information in a clear, concise and effective manner, using plain language, recognising that there are limitations to what an insurer can achieve when the product it is selling is a contract. However, this does not negate the duty on a customer to recognise the importance of their decisions and invest the time to get it right, including by reading the policy.

Understanding policy options

Plain language

7.3 IAG agrees in principle with Option 1, requiring insurers to present their policies in plain language. We intend to do everything we can to encourage existing and potential customers to engage with the process and understand their options. Because of this intent, we currently actively draft our policies with the 'plain language' direction in mind.

7.4 We are unable to support this option more strongly because there is no detail on how:

- a consistent, minimum level of 'plain language' will be defined, measured, applied, monitored, and enforced across the industry
- differences between business and consumers and related product would be recognised

- a balance will be struck between simplicity and precision, so as to maintain the ability of insurance contracts to be adjudicated by courts in the event of disputes

- this obligation would work with the proposed duty to 'pay due regard to the information needs of customers and to communicate in a way which is clear and timely'.

7.5 Until this detail is available we are unable to assess whether this option is workable, would result in improved customer and market outcomes, and would not bring about unintended consequences.

Definitions

7.6 IAG also supports Option 2 in principle, requiring core policy wording to be clearly defined. The objective of this option is very important - a customer should be able to pick up an insurance policy and understand what it means.

7.7 However, our concerns with Option 2 reflect out concerns with Option 1; there is no detail on what this obligation would mean in practice, how it would relate to other duties, and the impacts it would have on customers and the sound functioning of the market.

Product summaries

7.8 In light of the experience in Australia, IAG does not think that requiring a summary statement to be provided (Option 3) would be a positive move for New Zealand.

7.9 The Option Paper has suggested that a mandatory summary statement would draw customers' attention to the key aspects of the policy in order to aid understanding of the product. However, the experience in Australia is that it is difficult to define the information that is pertinent, and the outcome is an absence of consistency across summary statements. The information found within the statements of two providers does not line up and is therefore incomparable. The UK has gone a step further and specified the information to be included, but this also has not led to improved comparability.

7.10 The specifics of insurance contracts and products do not lend themselves to summary statements. Insurers do not know which of a myriad of claims might arise when the customer accepts the contract, and specific terms cannot be read in isolation (for example, a policy may have greater cover of one risk, but comparatively less cover of another, or vice versa). It is therefore difficult to decide upfront which aspects should be included in the summary statement for a particular customer.

7.11 Further, we are concerned that summary statements will be used as a tool to assist customers not to read the contract. This will have the effect of reducing rather than improving customer engagement and is counter to the assessment criteria – for customers to have the information needed to make informed decisions about insurance.

Comparison platforms

7.12 We also have significant concerns with the proposal to introduce mandatory participation in third party comparison platforms (Option 4).

7.13 We provided extensive information of customer decision making and the performance of comparison sites in our submission on the issues paper. We will not repeat that content but provide below the key messages:

- There is no single set of attitudes and expectations that consumers bring to their insurance decisions. Levels of engagement, decision criteria, desired outcomes, and decision quality vary and combine in many ways. Enabling better decisions is a complex and multifaceted problem that needs a variety of solutions.
- Against this backdrop there is only so much insurers or other actors can do to help customers to engage and make informed and considered choices. It requires customers to invest the time and the effort to make it happen.
- The 'all risk' policies used in New Zealand are inherently difficult to compare at a headline line level, as the differences in cover are articulated in the exceptions and the detail of how they are applied.
- International research suggests that comparison sites have a track record of not meeting conduct standards or meeting consumer needs and reinforce priced-based decision making.
- Price is a function of cover and cheaper insurance typically means less cover, which is why insurers have traditionally competed on product and service quality.

7.14 Consequently, we remain deeply concerned that the use of comparisons site will reinforce behaviours that will trigger a race to the bottom and ultimately cause harm to consumers and to the insurance market.

8. Other miscellaneous issues

We support introducing a statutory obligation on intermediaries to pass on information to insurers. We also support the principle of making intermediaries agents of the insured but consider that this should be subject to a separate inquiry or review.

We support the consolidation of statues, but do not support the proposal to codify the duty of utmost good faith.

Intermediaries

8.1 Our overwhelming experience with brokers is that they are customer centric, ethical, and display professionalism. However, we recognise that, from time to time, brokers fail in their duty, including by:

- not giving material information to an insurer;
- not matching the client's insurance needs with an appropriate insurance product;
- misrepresenting the nature of the risk to be insured; and/or
- not managing insureds' premiums per Sections 77P-77T of the Financial Advisers Act.

8.2 However, we disagree that, if a broker fails to pass on information to an insurer, the insurer should be required to bear the loss. Accordingly:

- We agree with the Option Paper's problem definition, and description, in particular where it points out New Zealand's unique position in common law jurisdictions.
- We support the Option Paper's criteria for reviewing the options, particularly that the insurer should not unjustifiably bear liability for third party failures.

8.3 In light of this, we do not support retaining the status quo (Option 1).

8.4 In principle, we support Option 2 – that would provide for intermediaries to become agents of the insured.

8.5 It is not IAG, but the customer who engages the broker to search the market and find the insurance product on their behalf. Customers would therefore expect that their broker is working for them, and their interests (and would be entitled to hold this expectation). It would therefore follow that customers would expect brokers to be held responsible for their errors and shortcomings.

8.6 We understand that this option would allow customers to obtain redress against the intermediary, in the event that the customer's information has not been passed on. We note that, per our discussion on the context of disclosure duties above, the instances that this would be required would be infrequent. It is extremely rare that customers are penalised for the failures listed above.

8.7 Our concern with Option 2 is the extent of the task. This is a significant proposal, the size of which is hinted at in paragraph 111 of the Options Paper. In the absence of further analysis, IAG considers that this is too big a question for this piece of work. We would encourage MBIE (or another entity) to take this on as an additional project or review.

8.8 We also support Option 3 (a statutory obligation on intermediaries to pass on information to insurers) and believe that this would be a constructive option to implement in the interim.

Duty of utmost good faith

8.9 We do not support the proposal to codify a duty of utmost good faith. We agree that this duty gives important overarching direction for both parties to an insurance contract and supports many of the criteria used to assess the options above.

8.10 However, we do not see that there is a problem to be solved by codifying this duty and consider that it is best set out in common law, despite possible changes to the sector in the wake of this review.

8.11 We disagree with the assessment that codification of this duty would achieve certainty. While the intent of this duty may be the same as those proposed in the review of Financial Conduct, the substance of the duty, and what it means to comply, may slightly differ. In this context, codifying the duty of good faith will complicate the regime, by introducing additional (and possibly conflicting) statutory direction for compliance.

8.12 We are also conscious that, because this duty is difficult to define (and therefore possibly broad in its reach), codifying it would open the door to vexatious litigation, as a 'catch-all' avenue for claims.

8.13 We therefore support keeping the duty at common law.

Consolidation of statutes

8.14 We support the proposal to combine statutes and agree that this will improve legislative clarity and succinctness.

Insurance claims

8.15 Further to the position we set out in our submission on the Options Paper for Financial Conduct, we think it would be more appropriate for MBIE to consider its options relating specifically to Insurance Claims as part of this review. We summarise our position on these options as follows:

- IAG is not convinced that specific insurance duties and requirements are justified.
- For ensuring that claims handling is fair, timely and transparent, rather than a broad and ill-defined proactive duty, it would be better to have a more limited power for the regulator to inquire into the conduct of insurers in their settlement of claims in specific circumstance, if concerns were raised. This would be a more targeted, proportionate form of regulation.
- We do not support statutory requirements to settle claims within a set time. The focus on settling claims should be on quality, and on meeting the needs of the specific customer in the specific context of the claim. Requiring quick settlement would lead to rushed decisions, and a higher risk of outcomes that were counter to the customer's interests.
- Further, in many instances such as natural disaster scenarios, claims decisions rely on external expert advice. The insurer has no control over the availability of such expert advice or the speed of delivery. Creating ‘set times’ is not appropriate in an environment where the party subject to meeting it is dealing with factors outside its control.