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

Options Paper: Conduct of Financial Institutions

Introduction

Southern Cross Benefits Limited has traded as Southern Cross Travel Insurance since 1982 and now has over 37 years' experience as a specialist travel insurer. The company is part of the Southern Cross Group and is 100% New Zealand owned, but operates as a separate legal entity to the Southern Cross Medical Care Society with its own dedicated Board of Directors.

Southern Cross Benefits Limited is New Zealand's largest travel insurer by market share. Each year we sell more than 300,000 insurance policies to customers in New Zealand and Australia. Annually we receive more than 40,000 claims.

Thank you for providing an opportunity to submit on the options paper "Insurance Contract Law Review". Southern Cross Benefits Limited is pleased to be involved in the review of contract law. We recognise the political and public concern regarding existing insurance contract laws and are pleased to explore a solution that works in the interests of all stakeholders. We believe that the health of the insurance sector depends on the level of trust and confidence in which it is held by consumers. A sound legal framework is crucial to achieving this outcome, one that recognises the interests of both the insurers and the consumers on whom our businesses depend.

We broadly support MBIE's proposals in relation to non-disclosure/misrepresentation, understanding and comparing policies, and miscellaneous issues. In respect of remedies for dishonest non-disclosure/misrepresentation, we support retaining the right to avoid the contract.

We are concerned that changes to the Unfair Contract Terms provisions may create an environment that is harsh on insurers, creates uncertainty around whether a claim can be declined, and impose remedies that may not be appropriate in the circumstances.

We have provided feedback on the specific questions below.

1. What is your feedback regarding the objectives for the review?

We support the objectives. They neatly summarise goals which should underly insurance law reform:

- to ensure interactions are fair, efficient and transparent;
- to minimise barriers to insurers providing insurance; and
- to protect consumers' interests.

Unless otherwise stated, where we refer to non-disclosure we also mean misrepresentation.

2. What is your feedback in relation to the options for disclosure by consumers? 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 (including the status quo) do you prefer and why?

Disclosure is a critical part of insurance contract law and is essential so that insurers can understand and correctly price risk. The consumer will always know better than the insurer the history of the risk, at the time cover is applied for. To fix this imbalance, relevant and material knowledge needs to be passed on to the insurer.

As a travel insurer most of our underwriting has been based on a very limited range of information from the consumer. Historically we have only rarely attempted to exercise remedies for non-disclosure. However, it is important to ensure that in the rare event that we exercise our legal rights, that the law provides a solution that is fair to both us and the consumer. Since many of our policies are of short duration, time is of the essence, so any changes to the law must not add complexity.

The status quo (the duty to disclose and consequences for non-disclosure) would work well were it well understood by consumers. While insurance policy applications have suitably placed statements of the duty of disclosure, it might be argued that more care needed to be taken to explain the duty to consumers, especially by those intermediaries who are instructed by the consumer and should act in the interests of the consumer. Unfortunately, not enough has been done to raise awareness and educate the consumer, so that it is probably too late to fix the status quo in order to rebuild consumer confidence.

A further problem with the status quo is that the consequences for non-disclosure in a claims context (that allow an insurer to void a policy for non-disclosure of a matter that may not even be directly related to claim subsequently made) can in some circumstances lead to unfair consumer outcomes. Where there is no connection between the fact that was not disclosed and the circumstances of the claim, no dishonesty, and where if the fact had been disclosed the insurer would have agreed to cover but on different terms, avoidance seems counter-intuitive and disproportionate.

We would not support Option 1 (a duty on the consumer to take reasonable care not to make a misrepresentation). Option 1 puts the onus on the insurer to ask all relevant questions to cover each possible scenario by the consumer, leaving the insurer to take the risk if it fails to do so. This approach would cause the consumer to have to answer many more questions in the application and therefore be more onerous than the status quo. There is a significant disadvantage from an insurer's perspective, which is the risk that an consumer may be aware of a circumstance that is clearly relevant to the risk but is so unusual that it is not within any of the insurer's specific questions.

We would support Option 2 (a duty to disclose information that the consumer knows and that a reasonable person in the circumstances could be expected to know, to be relevant to the insurer in making the decision to accept the risk). While the applicant is still required to disclose relevant information, it is only to the extent that a reasonable person would know to be relevant. This approach is no substitute for and less transparent than detailed and specific questions (Option 1), but it does not place the insurer at a disadvantage in respect of an unusual circumstance not covered in the detailed questions. We note in passing that some care would be required to explain the duty to the consumer at application time.

We don't support Option 3 (requiring health and life insurers to use medical records to underwrite). While Option 3 would lead to a better outcome for consumers, it would come at significant increased cost. Medical records, especially for older consumers, can run to hundreds of pages. The insurers would need to employ more underwriting staff, which would push up the cost of the cover. Option 3 would significantly lengthen the time between application for cover and the insurer confirming cover (or not), due to record collection logistics, although perhaps that could be mitigated with interim cover. This approach would also drive insurers towards products with substantial exclusions. This would be a poor outcome for consumers, who need comprehensive cover.

We are a travel insurer, where part of our policy coverage is for emergency medical treatment and some clarity would be required as to whether Option 3 would apply to us. Like most of the travel insurance industry, we primarily underwrite using an automated tool. Were Option 3 to be made into law, we would have to employ a team of underwriters, which would introduce the possibility of error and inconsistency, as well as increasing significantly costs which would have to be passed onto the consumer as premium increases.

Ultimately the deciding factor is that consumers should understand their own heath records, and they need to take responsibility for control and disclosure.

Do you agree with the costs and benefits of the options?

Option 1 – We broadly agree, subject to our comments above.

Option 2 – we agree with the benefits noted but refer to our additional points above. We don't agree that this option is less favourable to consumers particularly if a specific questionnaire is provided to assist them in disclosure (counters both bullet points under "costs" for this option). This is an effective balance of interests between the consumer and the insurer with good outcomes for both.

Option 3 – we broadly agree, subject to our comments above.

Do you have any estimates of the size of those costs and benefits?

We would require more detail to give estimates of the costs of Option 1 and 3. Option 2 is unlikely to create additional costs.

Are there other impacts that are not identified?

No.

Are there other options that should be considered?

No.

Which option (including the status quo) do you prefer and why?

As noted above, Option 2, for the reasons given above.

3. ***Should insurers be required to warn customers of the duty to disclose? Why, Why not? Should insurers be required to warn all insureds of the duty to disclose, including business?***

Yes, insurers should clearly advise customers of their obligations to disclose, and set out the consequences if they don't. This is our current practice. While we don't offer our product to businesses currently, we consider that insurers should warn all consumers, including businesses.

4. ***Should insurers have to tell consumers what third party information they will access, when they will access it and if they will use it to underwrite the policy?***

We support this obligation on insurers. This is our current practice and ensures transparency.

5. What is your feedback on the options in relation to disclosure by businesses? In particular: Should businesses have different disclosure obligations to consumers? Do you agree with the costs and benefits of the options? Do you have any estimates of the size of these 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?

While we don't offer our product to businesses currently, we consider that the status quo should remain for businesses. The chief criticism against the status quo is that consumers don't understand the duty of disclosure. However, businesses can be expected to have a higher degree of awareness of their legal duties and obligations than consumers, since businesses often employ professionals to advise them on such matters as insurance. Most business insurance is transacted through intermediaries, who owe their client the business a duty to properly explain the duty of disclosure.

Were we to offer our product to businesses such as a group travel insurance product, it is likely that we would require very little underwriting information, so a change to the existing law in this area would be unlikely to significantly affect what we do.

6. If we have a separate duty of disclosure for businesses, should small businesses have the same duty as consumers? Why/ why not? If so, how should small businesses be defined?

While we don't offer our product to businesses currently, we consider that small businesses should have the same duty as consumers.

7. If a duty of fair presentation of risk is adopted, should businesses be allowed to contract out of the duty? What are the costs and benefits of allowing businesses to do so? If businesses are allowed to contract out, should the duty apply to all businesses?

While we don't offer our product to businesses currently, we consider that a duty of fair presentation of the risk is very similar to the status quo, and therefore we would support this duty for businesses.

8. What is your feedback in relation to the disclosure 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 impacts that are not identified? Are there other options that should be considered? Which option do you prefer and why?

Feedback on options for disclosure by consumers

Insurers are primarily concerned with whether the correct information is disclosed. The moral element of whether the non-disclosure was deliberate/reckless or accidental is secondary, but is important because it goes to the trust and confidence that underlies the relationship between insurer and consumer. On this basis, we prefer Option 1.

Do you agree with the costs and benefits of the options?

Option 1 (remedies based on intention and materiality) – while often it can be very difficult for an insurer to prove deliberate/reckless non-disclosure, it is important not to jettison remedies for dishonest behaviour by consumers. The cornerstone of a contract of insurance is trust and the duty of utmost good faith. Any law reform must have as a priority measures which prevent at all costs any erosion of that trust and duty. Where an insured chooses deliberately to withhold information which would have influenced the decision of the insurer in choosing to give cover and if so on what terms, insurers, and we think most consumers too, would say that fairness requires the contract to be treated as if it never existed.

Option 2 – see above for comments on the benefits for this option.

Option 3 – We agree with the benefits as stated, but as we have noted, by not having more serious consequences for deliberate/reckless non-disclosure, and only focussing on materiality, we may lose one of the fundamentals underpinning contract law, when there is a need to build and not erode trust and confidence.

Do you have any estimates of the size of those costs and benefits?

Without more information, it is not possible to estimate the size of the costs and benefits.

Are there other impacts that are not identified? Are there other options that should be considered?

No.

Which option do you prefer and why?

We favour Option 1 because it is the fairest for the insurer and consumer. The Option 1 remedies correlate to the degree of materiality (or harm) of the non-disclosure, and also have reference to the moral element of the consumer (deliberate or reckless non-disclosure).

If the insurer would not have entered into the contract, then it makes sense that the remedy should be avoidance, refusal/recovery of claims and return of premium.

If the insured would have varied the terms (except the premium amount), then either the contract is treated as continuing on those terms or the insurer can cancel. The option should be the insurer's.

If the insurer would have charged higher premiums, then the insurer may reduce the claim amount accordingly.

In coming to this view, we have assumed that Option 2 is no different from Option 1 in respect of avoidance for deliberate/reckless non-disclosure: that the test is whether the insurer would not have entered into the contract, not a lower threshold where the insurer would have entered into the contract anyway, but on different terms or at a higher premium.

We do not support Option 3 because it would mean that consumers who were dishonest were not properly held to account for their behaviour.

9. 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?

Yes.

10. 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?

Yes. The parties are put back into the position in which they would have been had proper disclosure been made.

11. Should we clarify that where a contract has been avoided and all claims rejected, the insured is not required to refund claims money if it's not easily returnable and would be hard and unfair to the insured? Why or why not?

We do not consider that it is fair and reasonable for a consumer to retain money that they have received from an insurer as a result of a deliberate/reckless and/or material non-disclosure, irrespective of whether it is difficult for the consumer to repay.

12. Do you agree that section 35 of the Contract and Commercial Law Act should not apply to insurance contracts? Are there any other sections of the Contract and Commercial Law Act that should not apply to insurance contracts?

Yes. If the objective is to consolidate existing insurance contract law and have a separate set of rules that apply to insurance contracts then it would be helpful to have all relevant provisions in the one Insurance Contract Act. However, if the remedies for non-disclosure and misrepresentation are removed they should be removed for both insurer and consumer.

13. Do you agree with the proposed change to the misrepresentation provisions in the Insurance Law Reform Act 1977? Why/ why not?

Yes, provided the remedies for non-disclosure are fair and reasonable to both parties (see our comments above) and reflect the current situation as set out in the Insurance Law Reform Act.

14. Which of the terms in Table 4 are unfair? In your opinion are they exempt from the unfair contract terms prohibition?

The insurance specific exemptions to the Unfair Contract Terms of the Fair Trading Act ("UCT") are important and necessary to protect the legitimate interests of insurers. Specifically, the need to exempt terms that define the main subject matter of the contract (i.e. set out what is insured and to what extent) and terms that exclude or limit liability on the happening of certain events (i.e. clearly specify what is not covered) comprise how travel insurance products are structured and how risk is measured and how the products are priced.

We will comment only on examples 1, 6 and 8 which relate to travel insurance.

In example 1, in our view, it is not unfair that a travel insurer can require pre-approval before incurring health care costs. Generally, this condition only affects a consumer's claim adversely to the extent that the insurer's interests are prejudiced by the consumer not seeking pre-approval. For example, a consumer fails to seek our pre-approval and takes medical care in the most expensive hospital. Had the insurer been consulted, it would have arranged hospitalisation in an adequate but less expensive hospital. The insurer would still pay the claim but with a reduction to reflect the costs that could have been saved had the insurer been consulted. In our view, this is a legitimate term to protect the insurer's interests against consumers incurring unreasonable costs, which in turn keeps premiums affordable. The term may also benefit the consumer in that the travel insurer will generally be better informed as to the nearest and/or most suitable hospitals and specialists, and may be able to arrange treatment more speedily than the consumer.

In example 6, MBIE has given the example of blanket mental health exclusions. The existing avenue to challenge blanket mental health exclusion is the Human Rights Act. No further legal mechanism is necessary to review blanket health exclusions. There is increasing data available on mental health to help travel insurers more accurately identify, manage and price risk for different mental health conditions.

In respect to example 8, (broad exclusions for pre-existing conditions - insurers can decline claims for any symptom, regardless of whether the consumer knew it was a symptom) one of the fundamental principles of travel insurance is that it is only intended (and priced) to cover conditions that occur after the policy starts. This is to avoid anti-selection whereby a consumer who knows they are suffering certain symptoms or a pre-existing condition can unfairly apply for and obtain travel insurance. It is possible (and in fact not uncommon) that while the condition was not diagnosed prior to the consumer taking out the policy there are signs and symptoms that occurred prior to the start date which mean the applicant did know, or should reasonably have known, about the condition or the symptoms. If the consumer wishes to have cover, he or she should be disclosing these to the insurer so that risk can be properly assessed and underwritten and the policy priced appropriately. This is necessary for the legitimate interests of the insurer and provides protection for the consumer.

In practice, we do not decline a claim for a symptom in respect of which the consumer would not reasonably have been unaware prior to the start date of their insurance. Where the consumer seeks cover for pre-existing condition,

all we seek is complete and correct answers to our questions in relation to all the pre-existing conditions of which the consumer was aware of or should reasonably have been aware, at the date of application.

We therefore do not agree that there is a problem with the status quo. We do not believe that consumers are being disadvantaged by genuinely unfair terms. As acknowledged in the options paper, just because a particular exclusion is a surprise to a consumer doesn't mean the term is unfair.

We maintain that the insurance-specific exemptions to the UCT are reasonably necessary to protect the legitimate interests of insurers. If insurers can't prevent anti-selection or reasonably assess and underwrite risk, then they may decide it's too difficult to offer cover at all to certain people or increase premiums for everyone, neither of which are good outcomes for consumers.

15. ***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?***

Do you agree with the costs and benefits of the options? Which option do you prefer and why?

See above for general comments on UCT.

We don't believe that consumers would benefit or gain better protection from option 1 in bringing insurance contracts under the general UCT provisions for all standard form contracts or from option 2 in removing all insurance specific exceptions from the FTA. It's difficult to see how options 1 or 2 would "improve consumer choice of fair insurance products and help consumers to get what they paid for", as compared to the status quo. It's possible the opposite would be true, and consumers would end up with less choice and higher premiums.

We do not support the self-enforcement of the UCT. Making the test for protection of legitimate interests dependent on the impact on a particular consumer, and not the whole class of consumers, would undermine the nature of insurance which is based upon the pooling of risk and create significant contractual uncertainty.

Options 1 and 2 could lead to uncertainty in relation to the potential exposure to sections of their policies being subject to court orders, could potentially lead to insurers offering more restricted ranges of insurance contracts, including the possible withdrawal of more affordable contracts that provide relatively less cover purely because the scope of cover is limited. We don't believe that this is likely to result in better outcomes for consumers. A travel insurance policy with no exclusions is not of itself necessarily a better or fairer contract for the consumer. It may in fact lead to extremely limited policies that only cover very specified medical conditions and only in limited circumstances.

The Options Paper refers to "broadly worded exclusions for mental health, pre-existing conditions and unlawful acts", but these exclusions are not unfair but necessarily define the main subject matter of the contract. For example, medical cover under travel insurance is intended to provide cover for emergency medical assistance, and not every medical treatment that is available.

We don't believe that conduct regulation is the correct method or place to provide for exemptions to unfair contract terms or that its helpful to have UCT provisions in another separate set of regulations. If the objective is to have a consolidated insurance contract law, then any specific provisions applying to insurance contracts should be set out in the insurance contract legislation they can't just be dealt with as an exception to the UCT provisions.

We believe the status quo is the preferable option (we are unaware of any actual proven problems with it), but if a change was made option 1 (or possibly option 2a) would be a better option than options 2 and 3 in that they recognise that special nature of insurance contracts.

16. ***What is your feedback on the options to help consumers understand and compare contracts? 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?***

What is your feedback on the options to help consumers understand and compare contracts?

We support a regulatory solution as we believe that it is in the consumer's interest to be able to quickly and meaningfully be informed of differences between the product of one insurer and another.

Unfortunately, the reality is that not enough consumers read insurance policies. Without understanding the insurance policies consumers cannot be in a position to make informed decisions about product choice.

We accept that insurance policies are sophisticated documents with many interlocking provisions. It is not easy to reduce policy terms into summary statements or to put insurance policies into simple language. Producing summary statements necessarily requires a degree of simplification which may not fully represent to the consumer the true scope of the cover. However, we believe that requiring insurers to take the above steps would put consumers, particularly vulnerable consumers, in a better position than that in which they now find themselves. We also support third party comparison platforms.

Do you agree with the costs and benefits of the options? Do you have any estimates of the size of those costs and benefits?

We agree with the costs and benefits set out for all 5 options. While it is difficult to estimate the size of costs to insurers, we expect that it would be moderate, depending on the scale of the change.

Which option do you prefer and why?

We support all of the options 1-5. We believe that consumers need a better understanding of insurance policies by consumers, and that it is unrealistic to believe that this will occur without some legislative intervention.

17. ***What is your feedback on the options in relation to intermediaries? 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?***

The status quo is that under s.10 of the Insurance Law Reform Act 1977, an intermediary is deemed to be the insurer's representative in respect of the matters known to the representative before the insurer accepts the consumer's proposal. Our advisers are our agents, not the agents of the consumer, and therefore truly our representatives, so the status quo works fairly for us and the consumer. However, for the benefit of the broader insurance industry, we consider that s.10 should clarify whether it applies to agents who act for the consumer, and whether the "matters known" are facts relevant only to the context of non-disclosure, or whether s.10 applies in other contexts.

18. ***Can the issues with the status quo be overcome with insurers contractually requiring representatives to pass on all material relevant information? What benefits of a statutory obligation requiring representatives to pass on information?***

No. There is benefit in clarifying the law in this area to provide certainty.

19. ***Should consumer insureds be treated differently from commercial insureds in relation to these issues?***

No.

20. ***What is your feedback on the options in relation to section 11 of the Insurance Law Reform Act 1977? 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? Are the options preferable to the status quo?***

We support Option 1 (removal of certain types of exclusion from the operation of Section 11 of the Insurance Law Reform Act 1977). Section 11 interferes with the way some insurance products are designed to work. For example, we sell travel insurance cover to consumers who wish to ride small motorbikes while on holiday. Statistically we know that consumers who drive a motorcycle with a small capacity motor are less likely to have a crash than consumers who drive a motorcycle with a large capacity motor. Our policies include an exclusion from cover where the motorbike is more than 200cc. We price the risk based on the assumption that we will only be paying claims for crashes where the motorbike has fewer than 200cc. However, section 11 operates so that we still cover larger capacity motorbikes where it can be shown that the engine size (as opposed to the driving of the vehicle) did not cause or contribute to the accident, which is contrary to what the parties intended. We have a similar difficulty in relation to our exclusion for crashes where the driver of the motorbike was unlicensed. Logistically it is challenging for a travel insurer to assess this kind of claim. The accidents occur overseas and often unbiased accounts of what happened are not available, making an assessment of section 11 factors difficult. Because of section 11, we cannot therefore effectively measure and price the risk. For this reason, we support Option 1.

21. ***What is your feedback on the option to provide that Section 9 of the Insurance Law Reform Act 1977 does not apply to time limits under claims made policies? 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? Is the option preferable to the status quo?***

Our policies do not contain liability cover that is triggered on a claims-made basis. However, for the benefit of the broader insurance industry, we would support Option 1, as it would correct the cause of unfairness to liability insurers providing cover for professional liability.

22. ***If the option is adopted should there be an extended period (e.g. 28 days) for notifying claims or potential claims after the end of a policy term.***

No comment.

23. ***What is your feedback on the option for section 9 of the Insurance Law Reform Act 1936? 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 (including the status quo) do you prefer and why?***

We cannot recall ever having had a situation arise where a third party has attempted to exercise rights under section 9 against us directly in respect of the liability cover in our policies. That said, for the benefit of the broader travel industry, we would support Option 1 so that the wronged third party could claim against us directly without a statutory charge being created.

24. ***If the option is adopted, should it apply to insolvency only? Should third parties be required to get leave of the court? Should reinsurance contracts be excluded from the application of the option?***

The provision would have to set out clearly the circumstances in which it would apply, which should be limited to the insolvency of the consumer.

25. ***What is your feedback to the options in relation to the duty of utmost good faith? 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 (including the status quo) do you prefer and why?***

We agree that the duty of utmost good faith should remain and don’t particularly have a preference as to whether it remains a common law duty or is codified.

26. ***What is your feedback on the proposal to consolidate non-marine insurance statutes into a single statute?***

N/A so no comment.

27. ***What is your feedback on the proposal to consolidate non-marine insurance statutes into a single statute?***

N/A so no comment.

28. ***Are the above provisions redundant? Why/why not? Are there other redundant provisions in the legislation covered by this review?***

N/A so no comment.

29. ***What is your feedback on the proposed option in relation to registration of assignments of life insurance policies? What is your feedback on the proposal to consolidate non-marine insurance statutes into a single statute?***

N/A so no comment.

30. ***Should the maximum payment amounts in life insurance policies for minors be increased? Why or why not?***

N/A so no comment.

Southern Cross Benefits Limited