Submission on *Exposure draft Insurance Contracts Bill*

Your name and organisation

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Introduction to Fidelity Group.

This submission on the Exposure draft of the Insurance Contracts Bill, is from the Fidelity Group, Fidelity Life Assurance Company Limited and Fidelity Insurance Limited. We welcome the opportunity to provide feedback.

Overview of our submission on the draft Insurance Contracts Bill.

Fidelity Life supports the purpose of the insurance contract law review in ensuring we have well-functioning insurance markets that enable individuals and businesses to protect what matters most to them.

For the Insurance Contacts Bill (the Bill) to achieve its purpose and ensure there are equitable outcomes for all market participants, the legislation needs to reflect the unique characteristics of insurance. These characteristics are inherent in the nature of insurance contracts, and how they are distributed to customers:

- To provide life insurance, as an insurer we must be able to accurately price risk. To do this, we depend on accurate information from the customer. We must be able to rely on this information. Trust between an insurer and the customer plays a key part in the provision of the service. The customer has significantly more information about the risk that forms the basis of the insurance than the insurer.
- A life insurance policy can be set up in two ways during the application stage: through underwriting individuals or groups of people, or without underwriting.
- Life insurers can also be bound by the terms of our reinsurance cover which requires us to follow agreed processes and assess claims against the agreed policy wording.
- Buying life insurance can involve customers contemplating negative situations such as death and serious illness, which they can be reluctant to consider on their own. Generally, distribution of life insurance is supply driven; life insurance policies are most commonly sold to customers by a qualified financial adviser based on an assessment of their protection needs.

The Bill should also take into account the other significant legislative changes that will affect the financial sector, in particular the changes being introduced by the Financial Markets (Conduct of Institutions) Amendment Bill **(COFI Bill)** to ensure there is no inconsistency or unnecessary duplication.

Our responses to the questions in the Consultation Paper are set out below. For questions we have not responded to, we have left blank. Fidelity Life is a specialist life insurer and our response is in the life insurance context.

Responses to consultation paper questions -

Part 1: preliminary provisions	
1	*Do you have any feedback on Part 1 of the Bill?*
Part 2: disclosure duties and duty of utmost good faith	
2	*Do you have any feedback on the Bill's provisions in relation to the duty for consumers to take reasonable care not to make a misrepresentation, including the matters that may be taken into account to determine whether a consumer policyholder has taken reasonable care not to make a misrepresentation?*
	Our feedback on the new duty for consumers to take reasonable care is focused on the importance of ensuring that the new disclosure duty is clear and well understood by both consumers and insurers and speaks to some of the implications for life insurance. The move to a reasonable care duty puts the onus on the insurer to ask the right questions. For life insurance insurers the only opportunity to do this is at the time of application. An insurer's only knowledge of the proposing customer's medical and health situation is what is disclosed. Consequently, insurers risk being unable to solicit relevant information not included in specific questions. There will be a higher risk that material health risks are missed, potentially leading to additional claims. The additional claims may require higher premiums for healthy lives to compensate. More extensive underwriting will increase underwriting and compliance costs. We would also note that while the duty to take reasonable care applies to the policyholder (the owner of the policy), the policyholder and the life assured are not always the same person. If the new regime is to operate effectively, it will be essential the duty to take reasonable care is clear and well understood by all participants so they continue to have confidence in the insurance market, in line with the stated purpose of the Draft Bill set out in clause 3. For example, will insurers be able to take disclosures made by customers at face value? If an insurer subsequently receives contradictory medical notes will that be sufficient to demonstrate a failure by the consumer to take reasonable care so that remedies set out in Schedule 2 of the Exposure Draft apply? Consideration could be given to setting out in regulations prescribed wording which insurers could choose to use in policies to explain what "reasonable care" means. It is difficult to reconcile the customer's new duty to" take reasonable care" with clause 17 of the Exposure Draft, which provides that a failure on the policyholder's part to answer or completely answer a question is not a misrepresentation. This provision fails to acknowledge the customer is the one with the knowledge and the insurer has either none or little at that point. This fundamentally alters the duty of good faith between the parties where the responsibility was equally owned between the insurer

and the prospective customer, to one in which the insurer shoulders the burden on matters over which it has no control.

Under the existing duty of disclosure avoidance could be the outcome if the customer, who has more knowledge than the insurer, failed to tell the insurer what the insurer needed to know. While this would apply only to a small minority, it is an issue for insurers as only a few extra claims could involve a lot of money, equal to the premiums for several hundred or thousand policies. Thus a few extra claims may significantly increase everyone else's premium. This could potentially have a flow on impact and could reduce the confident participation of insurers and reinsurers in the New Zealand insurance market, and exacerbate New Zealand's under-insurance problem.

In addition, the effect on the duty of Clause 16, which requires insurers to consider certain subjective matters specific to the consumer, is not clear. Does this clause potentially reduce the policyholder's culpability for a failure to take reasonable care in line with the requirement under section 14? This may be an area where guidance would be useful to assist both policyholders and insurers understand the intention and scope of this provision.

Finally, we think some aspects touched on in this Bill seem to overlap with matters that are already being addressed in the COFI Bill. In particular, instead of including clause 16 in this Bill, should it be left to insurers to apply the fair conduct principle across their business, including assessing vulnerabilities at claims time and determining an outcome accordingly? This is an approach that Fidelity Life already takes and we do not think anything is added by including it within this legislation.

3 *Do you have any feedback on the Bill's provisions in relation to remedies for breach of the consumer duty?*

As noted in our 2019 submission responding to MBIE's Insurance Contracts Law Options Paper, Fidelity Life supports a proportional remedy for breach of the consumer's duty.

We seek to treat all our customers fairly and in situations where there has been a material non-disclosure we aim for a proportionate response. Fair treatment in providing life insurance is about ensuring consumers are accurately assessed for the risk that they pose and are not impacted by those consumers where disclosure has not been adequate. We want to ensure that everyone is paying premiums based on their level of risk. In doing so, we try to balance the risk, making it fairer for all our customers.

It is important that the shift in the duty of disclosure, which will reduce the consumer's current duty, provides the right incentives to consumers to fully disclose and provides appropriate remedies where this has not occurred. This is necessary if insurance is to continue to be priced appropriately and is particularly important in the New Zealand market which has one of the lowest penetration rates of life insurance in the developed world. In almost all circumstances the consumer will know more about the facts that affect their health, wellbeing and lifestyle than the insurer. Insurers rely on the consumer to provide accurate information so that the insurer can fairly consider how certain risks apply to them.

We agree with the remedy proposed in Scenario 1 but consider that the remedies proposed in Scenarios 2 and 3 should be amended to provide for more flexibility in how they are applied.

In Scenario 2, which applies where the qualifying misrepresentation was not deliberate or reckless but without it the insurer would not have entered the contract on any terms, the remedy proposed is to refuse all claims and return the premiums.

We think a preferable approach is for the insurer to have the discretion to also deduct an administration cost from the premiums to be remitted to cover the reasonable costs and expenses incurred by the insurer. The insurer will have incurred some cost in issuing the policy and during the period the policy has been in force as well costs in assessing any claim. Returning all of the premiums would not therefore have the intended effect of putting the insurer in the position it would have been in had the insurer been provided with the correct relevant information at the start. The cost to be deducted could be calculated on an individual contract but limited to a set percentage.

In Scenario 3, the remedy proposed is for the extra premium that would have been charged if the insurer had been aware of the misrepresentations to be deducted from the amount of the claim. We consider that the remedy should be wider to allow for the situation where the insurer becomes aware of the misrepresentation but no claim is payable or perhaps even made. The non-disclosure may have come to the insurer's notice in wider circumstances than the policyholder making a claim. The remedy should deal with the policy going forward and the insurer should have the discretion to amend the terms of the policy and reduce the amount of cover in line with premiums paid.

Further, we consider that the UK approach is preferable to the remedy proposed in the Consultation Paper, which is to reduce the amount of the claim by the difference in the premium that would have been charged. Reducing the claim by the difference in premium will result in the extra risk falling on the insurer, and by implication all policyholders. The risk of the pool making a loss will be increased and the harm of the non-disclosure will be suffered by other policyholders who will bear the cost, through increased premiums. The policyholders who did not disclose material information will have received cheaper cover which increased the size of the general premium increase required for the pool to be break-even.

In contrast, the UK approach, whereby the claim is reduced proportionately based on the premium actually paid, provides a more equitable remedy for the other policyholders and a greater incentive on policyholders to provide accurate disclosures to the questions the insurer asks. The UK approach is also more consistent with the licensed insurer's obligation to carry on business in a prudent manner, which includes balancing risk and costs to ensure that the business is sufficiently funded. We have developed some examples of how risk pooling works under both approaches and would be happy to provide you with these and discuss this with you.

4	*Do you have any feedback on the Bill's provisions on remedies for breach of the consumer duty in relation to life insurance policies where the misrepresentation was not fraudulent and more than three years ago?* We propose that the period during which a life insurer may utilise the remedies set out in Schedule 2 of the Draft Bill be increased from three years to five. Outside the five-year time period, the insurer would need to prove the misrepresentation had been made fraudulently. The average duration for which a life policy must be paid to collect enough premium to make the pricing/pooling effect equitable for all customers is generally recognised to be eight years. We support the industry view that the timeframe for the fraud test should more closely reflect that. This would provide a better balance of insurer and consumer interests and would be a better outcome for the other policyholders who bear the cost of the fraudulent activity through increases in their premiums.

	We think it would be helpful if 'fraudulent' was defined in the legislation, as is currently the case in section 4 of the Insurance Law Reform Act 1977. Finally, the definition of 'life policy' in the Draft Bill uses the definition in s84 of the Insurance (Prudential Supervision Act) 2010 and captures disability and income insurance contracts in s84(1)(d). The remedies for misrepresentations that will apply will therefore be the remedies applicable to life policies in Schedule 2 of the Draft Bill. This will limit the insurer to establishing that the misrepresentation was fraudulent or that it occurred within the three-year period on which the insurer sought to avoid the contract. This expansion of the definition of life policy will result in the insurer having greater risk than under the current legislation and the cost of this insurance will increase.
5	*Do you have any feedback on the Bill's provisions in relation to the disclosure duty for non-consumers?*
	In our 2019 submission on the Options Paper, we commented that it would be clearer if there was a single duty of disclosure, regardless of the type of insurance contract or the category of insurer. Having two different duties as proposed in the Draft Bill will provide some challenges to life insurers in determining how to apply disclosure duties where a policy has both consumer and non-consumer components and where the policy holder does not fit neatly into either category. This is another area where it may be useful for guidance to be issued.
6	*Do you have any feedback on the Bill's provisions in relation to remedies for breach of the non-consumer duty?*
7	*Do you have any feedback on the provisions in relation to the insurer's duties to inform policyholders of the disclosure duties, and insurer access to third party information, including how the duties apply for variations of insurance contracts?*
	Fidelity Life strongly agrees that insurers should warn consumers of their disclosure duties because this helps to achieve the certainty that is important to both parties. We currently provide information on the duty of disclosure in our applications and other policy documentation. We think it would be useful for some standard form wording describing the duty of disclosure to be set out in regulation. We do not propose that insurers be required to use the standard wording but if they choose to do so it should provide a "safe harbour". The regulations should be technology neutral and allow differing ways of communicating about the duty.
8	*Do you have any feedback on the consequences in the Bill if an insurer breaches duties to inform policyholders of the disclosure duties, and insurer access to third party information?*
9	*Do you have any feedback on how the Bill codifies the duty of utmost good faith?*
	Our preference is for the duty of utmost good faith to remain in common law because we think codifying the legislation risks creating confusion and uncertainty.

However, noting that Cabinet has agreed to it being codified, if it is to be carried through into the Bill it needs to be made clearer in the legislation that changes to the duty are not affected in any manner apart from what is amended by clause 14.

The wording in the Draft Bill does not make it clear whether clause 59 changes the law as it currently exists or overrides it and creates a new legislative duty different to the common law. This could be clarified by including a new subclause (2) in Clause 59 along the following lines:

59 Duty of utmost good faith

(1) A contract of insurance is a contract based on the utmost good faith.
(2) Section 59 (1) does not modify the existing common law except in so far as it is modified by section 14 of this Act.

Clause 60 can then be deleted.

10 *Do you have any feedback on the Bill's provisions relating to information provided by a policyholder to a specified intermediary?*

We recommend that subclause (3) of clause 63 of the Draft Bill be deleted. The subclause excludes from a specified intermediary's duty to pass on representations to the insurer representations made by the policyholder where the specified intermediary believes on reasonable grounds that the representation is a misrepresentation.

It would be preferable for both insurers and intermediaries if the intermediary is required to pass on **all** representations so that the insurer can make its own assessment of the information and take any action that may be required. The provision as drafted may also conflict with insurers' existing distribution agreements (to pass on all relevant information) and may have implications for Professional Indemnity insurance.

In addition, we think the intermediary's duty in clause 63(2) should be to pass on **all** representations, rather than to the lesser duty to "take all reasonable steps to pass on the representation".

11 *Do you have any other feedback on the drafting of Part 2 of the Bill?*

Part 3: terms of insurance contracts

12 *For claims-made policies, do you consider that 60 days after the end of the policy term is an appropriate period for allowing the policyholder to notify relevant claims or circumstances that might give rise to a claim?*

13 *Do you consider that insurers should be required to notify policyholders in writing no later than 14 days after the end of the policy term of the effect of failing to notify a claim or circumstances that might give rise to a claim before the end of the 60 day period?*

14	*Do you have any other comments on clause 69 of the Bill (Time limits for making claims under claims-made liability policies)?*
15	*Do you have any feedback on the exclusions listed in clause 71(3), which are not subject to the rule for increased risk exclusions in clause 71(1)?*
16	*Do you have any other feedback on Subpart 4 of Part 3 of the Bill (Third party claims for liability insurance money)?*
17	*Do you have any feedback on Schedule 3 of the Bill (Information and disclosure for third party claimants)?*
18	*Do you have any comments on not carrying over section 10(1) of the ILRA 1977?*
19	*Do you have any other feedback on the drafting in Part 3 of the Bill?*
Part 4: payment of monies to insurance intermediaries	
20	*Do you consider that changes should be made to requirements for how insurance brokers must hold premium money such as restrictions on brokers' ability to invest or more stringent requirements in line with the client money and property rules in the FMC Act?*
21	*Do you have any feedback on the proposed penalties for non-compliance with Part 4 of the Bill?*
22	*Is it necessary to retain clause 102 (broker to notify insurer within 7 days if a premium has not been received by the broker), and if so, what should be the consequence for breach of clause 102?*
23	*Do you have any other feedback on Part 4 of the Bill?*
Part 5: contracts of life insurance	

24	*If you consider that change needs to be made regarding interest payable from 91st day after date of death, please provide any further reasons and provide feedback on whether interest should only begin accruing after 90 days if the insurer has been notified of the death claim and (where relevant) letters of administration or probate have been obtained.*
	We consider a fairer solution is that interest is payable only after a reasonable period (for example, 30 days) following receipt by the insurer of all information that is reasonably necessary to process the claim. An insurer has no ability to pay the claim until it has received the claim and the details necessary for payment. In the case of a death claim, the length of time taken for a claim submission is in the hands of those managing the estate. Consequently, insurers have no certainty as to the amount of interest that they will have to pay under the current legislation or clause 120 of the Draft Bill. While interest payable calculated in accordance with Schedule 2 of the Interest on Money Claims Act 2016 has been reduced from the pre-2018 amounts, it is unlikely that the insurer will be earning more on the money than it will be required to pay out. The Consultation Paper notes that the provision "may be helpful to incentivise insurers to process death claims expediently". We do not think life insurers require an incentive to pay claims expediently as we are in the business of doing so. Paying claims is at the heart of our promise to our customers. This seems to be supported by the Financial Markets Authority and Reserve Bank of New Zealand's report on their thematic review of Life Insurer Conduct and Culture which stated "There was clear evidence of claims staff having a strong focus on good customer outcomes".[1] However, if for some reason there has been a delay by the insurer in paying a claim, we agree that the insurer should bear some cost. The solution we are proposing should deal adequately with that situation.
25	*Do you have any feedback on the proposal that any mortgaging of life insurance policies under new policies be dealt with under the Personal Property and Securities Act 2009?*
26	*Do you have any feedback on the Bill's requirements relating to assignments and registrations generally?*
	We think the transfer of policy ownership can be adequately dealt with by the insurer recording the transfer without the need for the insurer to keep a separate register as proposed in clause 126(a). It is not clear that this requirement would be of any benefit.
27	*Are section 75A of the LIA (relating to a policy entered into by a person for the benefit of the person's spouse, partner or children) or section 2(1) of the Life Insurance Amendment Act 1920 (relating to the reversion or vesting of life policy assigned to a spouse or partner) still necessary?*
28	*Do you have any other feedback on Part 5 of the Bill?*

[1]Life Insurer Conduct and Culture, Findings from an FMA and RBNZ review of conduct and culture in New Zealand life insurers, January 2019, 6

Part 6: regulation-making powers and miscellaneous provisions	
29	*Do you have any feedback on Part 6 of the Bill?*
Part 7: unfair contract terms and presentation of consumer policies	
30	*Do you see any unintended consequences from removing sections 18-20, 34-39 and 42 from the MIA?*
31	*In relation to unfair contract terms: which option do you prefer and why?*
	Our preference is for Option B which would define the main subject matter of insurance contracts in broader terms. Including terms that define the risk accepted by the insurer and the insurer's liability in the main subject matter is appropriate for insurance contracts where the contract is the product itself. The certainty option B provides will ensure that contracts can continue to be priced appropriately. These terms also factor in the implications relating to reinsurance and the need to ensure its continued accessibility. Insurers need to be able to address their risk with a degree of certainty in order to accurately price cover in a way that allows consumers to buy that cover and stay within the reinsurer's underwriting guidelines. If these matters are not included in the subject matter of the insurance the expectation is that insurance cover would increase in cost as insurers would need to price in the risk that the fundamental nature of the insurance bargain could change from what was set out at the time of underwriting the policy. In some circumstances this may make the insurance uneconomical for the consumer and exacerbate the current situation where New Zealanders are under-insured when it comes to life insurance. Insurers will be bound by the new conduct legislation so this should provide comfort that exclusions are not drafted more broadly than necessary and that contracts do not contain terms that are unfair to the consumer.
32	*Do you have any feedback on the drafting of either of the options?*
33	*Do you have any comments on the obligation that consumer insurance contracts be worded and presented in a clear, concise and effective manner?*
	Fidelity Life supports the use of plain language in our policies and definitions as this helps to achieve greater understanding and certainty for customers, intermediaries and insurers. However, we would be concerned if the application of statutory obligations requiring that insurance contracts are clear, concise and effective was too prescriptive and inflexible. Any statutory obligation must take into account the nature of contracts of life insurance which rely on some technical information to convey specific meanings. Medical definitions are necessary to spell out the coverage and the exclusions. Further, life insurers can also be bound by the terms of their reinsurance cover which require insurers to follow agreed processes and assess claims against the agreed policy wording. Any fundamental changes to

	current processes may increase the cost and availability of insurance in New Zealand. We want to ensure reinsurance arrangements remain as we rely on reinsurers for product development, pricing and claims experience and international best practice. There needs to be some degree of flexibility so that, for example, technical information can be included in policies. Any simplification cannot come at the cost of losing the meaning. Otherwise, there is an increased risk of uncertainty, and ultimately cost, or a longer-term risk that the coverage offered will be reduced to make the product affordable i.e. products no longer cover as many conditions because to explain all the limits of the cover will be quite complex and simplifying the wording will open up risk considerably. The complexity inherent in life insurance will often be mitigated by working with intermediaries who can help consumers to understand the technical information. We also note that many life insurers will have been working on revising their policy wording following the FMA and RBNZ's review of Life Insurer Conduct and Culture. It is not clear that there would be much benefit to be gained if life insurers were required to carry out another review in order to comply with this new high-level requirement.
	Do you have any comments on the regulation-making powers in clause 184?
	Do you think regulations specifying form and presentation requirements for consumer, life and health insurance contracts (eg a statement on the front page that refers to where policy exclusions can be found) would be helpful? If so, please explain.
	We think it is important that documents are clear and accessible so that they can be well understood. However, we query the value of prescriptive regulations of this nature. Any regulations would need to be technology neutral to take into account that documents are increasingly being accessed online.
	Do you think regulations specifying publication requirements for insurers would help consumers to make decisions about insurance products? If so, please explain.
Timing and transitional arrangements	
37	*Do you have any initial feedback on when the Bill's provisions should come into effect?*
	The transition period needs to reflect the scope of the change contemplated by this reform. The change will require process and documentation updates and related training for insurers internally, as well as extensive communications with intermediaries and customers. The transitional period should take into account any regulations or guidance that will need to be issued before all the requirements can be known and understood. We consider that the transitional period should be 3 years from the date all this information is finalised.

38	*Do you have any feedback on the transitional provisions in Schedules 1 or 4, or other proposed transitional arrangements?*
Schedule 5: amendments to other Acts	
39	*Do you have any feedback on Schedule 5 of the Bill?*

Other comments
