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Te Kāhui Ture o Aotearoa

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12 May 2022

Financial Markets Policy Building, Resources and Markets
Ministry of Business, Innovation & Employment
Wellington

By email: insurancereview@mbie.govt.nz

Re: *Exposure draft Insurance Contracts Bill*: consultation paper

1 Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to provide feedback on the *Exposure draft Insurance Contracts Bill* consultation paper (**Consultation Paper**).

1.2 The Law Society's submission is limited to legal issues, issues affecting the rule of law, and ensuring the workability of the proposed legislation. The submission does not therefore comment on policy matters or respond to all consultation questions.

1.3 This submission has been prepared with input from the Law Society's Commercial and Business Law Committee.

2 Feedback on Part 1 of the Bill (question 1 of consultation paper)

Definition of "policyholder" (clause 5)

2.1 The definition of "policyholder" in clause 5(a)(ii) is limited to the person who has entered into a contract of insurance (or an assignee etc of such a person). It does not capture other persons who are designated as the "insured", and for whom cover is provided under the contract. For example:

(a) The "policyholder" under a directors and officers liability policy will typically be the company, but the "insured" will be the directors and officers;

(b) The "policyholder" under a liability policy taken out by a group of companies, or related companies, may be only one of the companies, with other companies designated as the "insured" but not being policyholders;

(c) Professional services firms (such as legal, accounting and engineering firms) take out liability cover for principals, consultants and employees who, again, are designated as the "insured" but are (rightly) not policyholders.

2.2 The proposed definition will not always work for provisions directed at the person indemnified under the policy where that person is not the policyholder. For example:

(a) Clause 88, which relates to the application of limitation defences where a claimant has commenced a proceeding against a specified (insolvent) policyholder. If a bankrupt director indemnified under a Directors and Officers (**D&O**) liability insurance policy is not a "policyholder" (because the "policyholder" was the company that "entered into" the policy for the benefit of the directors), the director cannot be a "specified policyholder" and the intent of clause 88 would be defeated.

(b) Clause 68 ("Provisions prescribing the manner or time of claims or proceedings not binding") which would typically apply to all insured persons, and not just the person who entered into the contract. The intent of the Act would be defeated if clause 68 does not extend to other persons for whom cover is provided by the contract.

2.3 We therefore invite officials to give further thought to the definition of "policyholder" in the Bill.

Conflict of Laws (clause 7)

2.4 Clause 7 limits the parties' ability to contract out of the application of the Act through a choice of law provision, and effectively precludes the use of 'choice of law' clauses in insurance contracts (other than reinsurance).

2.5 A similar approach is taken in the Insurance Contracts Act 1984 (Australia).[1] However, the Australian legislation refers to the "proper law" of the contract, whereas clause 7 refers to the contract being "governed by" the law of New Zealand.

2.6 It may be worth highlighting the impact of clause 7 on choice of law clauses in the Explanatory Note to the Bill when it is introduced.

3 Duty for consumers to take reasonable care not to make a misrepresentation (question 2)

Definition of "consumer insurance contract" (clause 10)

3.1 We suggest a change to the definition of "consumer insurance contract".

3.2 The draft definition follows closely the definition of "consumer" in the Consumer Guarantees Act 1993. While statutory tests for "consumer" should be the same wherever possible, the reference to "personal" could have unintended consequences. Many liability policies (such as D&O policies) are taken out for the "personal" benefit of the directors of the company. Such policies are not consumer contracts. The current definition would have to be read down to exclude policies which insure individuals who act in trade.

3.3 One potential solution would be to include some examples in the clause 10 definition (for instance, a "personal" contract of insurance would include a domestic house and contents policy, but not a policy insuring an individual acting in trade (such as a D&O policy)). The Consumer Insurance (Disclosure and Representations) Act 2012 (UK) uses the following language:[2]

> *"consumer insurance contract" means a contract of insurance between—*

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1 Insurance Contracts Act 1984 (Australia), section 8.

2 Consumer Insurance (Disclosure and Representations) Act 2012 (UK), section 1.

(a) *an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession, and*

(b) *a person who carries on the business of insurance…*

Extending protections to small businesses

3.4 The Law Society's submission on MBIE's 2018 *Insurance Contract Law Review* Options Paper stated:[3]

> "Consideration could be given to including small businesses as consumers. Large entities, including local government, will have insurance experts to assist them tailor an insurance programme. Small New Zealand business owners are unlikely to have more insurance expertise than a consumer."

3.5 Small businesses suffer from the same vulnerabilities as consumers, and we remain of the view that small businesses should have the benefit of the protections afforded by this Bill. This could be achieved by simply amending the definition of "consumer insurance contract" in clause 10 to include contracts entered into by small businesses.

Presumption relating to consumer insurance contract (clause 12)

3.6 'Business purposes' certificates are binding on the policyholder even when the policyholder is actually a consumer (or to put it another way, to protect the insurer where the policyholder holds themselves out as a business customer, but is not). The certificate is not valid if the insurer or the intermediary knew or had reason to believe it was false or misleading.[4]

3.7 There should be some checks and balances around this process to avoid consumers being pressured to sign a certificate, or being asked to sign one without fully appreciating its impact. We suggest including a requirement for insurers to advise policyholders of their right to seek independent legal advice before signing such a certificate. Alternatively, the policyholder could be given the opportunity to withdraw their certificate if the insurer seeks to rely on it.

Duty which replaces previous duties relating to disclosure (clause 19)

3.8 Clause 19 provides that a policyholder's duty to take *"reasonable care not to make a misrepresentation to the insurer before the consumer insurance contract is entered into or varied"* replaces any duty relating to disclosure or representations by a policyholder to an insurer. The relevant provisions of the Bill (including relevant clause headings) should therefore be updated to clarify that the current duties of disclosure are to be replaced with this new duty and that the duty of disclosure is abolished for consumer insurance contracts.

3.9 Clause 19(2) could also be more clearly worded, as follows:

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[3] At page 4. A copy of that submission is available here: https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/0006-124197-l-MBIE-Insurance-Contract-Law-Review-16-7-18.pdf.

[4] Financial Markets (Conduct of Institutions) Amendment Bill, clause 446V(3).

"*See* also **section 60**, which provides that the effect of **section 59** (which recognises that a contract of insurance is a contract based on the utmost good faith) does not impose any other duty relating to disclosure of a matter or representations."

Group insurance (clauses 21 to 24)

3.10 Subpart 2 (Group insurance) applies where person A enters into (or varies) a contract of insurance in order to provide cover for person B. The Bill could be improved by specifying that person A is a policyholder (as defined in clause 5) for the purpose of subpart 2, and is subject to the duties and responsibilities of policyholders.

4 Provisions relating to remedies for breach of the consumer duty (question 3)

Remedies available to insurers (clauses 26 and 51)

4.1 We suggest some additional clarification to clauses 26 and 51.

4.2 These clauses are effectively subject to the duties set out in clause 55 to inform the policyholder of the policyholder's duties under subparts 1 or 4. It would be helpful to indicate this either in clause 26 or as an explanatory note beneath it.

4.3 Schedule 2 clause 7 (remedies for variations) provides that the insurer may avoid the contract "by notice to the policyholder". The notice provision does not appear in clause 2 (the comparable provision for remedies for contracts other than variations) and should be added to that clause. Strictly, those words are unnecessary because the law already requires avoidance to be given by notice to the policyholder, but it is useful for the notice requirement to be contained in the Bill.

Amendments to the Contract and Commercial Law Act 2017 (clause 26)

4.4 It appears the intention of the Bill is to remove the insurer's right to claim damages for misrepresentation under the Contract and Commercial Law Act 2017 (**CCLA**) and to limit the insurer to the new statutory remedies under this legislation. If so, it appears there is a drafting error. On page 80 of the draft Bill, the reference to new subsection (3) to be inserted after section 37(3) of the CCLA should be to a new subsection (4).

4.5 This amendment would give the insurer the right to bring a negligence claim (in tort) against a policyholder who has made a misrepresentation in breach of their duty under subpart 1. The right to pursue a negligence action in this situation seems anomalous,[5] and we query whether this is the intended effect of the proposed legislation. If this is not the intended effect, proposed new subsection 35(3) could be amended as follows to ensure that there is no right to claim statutory damages under the CCLA:

"(3) Subsection (1)(a) does not apply if—"

4.6 The Law Society has also previously submitted that section 34 of the CCLA (which effectively allows parties to include contractual terms which apply instead of sections 35 and 37 of the

[5] Section 35(1)(b) of the Contract and Commercial Law Act 2017 provides that a party that is induced to enter into a contract by a misrepresentation made by another party is not entitled to damages for deceit or negligence in respect of the misrepresentation.

CCLA) should not apply to insurance contracts.[6] We remain of that view, and suggest amending the Bill to clarify that proposed new sections 35(3) and 37(4) cannot be overridden by the parties' own terms (under section 34 of the CCLA).

Provisions of no effect (clause 62)

4.7 If clause 62 is intended to avoid the application of section 34 of the CCLA, it should include a new subclause to the effect that it overrides clause 34 of the CCLA.

5 Remedies for breach of the consumer duty in relation to life insurance policies (question 4)

Support for the proposed reduction in claim amount

5.1 The Consultation Paper requests feedback on the proposed approach set out in clause 5 of Schedule 2.[7]

5.2 The Law Society agrees with the approach taken in the Bill. An insurance contract is not a wager or investment. If there is no evidence of bad faith (as the misrepresentation was neither deliberate or reckless), it is appropriate and fair that the claim is reduced so that that the insurer received the amount it would have received if there had been no representation and the customer's claim is paid.

Definition of "life policy"

5.3 We suggest the definition of "life policy" be extended to deal with common policy marketing practices.

5.4 The definition of "life policy" is used to set the parameters for the Schedule 2 remedies. Consideration should be given to the practice of insurers to sell policies in 'bundles' that have life cover as the main element with 'add-ons' of non-life policies, such as income protection, Total Permanent Disablement cover and trauma cover.

5.5 To a customer, the bundle of life and non-life products at point of sale all appear to be related to a life insurance contract. For that reason, consideration should be given as to whether the definition of "life policy" should be extended to include any other cover that is sold in a bundle with the life policy. This would provide the customer with the same protection for all their covers.

6 Remedies for breach of the non-consumer duty (question 6)

6.1 We do not have any specific feedback regarding these provisions, but we note our comments in relation to breach of the consumer duty.

7 Insurer's duties to inform policyholders of the disclosure duties and access to third party information (question 7)

7.1 We have some reservations about these provisions for two reasons:

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6 Law Society submission on MBIE's 2019 *Insurance Contract Law Review* Options Paper (27 June 2019) at page 2. A copy of that submission is available here: https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/0017-136430-l-MBIE-Insurance-Contract-Law-Review-options-paper-27-6-19.pdf.

7 At page 14.

(a) First, it would allow insurers to underwrite a risk at the time a claim is made. It is not fair to consumers that the insurer has access, at the time of underwriting, to medical records and other information, but chooses not to consider those records until a claim is made. If the medical records contain material information, the insurer should either access that information at the point of underwriting or accept the risk of that customer (provided the customer has discharged the duty to take reasonable care not to make a misrepresentation).

(b) Second, disclosure to consumers has been shown to be of limited value in protecting their interests. Disclosure of the fact that insurers will not look at medical information until a claim is made will not be sufficient to prevent any harm to the consumer.

8 Consequences of insurer breaching duties to inform policyholders of the disclosure duties and access to third party information (question 8)

8.1 We support the consequences specified in the Bill, but note that we have some reservations about the usefulness of such disclosure because consumers are provided with a large volume of information by financial institutions, and this information is not always clearly understood by consumers.

9 Codification of the duty of utmost good faith (question 9)

9.1 Clause 59 codifies in legislation the duty of utmost good faith. Clause 60 clarifies that the duty of utmost good faith does not impose a disclosure duty on the policyholder other than the duty to take reasonable care not to make a misrepresentation (consumers) or the duty to make a fair presentation of risk (non-consumers).[8]

9.2 The Bill leaves the scope and content of the duty to be developed by the courts on a case-by-case basis. The Court of Appeal has held that the mere fact that a contract of insurance is a contract of utmost good faith does not mean there is an implied term of good faith in every insurance contract that applies to all aspects of the parties' dealings.[9] Rather, the obligations one party owes the other are context-specific.[10]

9.3 Against that background, it is unclear whether the effect of clause 60 would be that a policyholder has no statutory duty of disclosure after they have entered into a contract of insurance. We invite officials to clarify how this duty of utmost good faith is to be discharged in the Explanatory Note of the Bill.

10 Terms of insurance contracts (Part 3 of the Bill)

Should insurers 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 (question 13)?

10.1 The Law Society agrees that insurers should be required to notify policyholders of this matter within this time.

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8 Consultation Paper, page 18.

9 *Southern Response v Dodds* [2020] 3 NZLR 383 at [194].

10 Above n 9.

10.2 It is not clear if the insurer's obligation to give the notification required by subsection 2 is to be given at or around the end of the relevant period (i.e. specifically drawing the issue to the attention of the insured at the time it matters most) or whether it can be satisfied by notification in the policy itself (where it would be less helpful to the insured). The current wording could permit the latter.

10.3 In practice, policyholders are already routinely prompted to identify and notify any circumstances that could give rise to a claim prior to renewal of a liability policy. The prompt typically occurs by way of a question asked in the form submitted by the insured prior to renewal. It should be noted, however, that such questions do not spell out the consequences of failure to notify, as the proposed notice requirement would do.

Other feedback on Subpart 4 of Part 3 of the Bill (question 16)

10.4 The Law Society supports the changes made by subpart 4 of part 3 of the Bill.

10.5 It appears there is a word or number missing before or after "subpart" in clause 89.

Comments on not carrying over section 10(1) of the Insurance Law Reform Act 1977 (question 18)

10.6 Section 10(1) and its relationship with sections 10(2) and (3) have undoubtedly been a source of confusion and should not be carried over.

Other feedback on the drafting in Part 3 of the Bill (question 19)

Insurer not liable to pay greater cost (clause 70)

10.7 Clause 70 is aimed at property insurers, but only expressly excludes life policies. It is not clear how it would apply to other non-life policies such as income protection and health policies. It is preferable to specify that clause 70 only applies to contracts of insurance the subject of which is property.

10.8 The schedule 3 regime for disclosure of details about insurance policies to third party claimants (given effect by clause 93) seems ripe to lead to disputes. See, for example, the wording of clause 3(1) which includes "reasonably believes" and "might reasonably be regarded".

Disclosure and inspection where notice given under clause 6 (clause 7)

10.9 This clause provides that a person who is not a party to the proceeding is to be treated as having the same rights and duties of a party subject to an order for standard discovery. Non-parties orders to give discovery under the High Court Rules are normally entitled to their reasonable solicitor-client costs when giving discovery (whereas parties bear all of their own costs prior to determination of the claim). A person given a notice under clause 6 will incur costs seeking legal advice and giving discovery on the same basis as a party. The Bill should include a new sub-clause providing expressly that a person required to comply with a clause 6 notice is entitled to recover their reasonable solicitor-client costs from the person issuing the notice unless the court directs otherwise.

11 Payment of monies to insurance intermediaries (Part 4 of the Bill)

Should changes be made to requirements for how insurance brokers must hold premium money (question 20)?

11.1 The Law Society is not well placed to comment on whether any changes are required. If officials determined that changes are in fact required, we would be happy to provide further feedback on the implications and workability of those changes.

12 Feedback on the proposed penalties for non-compliance with Part 4 of the Bill (question 21)

12.1 The Law Society supports consistency with the Financial Markets Conduct Act 2013.

13 Contracts of life insurance and requirements relating to assignments and registrations (Part 5 of the Bill)

13.1 We do not have any specific feedback regarding the Bill's requirements relating to assignments and registrations generally. However, we note there is regulation around transfers by insurers of their rights and obligations under policies, under the Insurance (Prudential Supervision) Act 2010. The Bill could also clarify whether applications under clause 129 could be by way of originating application.

14 Unfair contract terms (Part 7 of the Bill)

Options presented in the Consultation Paper (question 31)

14.1 Bringing insurance contracts within the unfair contract terms regime is significant. Given the definition of small trade contracts, this would bring a very large number of insurance contracts within the unfair contract terms regime.

14.2 While Option A is more advantageous to insured parties, and consistent with the law in Australia and the UK, the Law Society is not well placed to weigh the competing policy considerations and their consequences. However, we note that unfair contract terms laws have resulted in very few cases coming before the New Zealand courts (although the addition of the Financial Markets Authority (**FMA**) as the regulator responsible for financial services contracts may result in increased enforcement activity).

14.3 We further note Option A would likely compel insurers to review their insurance contracts and prepare revised contracts which are easier for policyholders to understand.

Feedback on the drafting of the options (question 32)

14.4 Option A includes the words "to the extent that the term describes what is being insured".[11] Presumably this is intended to refer to the thing being insured (i.e. the house that is insured or the life of the person who is insured, but not terms that define all the exclusions to cover). If so, it would be helpful if it could be described this more clearly.

14.5 If exclusions from cover are not intended to be carved out of the unfair contract terms regime, this should be expressly stated, perhaps by an example or explanatory note.

[11] Proposed new section 46KA(2) of the Fair Trading Act 1986.

Comments on the obligation that consumer insurance contracts be worded and presented in a clear, concise and effective manner (question 33)

14.6 This proposal is well-intentioned and there may be some benefit in the FMA having the power to issue stop orders requiring the withdrawal or amendment of misleading or plainly unclear policy drafting.

14.7 The Bill does not impose a monetary or other civil penalty for the breach of the obligation to ensure that contracts are worded and presented in a clear, concise and effective (although any supporting regulations could carry civil liability).[12] We make the following comments in relation to this proposal:

(a) We acknowledge that some consumer policies are already written in well-intentioned 'plain English', and some insurers even compete for 'plain English' writing awards and use them as marketing tools.[13] However, there is value in requiring all insurers to include a summary of the main terms of the policy at the start of each policy to assist consumers and other parties (such as small businesses). This requirement could be effected by regulation.

(b) Second, there are other anticipated enforcement mechanisms to ensure insurers comply with the obligation to word and present policies in a clear, concise and effective manner. The Consultation Paper states:[14]

> "The obligation will also be a market services licensee obligation, once insurers are licensed through the Conduct of Financial Institutions regime. This would mean the FMA could use a range of tools to enforce compliance (see section 414 of the FMC Act)."

14.8 We also note that the Financial Markets (Conduct of Institutions) Amendment Bill (**CofI Bill**) includes important reforms aimed at improving the conduct of insurers generally and introduces an enforcement mechanism through a new licensing regime. Therefore, the reforms contained in the CofI Bill should come into force before, or at the same time, this Bill is to be enacted.

Would regulations specifying form and presentation requirements for consumer, life and health insurance contracts be helpful (question 35)?

14.9 The Law Society would support a requirement on insurers to provide a summary sheet, provided that it was limited to 2 pages.

Would regulations specifying publication requirements for insurers would help consumers to make decisions about insurance products (question 36)?

14.10 The Law Society suggests that such regulations would only be effective once the reforms resulting from the Financial Markets (Conduct of Institutions) Amendment Bill (**CoFI reforms**) are in place and insurers are appropriately supervised by a well-resourced regulator.

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12 Consultation Paper at page 36.

13 See, for example: https://www.tower.co.nz/news/policy-wins-plain-english-award/.

14 Above n 12.

14.11 Disclosing information to customers in the absence of meaningful supervision does not tend to get good outcomes for customers.

15 Timing and transitional arrangements

Initial feedback on when the Bill's provisions should come into effect (question 37)

15.1 The Law Society strongly supports the introduction of the CoFI reforms and suggests that this Bill should come into force at the same time as CoFI reforms, in particular the licensing regime, to ensure consistency of approach.

15.2 Clause 3 of Schedule 1 provides that an insurer's calculation of reduction is not to take into account pre-commencement contracts. This should only be the case if the insurer's remedies for breach of the policyholder's duty of disclosure also does not take into account and is not otherwise affected by pre-commencement contracts.

16 Feedback on amendments to other Acts in Schedule 5 of the Bill (question 39)

16.1 We refer to our comments on Question 3 above in relation to the proposed amendments to the CCLA.

16.2 We would be happy to discuss this feedback further, if that would be helpful. Please feel free to contact me via the Law Society's Law Reform & Advocacy Advisor, Nilu Ariyaratne (Nilu.Ariyaratne@lawsociety.org.nz).

Nāku noa, nā

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