Insurance Council of New Zealand
Te Kāhui Inihua o Aotearoa

Level 2 Asteron House
139 The Terrace
Wellington 6011

(04) 472 5230
icnz@icnz.org.nz
www.icnz.org.nz

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Committee Secretariat
Finance and Expenditure Select Committee
Parliament Buildings
Wellington

Dear Committee Members

ICNZ SUPPLEMENTARY SUBMISSION ON THE CONTRACTS OF INSURANCE BILL

1. Te Kāhui Inihua o Aotearoa / The Insurance Council of New Zealand (**ICNZ**) provided a submission to the Finance and Expenditure Select Committee on the Contracts of Insurance Bill on 31 May 2024.
2. On further consideration of the Bill, we make the following additional submissions.

Definition of 'consumer insurance contract' – expediting changes to the Financial Markets Conduct Act

3. In our 31 May 2024 submission ICNZ strongly supported the introduction of an objective test to the Bill's definition of 'consumer insurance contract'. However, we did not comment on the amendments that the Bill will make to the definition of 'consumer insurance contract' in the Financial Markets Conduct Act 2013 (**FMCA**).
4. The Financial Markets (Conduct of Institutions) Amendment Act 2022 (**the CoFI Act**) was passed into law on 29 June 2022 but does not come fully into force until 31 March 2025. The CoFI Act will amend the FMCA to introduce a new regime regulating the conduct of financial institutions, and as part of this change will insert a definition of 'consumer insurance contract'.
5. Clause 182 of the Bill amends the FMCA's definition of 'consumer insurance contract' to introduce an objective test. The amendments in clause 182 are welcomed and will increase the alignment between the definitions in the Bill and the CoFI legislation.
6. However, the timing of this change needs to be expedited. Our members are currently preparing their CoFI financial institution licence applications. They are required to provide consumer numbers and product sets to the FMA as part of their CoFI financial institution licence applications, so clarity around timing of the change to the definition on 'consumer insurance contract' is essential to provide certainty on the scope of CoFI and avoid potential confusion and unnecessary compliance burden. This change needs to be brought into effect at the earliest opportunity, and before 31 March 2025 when the CoFI legislation comes into force.

Further amendments to the definition of 'consumer insurance contract' in the FMCA

7. Further, while we welcome the proposed amendments to the definition of 'consumer insurance contract' in the CoFI regime, they do not go far enough to address concerns around the application of the definition of 'consumer insurance contract' in section 446P(2) to some kinds of insurance.
8. That definition, as amended by clause 182 of the Bill, reads:

(2) For the purposes of paragraph (b) of the definition of ***consumer insurance contract*** in subsection (1), a contract of the kind referred to in this subsection is a contract of insurance to the extent that—

(a) it is entered into by the policyholder in order to provide insurance cover for 1 or more other persons, or it is varied or extended in order to provide cover for 1 or more other persons; and

(b) those other persons are not parties to the contract; and

(c) those other persons would ordinarily have the benefit of that insurance cover wholly or predominantly for personal, domestic, or household purposes.

9. First, in reviewing this again, we have identified that the reference to "contract of insurance" in the opening part of section 446P(2) (i.e. in the phrase "a contract of the kind referred to in this subsection is a contract of insurance") is an apparent error in the drafting. The opening part of section 446P(2) should instead say "a contract <u>of insurance</u> of the kind referred to in this subsection is a <u>consumer insurance contract</u>".

10. Second, we consider that the drafting of the extended definition that is intended to capture certain types of commercial contract (that involve a commercial contract but consumer beneficiaries as outlined in the example below 446P(2)) creates an unnecessary risk of potentially capturing some commercial insurance policies that offer merely incidental personal benefits. For example, a commercial motor policy, which is concerned primarily with accidental loss or damage to company vehicles for the benefit of the company, might offer incidental cover where the driver dies as a result of an accident. Or a commercial MDBI (Material Damage and Business Interruption) policy, which is concerned primarily with damage to commercial premises, might offer incidental cover for employees' personal effects, or for the cost of providing alternative accommodation for employees who reside at the damaged premises.

11. These types of incidental covers are common on a number of commercial policies. We do not consider they should be captured by the Act as consumer insurance contracts and we do not believe this was ever the intent.

12. To resolve this, we recommend that section 446P(2) is redrafted as follows:[1]

(2) For the purposes of paragraph (b) of the definition of ***consumer insurance contract*** in subsection (1), a contract of <u>insurance of</u> the kind referred to in this subsection is a ~~contract of insurance~~ <u>consumer insurance contract</u> ~~to the extent that~~ <u>if</u> —

(a) it is entered into, <u>varied or extended</u> by the policyholder ~~in order~~ <u>wholly</u> to provide insurance cover for 1 or more other persons~~, or it is varied or extended in order to provide cover for 1 or more other persons~~; and

(b) those other persons are not parties to the contract; and

(c) ~~those other persons would have the benefit of that insurance cover wholly or predominantly for personal, domestic, or household purposes~~ <u>the contract would have been a consumer insurance contract if entered into by those other persons rather than the policyholder</u>.

[1] The mark-up shows the recommended changes to section 446P(2) as currently set out in the FMCA.

A regulation-making power for CoFI

13. The Bill contains a regulation-making power for declaring contracts of insurance to be either 'consumer' or 'non-consumer' insurance contracts. See clause 165(1)(c) and clause 10(3). We consider that the Bill should also amend the FMCA to introduce an equivalent declaration power under that legislation for the purposes of subpart 6A of the FMCA/the CoFI regime.
14. This would help ensure that the categorisation of insurance contracts can be given effect to clearly and be consistent across the two pieces of legislation.
15. We note that the FMCA already includes other similar regulation-making powers, for example a regulation-making power to declare products to be financial advice products. It would therefore appear that our recommendation would be consistent with the existing regulatory framework under the FMCA.

Definition of 'group' insurance

16. Subpart 2 of Part 2 of the Bill sets out how the disclosure duties applies to 'group insurance'. These provisions are based very closely on section 7 of the UK's Consumer Insurance (Disclosure and Representations) Act 2012, with much of the drafting a word for word match. However, in some places, notably clauses 22(1)(c) and clause 24, the drafting has been altered for reasons that are not apparent. The consequence of these changes is to introduce uncertainty as to the scope of the subpart. In our initial submission on the Bill we proposed changes to clauses 22, 23 and 24 to bring these closer to the UK precedent.
17. As currently drafted, there is a risk that clause 22 could for example possibly be interpreted as applying subpart 2 of Part 2 to joint or composite insurance policies, or insurance policies that provide incidental cover for third parties. Examples include:
    (a) a contents policy taken out by a parent may also cover the contents owned by that person's child;
    (b) a vehicle policy may include cover for the policyholder's friends.
18. It appears clear from the intent, and also from the background materials for the equivalent United Kingdom provisions, that the group insurance provisions are not intended to apply where a person takes out insurance that also covers others (whether that policy is a joint policy or a composite policy). In relation to the examples above, it does not seem intended that the child's claim for damage to their contents remains valid despite the parent not taking reasonable care not to make a misrepresentation, or that cover exists for vehicle damage caused by the policyholder's friend even if the insurer was entitled to avoid the contract as a result of the policyholder's misrepresentations.
19. The following passage from the joint United Kingdom and Scottish Law Commission report encapsulates the purpose of the Group Insurance provisions:[2]

> "[Group Insurance] *would only apply if C* [i.e. B in cl 22] *is not a party to the contract. In many cases where one person takes out insurance on behalf of others, the correct legal analysis is that the beneficiaries are all co-insured, or that the person arranging the insurance acts as agent for the others. Take a case, for example, where a group of friends decides to go on holiday together, and one of them arranges travel insurance on behalf of the others. The correct legal analysis may be either that it is a joint policy, or*

[2] UK and Scottish Law Commissions (Law Com No 319 / Scot Law Com No 219), *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* at paragraph 7.13(2)).

that the arranger was an agent for each of the others. The group insurance provisions in our draft Bill would only apply where the C could not be characterised as a policyholder."

20. The example of a typical group insurance policy given by the United Kingdom and Scottish Law Commissions was an employer taking out life or health insurance on behalf of its employees. Group insurance does not include policies that an employer may effect purely for its own benefit. For example, an employer may effect key person insurance on crucial personnel. Although such insurance provides benefits on the death or serious illness of an employee, the intention is to cover the resulting loss to the employer.[3]

21. The United Kingdom and Scottish Law Commissions also noted that group insurance is underwritten on a different basis:[4]

    "*Group insurances are underwritten on a different basis to individual contracts. In particular there is less concern about the risk presented by individuals, since this is less significant when viewed within a pool of employees. Typically an insurer will grant a level of "free cover". This is cover granted to each member without individual underwriting - that is, without collecting any information from the member or from other sources such as the employer or the member's doctor."*

22. As noted above we have recommended changes to clauses 22, 23 and 24 to address these issues.

23. We also recommend that clause 24 be reworded to make clearer its application by replacing "If there is more than 1 person who has a duty under this subpart…" with "If there is more than 1 B…", so that overall it would read as follows when combined with our earlier submission:

    24 Breach by 1 member of group does not affect others

    (1) If there is more than one B, a breach on the part of one of them of the duty does not affect the contract so far as it relates to the others.

    (2) Subsection (1) does not apply to the extent that the person who breached a duty under this subpart was acting for or on behalf of others to the contract.

Variations and renewals

Renewals

24. As we previously submitted, by virtue of clause 1 of Schedule 1 of the Bill, the disclosure duties in Part 1 of the Bill have retrospective effect to contracts of insurance that were entered into before Part 1 comes into force but renew on or after the commencement of Part 1. In these circumstances, the contract was originally entered into on one legal basis but would now be subject to another.

25. This presents challenges for insurers, who will need to develop new systems and processes both for new and existing business. Preparing for compliance with the Bill (including the disclosure duties) for new business will be challenging in itself and will require up to three

[3] UK and Scottish Law Commissions' joint consultation paper LCCP 182 / SLCDP 134: *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured*, at paragraph 6.8(2).

[4] UK and Scottish Law Commissions' joint consultation paper LCCP 182 / SLCDP 134: *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured*, at paragraph 6.13.

years to prepare for. As such, we consider clause 2 allowing for the Bill to come into force by the third anniversary of Royal Assent is appropriate.

26. Preparing to comply with respect to renewals of existing policies will require significant additional work bearing in mind that the vast majority of ICNZ's members' customers are existing customers. Most notably there will need to be changes to renewal documents and systems to reflect the fact that more comprehensive information will need to be requested from insureds under consumer contracts at renewal given insurers will no longer be able to rely on insureds having a positive duty to disclose material information.

27. We therefore consider that a longer time period is required before the new disclosure rules apply to renewals (beyond the three years required for compliance with respect to new policies). We suggest that an additional two years (i.e. from when the new obligations apply to new contracts of insurance) strikes an appropriate balance.

28. If our request for leeway at renewal to implement the changes flowing from the new (lesser) disclosure obligations is not progressed, then we suggest that for the fact that a contract of insurance was originally entered into under the old disclosure regime should be a factor taken into account under clause 15 in determining whether the policyholder has taken reasonable care. This would allow regard to be had to the fact a different regime was in effect, for example, when interpreting insurers' original questions.

Variations

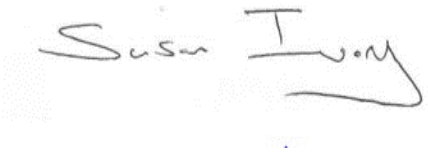
29. Applying the new disclosure duties to variations of contracts that are entered into or renewed under the existing disclosure regime is not practical. The variation of a contract can often be minor and unrelated to the policy wording (e.g. a change to a sum insured or excess for example). Insurers will already need to establish new systems for new contracts and for renewals and to require a third new process for variations would create yet another new process to be developed, implemented and managed. It could also complicate the process for customers seeking routine variations in their contracts, creating potential frustration for customers seeking to make a simple change to their policy that would often be unrelated to a disclosure.

30. We therefore consider that the disclosure duties should not apply to variations of contracts entered into or renewed before the new Contract of Insurance Act takes effect. We note that if this approach were adopted, the new disclosure duties would, for general insurance, apply to existing customer contracts at renewal of the policy. After renewal, the duties of disclosure in the Bill would apply to variations because there would be a new contract entered into after the Contract of Insurance Act has taken effect.

Conclusion

31. Thank you for the opportunity to provide this supplementary submission and to appear before the Finance and Expenditure Committee to discuss the Bill. Please contact Susan Ivory (susan@icnz.org.nz) if you have any questions about our submission or require further information

Yours sincerely



Hon. Kris Faafoi
Chief Executive

Susan Ivory
Regulatory Affairs Manager