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Our ref:

Dear Ms Waller

Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured

The Financial Services Consumer Panel ('the Panel') was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to the joint Law Commissions consultation paper on Insurance Contract Law: Misrepresentation, non-disclosure and breach of warranty by the insured.

The Panel welcomes this consultation paper and the general thrust of the provisional proposals. As the consultation paper notes reform is long overdue. The Panel supports the 3 guiding principles articulated in paragraph 1.75 of the consultation paper -

- (1) Insurers should ask questions about what they want to know; consumers should not be expected to give information that has not been asked for.
- (2) A consumer insured who was both honest and careful in giving precontract information should not have a claim turned down on the basis that the information was incorrect or incomplete.
- (3) A consumer who was honest in giving pre-contract information, but less careful than they should have been, should not automatically lose their claim. The outcome should depend on what the insurer would have done had it known the true situation -

as we believe this represents fair practice, would meet consumers' reasonable expectations and would not impose undue burdens on the industry.

The Panel believes the provisions for the new statute outlined in paragraph 4.2 of the consultation paper to:

- (1) abolish consumers' duty to volunteer information;
- (2) require consumers to be both honest and to take reasonable care to give accurate and complete answers to the questions they are asked;
- (3) protect those who acted reasonably; and
- (4) provide insurers with a remedy appropriate to the consumer's behaviour. The remedy should act as a strong disincentive to deliberate or reckless misrepresentations, and provide a fair solution for negligent ones

are reasonable and represent a significant improvement on the current law.

We are pleased that recognition is to be given to "a reasonable person in the circumstances" in determining whether a consumer should have realised that the insurer was asking for particular information.

The Panel does not think that courts can necessarily be assumed to interpret the reformed law in the same way as the Financial Ombudsman Service and therefore suggest that where a change in the law is proposed in order to reflect current FOS practice, this change should be as specific as possible.

The Panel notes that the consultation paper does not address the insurer's duty of disclosure and the remedies available to the insured where this has been breached. Although the circumstances in which an insurer breaches this duty may be rare, there is a need to consider whether the current remedy is sufficient.

The Panel has no particular views on business insurance but we cannot see why, in principle, businesses should not also benefit from a reform of the law. We have only commented on areas relevant to the Panel's remit.

The Panel has not sought to answer all of the questions in the Response Sheet. Rather we only comment where we have particular observations or suggestions.

Pre-contract information and consumer insurance

The case for law reform

The Panel strongly supports the case for reform. Under the proposed reforms we agree it is important that consumers are made fully aware of their obligations and the consequences of failing to meet them.

Defining consumers

The Panel agrees with the provisional proposal that the consumer regime should apply where an individual enters into a contract of insurance wholly or mainly for purposes unrelated to his business. We fully support the inclusion of 'or mainly' in the definition of a consumer insurance contract. We agree that consumers, who, for example, insure their home and set aside a room in their house to use as an office, should not find themselves excluded from the consumer regime.

We have no views about the need to exempt insurance of specific high value items, such as jets and yachts from the consumer regime, however we would observe that some cars can cost more than a small yacht.

The duty of disclosure

The Panel fully supports the provisional proposal that there should be no duty on the consumer proposer to disclose matters about which no questions were asked. This would bring the law into line with industry practice and FOS good practice and guidance.

We support the proposal that where the insurer asks a general question, the insurer should have no remedy in respect of an incomplete answer unless a reasonable consumer in the circumstances would understand that the question was asking about the particular information at issue. We wonder whether there is a need to clarify what is meant by an 'incomplete answer' – would this include a failure to answer a question altogether? We also suggest that an insurer should be precluded from claiming a misrepresentation where the question is obviously incomplete or has not been answered and the insurer has failed to follow this up.

Deliberate or reckless misrepresentations: where the proposer acts without honesty

The provisional proposal is that an insurer should have the right to avoid a policy where it has relied on a misrepresentation by the consumer proposer at the pre-contractual stage and the insurer shows that, on the balance of probabilities, the proposer made the misrepresentation:

(1) knowing it to be untrue, or being reckless as to whether or not it was true; and

(2) Knowing it to be relevant to the insurer, or being reckless as to whether or not it was relevant (paragraph 4.96).

The Panel believes that an insurer should not have the right to avoid a policy simply because the proposer made a deliberate or reckless misrepresentation. However, we are concerned about the effect of the presumption proposed in paragraph 4.99(2) that where the insurer has asked a clear question about an issue, the proposer is presumed to know that the issue is relevant to the insurer. A clear question can nevertheless still be a general question. We suggest that this provision should be expressly subject to the provision proposed in paragraph 4.32 that where the insurer asks a general question, the insurer should have no remedy in respect of an incomplete answer unless a reasonable consumer in the circumstances would understand that the question was asking about the particular information at issue. We would appreciate clarification of how 4.99(2) sits with the asthma example given in paragraph 4.62 and the spilt wax example in 4.63.

We suggest that the definition of "reckless" should not be left to the common law. We think it would be sensible to define or at the very least provide a non-exhaustive list of factors that the courts and the FOS should consider in determining the issue of recklessness.

We do not see the need for insurers to be entitled to retain the premium where an insured has made a deliberate or reckless misrepresentation (especially as this would unduly penalise those who pay the premium in full as opposed to those who pay by instalment). An administrative charge to reflect the reasonable costs of setting up the policy might be an appropriate alternative. However, if the law is changed so that the insurer may retain the premium then the Panel believes that the courts and the FOS should have the power to over-ride this right in appropriate circumstances (for example in the case of an innocent co-insured). Paragraph 4.50 refers to avoiding the contract from the start. In the case of renewable policies we presume this to mean to the start of the renewed policy. Could the insured be required to return any previous claims received under the policy?

“Innocent” misrepresentations: protecting the insured who acts honestly and reasonably

It is proposed that

(1) An insurer should not be able to rely on a misrepresentation if the insured was acting honestly and reasonably in the circumstances when they made the misrepresentation; and

(2) In assessing reasonableness, the type of policy, the way the policy was advertised and sold, and the normal characteristics of consumers in the market should be taken into account.

We suggest that paragraph (3) should read: - the test of whether the consumer proposer acted reasonably should also take into account any particular characteristics or circumstances affecting a consumer insured, so far as these were known to the insurer, *or should have been known to the insurer*. It would not take into account individual circumstances which *the insurer did not or could not have known*. (4.119)

In relation to the provisional proposals relating to the insurer’s entitlement to remedies for misrepresentation (paragraph 4.121), if the 'knowledge' presumption in 4.99(2) is to apply, the Panel suggests this should be subject to 4.32.

We agree with the provisional proposal that the burden of showing that a consumer proposer who made a misrepresentation did so unreasonably should be on the insurer.

Materiality: an end to the test based on a hypothetical “prudent insurer”

Our only comment is that any general question asked by the insurer should be subject to the provisional proposal made in paragraph 4.32.

Where the policyholder thinks the insurer will obtain the information

We suggest that where an insurer adds the warning 'do not assume we will contact your doctor for a report' this should not be relevant to determining whether it is reasonable for the insured to assume that the insurer will obtain the information.

Disclosure after the proposal has been accepted

In relation to provisional proposal (1) we suggest that after 'consumer' the words 'in their circumstance' should be added. We also believe that insurers should be required to specifically inform proposers of this duty.

Negligent misrepresentations: a compensatory remedy

In relation to provisional proposal (3) we wonder what would happen in respect of any prior claims already paid by the insurer which might have no connection to the fact/belief misrepresented. Could a consumer be required to return these?

We agree that there is a case for granting the courts or ombudsman some discretion to prevent avoidance where the actual insurer would have declined the risk, but the policyholder's fault is minor and any prejudice the insurer has suffered could be adequately compensated by a reduction in the claim. This discretion is important as the proposed remedies make no reference to the 'reasonable insurer'. We suggest this discretion should apply to each of the remedies.

Negligent misrepresentations in life policies: should the law impose a cut-off period?

We support the proposal that in consumer life assurance the insurer should be prevented from relying on a negligent misrepresentation after the policy has been in force for a certain period of time. We have no particular view on the appropriate time period, but do not think this period should be any longer than five years, especially as insurers in other jurisdictions do not appear to be disadvantaged by shorter periods.

Mandatory rules

We support the provisional proposal that it should not be possible to contract out of the new rules governing misrepresentation and non-disclosure in consumer insurance except in favour of the consumer (4.218). We believe this is an important aspect of the FSA requirement for firms to treat their customers fairly and reflects the unequal bargaining power of the parties.

Statements of past and present fact

We agree with the provisional proposal that an insured's statement of past or current facts made before a contract is entered into should be treated as a representation rather than a warranty. (4.229)

Third party claims

In view of the time taken to implement reforms in this area, if there is evidence that this has, or is likely to become an issue, we think the opportunity should be taken now to consider whether to extend the existing rights of third parties where for example the policyholder is insolvent, or the policy has been avoided as the result of a misrepresentation.

Group insurance, co-insurance and insurance on the life of another

We believe that where a member has made a deliberate or reckless misrepresentation but the insurer would have given a certain level of "free cover" without that information, the insurer should not be entitled to refuse all benefits in respect of that member. The Panel believes that the insurer should be obliged to provide the free cover that would have been provided in any event, provided that the eligibility criteria for the scheme are met.

Co-insurance

The Panel is not aware of any particular problems with this area, but we believe there is potential for the law and FOS practice to operate unfairly in the case of joint insurance where, for example, the innocent insured is not in a position to be aware that their co-insured has made misrepresentations.

The Panel believes that many consumers are not aware of the distinction between joint and composite insurance.

Consumer life-of-another policies: misrepresentations by the life insured

On balance we believe that the provisional proposal is fair to consumers.

Consumer insurance: "joint lives, first death" policies

We believe that consideration should be given to giving the courts and the ombudsman the power to adjust the remedy to ensure the fair treatment of innocent parties.

We agree that if a claim is refused following the death of a guilty party, the court or ombudsman should have discretion to order the insurer to continue the policy as a single life policy, payable on the death of the innocent party.

Warranties as to the future and similar terms

A written statement

We agree with the provisional proposal that an insurer should not be able to refuse a claim for breach of warranty unless the warranty was set out in writing.

Bringing warranties to the attention of insureds

We believe that it is important that the specific requirements of any warranty rather than just the existence of the warranty should be brought to the attention of the insured.

The Panel recognises that insurers may in the future simply rewrite warranties as exclusions. The Panel is concerned that the Unfair Terms in Consumer Contracts Regulations requirement that such exclusions do not defeat consumers 'reasonable expectations' might not provide sufficient protection, particularly in policies that cover more than one type of risk (such as buildings and contents insurance) and contain numerous exclusion clauses, many of which relate to only one specific type of risk. Even where before entering into the contract a proposer is aware of a clear and transparent exclusion clause (such as 'all liability will be excluded unless mortice locks are installed...'), a proposer may nevertheless still reasonably expect that the exclusion clause will not apply where the loss suffered is entirely unrelated to that exclusion (for example water damage caused by burst pipes). The Panel does not

accept that just because the FOS will most likely require a causal connection there is no justification for reform of the common law. The courts may not take the same approach as the FOS.

The causal connection test

The Panel generally supports the provisional proposals made in this area.

A mandatory rule for consumers

The Panel supports the provisional proposal that the causal connection rules should be mandatory in consumer insurance.

Pre-contract information and intermediaries: consumer insurance proposals

Clarifying the agent's role

The Panel generally supports the provisional proposals in this section, however as stated in the consultation paper, many insured simply see the intermediary 'as part of the industry'. They do not understand that the intermediary acts for them and not for the insurer. The Panel is therefore concerned that the mere requirement in the FSA rules that a proposer be informed that the intermediary conducts a 'fair analysis' is insufficient, without more, to make the proposer aware that the intermediary is in fact acting for the proposer for the purposes of obtaining pre-contractual information. A more specific disclosure requirement is necessary.

We believe that additional protection is necessary when consumers have been given bad advice about completing proposal forms by intermediaries who are not subject to FSA regulation.

No more transferred agency

We agree with the provisional proposals.

The Panel believes that where the intermediary has been fraudulent the innocent proposer/insured should have an adequate remedy against the principal.

The effect of a signature on a proposal form once basis of the contract clauses are abolished

The Panel fully supports this provisional proposal which we believe reflects the reality of modern day contracting.

Section 19(a)

The Panel supports this proposal which would reflect treating customers fairly requirements and is consistent with consumers realistic expectations.

Yours sincerely,

A handwritten signature in black ink, appearing to be a stylized 'P' or similar character, located at the bottom left of the page.

John Howard
Chairman