Archaic, unclear & unfair

Part 2: Peter J Tyldesley considers the proposals & prospects for consumer insurance law reform

In December 2009 the English and Scottish Law Commissions will publish a report recommending the reform of consumer insurance law. The recommendations will be restricted to the pre-contractual provision of information by the consumer—that is non-disclosure or misrepresentation by the consumer and basis of the contract clauses. Appended to the report will be draft legislation, the Consumer Insurance (Disclosure and Representations) Bill.

Current law
Part 1 of this article considered the rules on non-disclosure (see NLJ, 3 July 2009, p 961). Some of the criticisms of those rules apply equally to misrepresentation. If an insurer is induced to offer insurance cover by the misrepresentation of a material fact by a consumer it may, on becoming aware of the true position, avoid the policy and refuse to pay any claims. As with non-disclosure, it is irrelevant whether the consumer acted fraudulently, negligently or entirely innocently. Nor does the insurer need to show a link between the misrepresentation and any claim which has occurred.

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Not content with these rights some insurers also use “basis of the contract” clauses. An apparently innocuous statement on an insurance application form that the answers given form “Basis of the contract” is sufficient to convert the answers into warranties. A warranty is a particularly stringent term of an insurance policy. Breach of a warranty terminates cover automatically and immediately. If an answer on the application form is incorrect, cover under the policy never commences and any claims may be rejected. The use of basis of the contract clauses has been the subject of judicial criticism since 1853. Supposedly outlawed from use in consumer insurance by revisions to the Statement of General Insurance Practice in 1986 they continued to be used—see for instance Economides v Commercial Union Assurance Co Plc [1998] QB 587 at 591, [1997] 3 All ER 636.

Proposals for reform
The starting point for the Law Commissions’ recommendations is the abolition of the duty of disclosure. In its place will be a statutory duty on the consumer to take reasonable care not to make any misrepresentation to the insurer. If this duty is breached, a remedy will only be available if the representation is “qualifying”—that is if it was deliberate, reckless or careless. The remedies available to insurers will therefore depend on the type of misrepresentation:

• An innocent misrepresentation is not qualifying and so will give rise to no remedy—the policy will remain in force and any valid claim should be paid.

• A careless misrepresentation will entitle the insurer to a proportionate remedy, reflecting what it would have done had it known the true facts. So if the insurer would not have offered cover it may avoid the policy and reject any claims. It must however return any premium paid. If the insurer would have offered cover but on different terms, it may proceed as if those terms applied. This may affect claims. It may be, for example, that the insurer would have included an exclusion which, when applied, invalidates a claim. If the insurer would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim. For instance, if only half the correct premium has been received, only half the claim need be paid.

• A deliberate or reckless misrepresentation will entitle the insurer to avoid the policy and reject any claim as at present. It may retain the premiums unless it would be unfair to do so.

The basis of the contract clauses will be rendered ineffective. This is vital since they could otherwise be used to undermine the reforms proposed for non-disclosure and misrepresentation.

These proposals reflect best practice and the approach of the Financial Ombudsman Service (FOS) and so might be thought uncontroversial. Nevertheless, past experience suggested that there would be one major opponent to change. Recommendations for reform were made by the Law Reform Committee in 1957 and by its successor, the English Law Commission, in 1980. These earlier proposals were never implemented, in
large part because of the influence wielded by the insurers’ trade association.

The influence of the ABI
The Association of British Insurers (ABI) has a powerful lobby in Parliament. Like its predecessor, the British Insurance Association (BIA), it has shown itself to be adept at avoiding statutory intervention in the business of its members. Where necessary a voluntary code is offered as an alternative to changes in the law. For example, the BIA obtained an exemption from the Unfair Contract Terms Act 1977, even though it was intended that insurance contracts should be included. This exemption was described in 1984 by the then director general of the Office of Fair Trading, Gordon Borrie, as “amazing”. In return for the exemption the BIA produced two Statements of Practice, one for general and one for long-term insurance.

When the Law Commission drafted its proposals for insurance law reform in 1980, the BIA objected in robust terms. A Department of Trade official noted that the insurers’ trade association displayed at times “the objective disinterestedness of a Millwall supporter”. Eventually, in 1986, the government agreed with the ABI that the Law Commission’s proposals would be abandoned in return for minor amendments to the Statements of Practice. Peter North, who as Law Commissioner had been responsible for the 1980 review, described this behind-the-scenes deal as “a disgraceful way to proceed and a clear waste of public money”.

Why have the demands of the ABI held such sway over successive governments? The answer undoubtedly lies in the extraordinary contribution that the insurance industry makes to the financial wellbeing of the UK. In 2007 insurers paid out a daily average of £59m in general insurance claims and £211m in life and pension benefits. The insurance industry employs 309,000 people. In the 2006-07 financial year, insurers paid £9.7bn in taxes and as at 31 December 2007 insurers were managing £1,599bn in shares and other assets. Crucially insurers receive £48bn of overseas premiums per year, leading to a substantial contribution towards the UK balance of payments.

However, as Ben Parker observed: “with great power comes great responsibility”. Is the ABI using its power responsibly? Its reaction to the Law Commissions’ current review of insurance contract law has been disappointingly familiar. In July 2007 the director general of ABI, Stephen Haddrill, argued that

Voluntary codes v law reform
By 1999 there were 55 ABI codes, many of which directly or indirectly affected consumers.

The ABI argues that codes are more flexible than law and can be amended to suit a changing market. In reality changes to the codes may be few and far between.

A stark example of stagnation is to be found in the ABI Code on Application Form Design which includes part of the former Statement of Long-Term Insurance Practice.

Available from the ABI website, this code refers to the rules of the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) and the Financial Services Act 1986. LAUTRO was replaced by the Personal Investment Authority in 1994.
Prospects for reform
The Law Commissions’ decision to deal separately with consumer insurance is shrewd. Rules suitable for mass-market consumer policies may not be appropriate for bespoke business insurance purchased by large well-informed commercial concerns with the benefit of advice from a broker. Omitting business insurance from the report should also allay the fears of HM Treasury regarding the possible impact of reform on overseas earnings. And by focusing on pre-contractual provision of information by consumers the Law Commissions have limited their recommendations to an area where the law is plainly unsatisfactory and where the FOS has already successfully developed an alternative approach.

The consumer organisations are likely to support the Law Commissions’ proposals. Peter Vicary-Smith, Chief Executive of Which? recently spoke in favour of reform: “The current insurance law regime is failing consumers. We need greater protection for individuals and more certainty for both firms and those who need insurance.

I am strongly supportive of the work of the Law Commissions and want to see a clear legislative commitment from all parties to implementing their proposals.”

Resistance to change
Regrettably the ABI continues to resist change. After the ABI gave evidence to the All-Party Parliamentary Group on Insurance and Financial Services, David Worsfold, a respected commentator on insurance matters, wrote despairingly: “Many would say this regime [proposed by the Law Commissions] should provide a welcome degree of certainty based on no more than best current practice in the market.

“Instead, the ABI pleaded that it should be left to a combination of the Financial Services Authority (and its Treating Customers Fairly regime) and the Financial Ombudsman Service. This reform of insurance contract law is suddenly in danger of becoming a huge lost opportunity for the industry to align itself with the interests of consumers to the benefit of both. An urgent rethink is required.”

Privately some insurers have also expressed doubts about the wisdom of a negative response to what appear to be reasonable proposals.

Opportunity
There is one obvious opportunity for a reversal of existing ABI policy. A new director general takes office in November 2009. It would be welcome indeed if the incoming director general were to advocate reform as beneficial for insurers and consumers alike.

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