

Pearls of wisdom

It is time the government acted on recommendations to reform insurance law, says **Peter Tyldesley**

The Consumer Insurance (Disclosure and Representations) Bill, which received its second reading in the House of Lords on 15 June, will reform three key aspects of consumer insurance law: non-disclosure, misrepresentation and basis of the contract clauses. The bill is based on the recommendations of a report published by the English and Scottish Law Commissions on 15 December 2009 and enjoys broad support, with the Association of British Insurers, the British Insurance Brokers' Association and the Chartered Insurance Institute welcoming the proposed changes. Consumer Focus, the Trading Standards Institute and Which? are also in favour.

Insurance law has long been regarded as an area ripe for reform, with many of its rules perceived to be archaic, unclear and unfair. Until now the only substantial statutory intervention has been the Marine Insurance Act 1906, a codifying measure which embodies much older case law. Many provisions of the Act are taken to apply to consumer insurance policies – whether marine or non-marine – despite the fact that the Act was drafted before modern mass-market policies existed. Indeed the Act is based on a bill presented to the House of Lords in 1894, some two years, for instance, before the first motor insurance policy is believed to have been issued.

Reports by the Law Reform Committee in 1957, the Law Commission in 1980, the National Consumer Council in 1997, and the British Insurance Law Association in 2002 all concluded that insurance law reform is desirable. The proposed changes would address flaws in the current law in respect of non-disclosure, misrepresentation and 'basis of the contract' clauses (see box opposite).

Making legislation relevant

The Consumer Insurance (Disclosure and Representations) Bill has been slightly amended since it was published in the law commissions' report. However, the main provisions are unchanged and broadly reflect the approach taken by the Financial Ombudsman Service.

- The duty of disclosure on consumers will be abolished (clause 2(4) and (5)). If an insurer requires information it will need to ask a clear question (clause 3(2) (c)). Therefore, in a case such as *Lambert* (see box opposite) the insurer will have no remedy; it will be obliged to pay the claim.
- The remedies available to the insurer for misrepresentation are amended to reflect the conduct or state of mind of the consumer. There are three possibilities. First, clause 2(2) places an obligation on the consumer to take reasonable care not to make a misrepresentation to the insurer. Provided that obligation is met – and clause 3 sets out the criteria to be considered – the insurer will have no remedy. Second, if

the misrepresentation is careless and induces the contract, the insurer's remedies will be based on what it would have done had it known the true position (clauses 4 and 5 and schedule 1). In the case of Mr and Mrs C (see box), for example, the insurer would simply have added a hearing loss exclusion to the policy. This will have no impact on a claim for leukaemia, which the insurer will have to meet in full. Third, if the misrepresentation is reckless or deliberate and induces the contract the insurer may avoid the policy, refuse all claims and, unless it would be unfair to do so, retain the premium (clauses 4 and 5 and schedule 1).

- Basis of the contract clauses will be rendered of no effect (clause 6). Insurers will be unable to rely on a basis of the contract clause in any application form completed after the law is reformed.

Last month David Sanders, trading standards institute lead officer for civil law, spoke approvingly of these proposals: "Legislation is not relevant unless it moves with the times. Law governing business transactions in the 19th century and protecting the insurer has proved totally inadequate in protecting the consumer in the 21st century. The risk has changed and the law has to change to remain fair and relevant. TSI fully supports the reforms in this bill."

Individual insurers have also expressed their support. Gareth McChesney, head of home and motor portfolio management at Allianz Retail, recently said: "Allianz fully supports this reform, which will create

Outdated rules

The perceived problems with the three areas of law considered by the law commissions have been highlighted in a number of cases.

Non-disclosure

When applying for or renewing an insurance policy a consumer is currently required to disclose to the insurer all material facts, regardless of whether or not any relevant questions have been asked. A material fact is one which would have an effect, not necessarily decisive, on the mind of a prudent insurer in assessing the risk (*Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501).

If a non-disclosure induces an insurer to grant cover on terms which would not otherwise have been offered it may, on becoming aware of the true facts, avoid the policy from the outset and decline any claims which have arisen. This is so regardless of whether the non-disclosure was fraudulent, negligent or entirely innocent. Nor does there have to be a link with any claim that has occurred. In short, the law requires consumers to look accurately into the mind of a prudent insurer and provides a disproportionate punishment for those who act reasonably and honestly but nevertheless fail this test.

In *Lambert v Cooperative Insurance Society Ltd* [1975] 2 Lloyd's Rep 485 Mrs Lambert held an all risks policy on her jewellery for nine years. She had not disclosed that her husband had been convicted of several criminal offences – unsurprisingly, as the insurer had never asked about such matters. When a claim arose, the insurer became aware of the convictions, avoided the policy and rejected the claim. The Court of Appeal held in favour of the insurer, but MacKenna J made plain his regret at being obliged to do so: "The present case shows the unsatisfactory state of the law. Mrs Lambert is unlikely to have thought that it was necessary to disclose the distressing fact of her husband's recent conviction when she was renewing the policy on her little store of jewellery. She is not an underwriter and has presumably no experience in these matters. The defendant company would act decently if, having established the point of principle, they were to pay her. It might be thought a heartless thing if they did not..."

Misrepresentation

Similar rules apply for misrepresentation. In one notorious case reported by the Financial Ombudsman Service, Mr and Mrs C held a joint critical illness policy. Mr C claimed after Mrs C was diagnosed

with leukaemia, a condition from which she died. The insurer rejected the claim as Mrs C had given an inaccurate answer to a question on the original application form: she had inadvertently failed to disclose partial hearing loss, which was entirely unrelated to the leukaemia.

Basis of the contract clauses

If an application form states that the answers given form "the basis of the contract" the effect is to turn those answers into warranties. A breach of warranty terminates cover immediately and automatically. Cover will not recommence even if the breach is remedied. Nor does the information contained in the answers need to be material.

In *Unipac (Scotland) Ltd v Aegon Insurance* [1996] SLT 1197, a business insurance case, the court was prepared to accept that even a mere error in a telephone number might terminate cover: "We recognise that a consequence of holding that the declaration contains an express warranty of the truth of the answers to the questions in the proposal is that if there was an error in, for example, the postcode or telephone number of the proposer, the result would be that the defenders would be entitled to avoid the policy."

"Law governing business transactions in the 19th century and protecting the insurer has proved totally inadequate in protecting the consumer in the 21st century"

greater transparency for our customers and ensure they are treated fairly. As a responsible insurer, we are committed to ensuring that customers understand their rights and obligations, and have their genuine claims paid quickly. We do not envisage any significant cost implications from this legislation."

Special parliamentary procedure

The passage of the bill is also of some general interest as it is the first measure to be introduced after a special parliamentary procedure for uncontroversial Law Commission bills was successfully tested and made permanent. Such bills are introduced in the House of Lords, where

the debate before the second reading takes place in committee and scrutiny after the second reading takes place in a special public bill committee. This is not a fast-track procedure; it simply means that worthwhile measures which might not secure time on the floor of the House can nevertheless be implemented.

To stay within the procedure, bills must remain uncontroversial. This may limit the scope of amendments that can be moved. During the debate before second reading, for instance, it was pointed out that small or micro businesses presently suffer the same disadvantage as consumers. This may be true. However, the law commissions are not ignoring business insurance – it will be

the subject of a second consultation paper this year and a final report in 2012. There is arguably inadequate evidence to extend the current bill to businesses at this point, and the economic impact study commissioned by the law commissions relates only to consumer insurance. Worse still, such an amendment would almost certainly strip the bill of its uncontroversial status, leading it to drop out of the special parliamentary procedure and potentially be lost altogether.

The law commissions have produced a sound set of proposals which address some of the worst aspects of current consumer insurance law. Given the history of failed reform initiatives in this area, it is a notable achievement to have secured support from all sides. It is to be hoped that the bill will be swiftly enacted and that the law commissions will be encouraged to continue their work – many other areas of consumer insurance law remain in need of reform.

Peter J Tyldesley is senior research fellow at St Mary's University College, Twickenham. Contact: tyldesleyp@smuc.ac.uk