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The reform of insurance contract law – why have consumers waited so long?

By Peter J Tyldesley, LLB, AKC, LLM, AFSALS, MCI Arb, Solicitor
Consultant to the Law Commission

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Abstract

Why do insurers still deal with consumers on the basis of law established largely in commercial cases in the 18th and 19th centuries? Judges, ombudsmen, academics and, increasingly, practitioners agree that reform is long overdue. However, past initiatives have come to nothing. Most notably, the recommendations for change made by the Law Commission in 1980 have never been implemented.

The stagnation of the law is partly the result of successive governments agreeing with industry representatives that voluntary measures will be accepted as a substitute for reform. This paper considers two such agreements, but suggests that other factors have also been significant. In 1980, for example, the Law Commission rejected the reforms proposed in a draft European directive, leaving the Department of Trade in a weakened position to press for change. Combined with the outspoken hostility of the British Insurance Association towards the Law Commission's own recommendations, this proved sufficient to scupper any prospects of reform.

In 2005 the Law Commission and the Scottish Law Commission announced a joint review of insurance contract law. A final report is not anticipated before 2010. It appears that many insurers now support reform and the paper closes by advocating an interim step which could bring immediate benefits for consumers and insurers alike.

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Insurance contract law is based in large part on court cases and statutes from the 18th and 19th centuries [1]. The retention of archaic and unclear law obstructs legitimate business [2] and can leave policyholders dissatisfied and antagonistic towards the industry.

Non-disclosure – the current law

The duty of disclosure provides a good example of the way the law is weighted in favour of insurers. Although it is a reciprocal duty, it bears more heavily on the consumer than on the insurer. First clearly stated by Lord Mansfield in 1766, the strict law is that a proposer for insurance is obliged to disclose all material facts – that is, facts which would have an effect, whether decisive or not, on the mind of a prudent underwriter in assessing the risk [3]. If the non disclosure of a material fact induces an insurer to write the business, it may on becoming aware of the true position avoid the policy from outset and decline to pay any claims.

The main criticisms of these rules are well known:

- The test of materiality requires the proposer to look into the mind of a prudent underwriter. Most consumers do not have the knowledge or expertise to do so.
- There is no requirement of a causal connection between the non-disclosure and any loss that has occurred. An insurer may avoid the policy and decline to pay a claim even where the non-disclosure had no direct bearing on the loss.
- The conduct or state of mind of the proposer is irrelevant. Even if a non disclosure was entirely understandable and innocent, the policy may be avoided.
- Avoidance is an all-or-nothing remedy. Where a policy is avoided, cover is lost from the outset. The policyholder foregoes the right to have claims paid and may be required to return any payments already received. The avoidance will itself need to be disclosed on subsequent proposals, which may make it difficult to obtain cover. This position contrasts with that in jurisdictions which have adopted the principle of proportionality for certain categories of non-disclosure. In its simplest form, proportionality means that if the non-disclosure has led, for example, to only half the correct premium being paid, then only half the claim is met.
- Insurance contract law does not require the insurer to ask the proposer any questions. If questions are asked, a duty of disclosure still exists in respect of any matters which the questions do not cover.

The first four criticisms apply equally to the law of misrepresentation.

Arguments against reform

Those who oppose reform argue that whatever the weaknesses of the law there is no difficulty in practice. Insurers do not enforce their strict legal rights, and consumers are adequately protected by statutory regulation by the Financial Services Authority (FSA) and through access to the Financial Ombudsman Service (FOS). But if this were true, it is difficult to understand why there would be any objection to reform.

Many insurers do have high standards and will not rely on their legal rights. However, a study of insurance cases featured in past issues of *Ombudsman News* suggests that other insurers will take advantage of law which is unfair [4].

Regulation only directly addresses a small number of the weaknesses in insurance contract law. The FSA has imported into the Insurance: Conduct of Business rules (ICOB) and the New Conduct of Business Sourcebook (COBS) modified versions [5] of parts of the industry's statements of practice – pre-existing self regulatory codes [6]. It has been unable to go further by, say, abolishing the duty of disclosure. This is unsurprising. Regulation should be underpinned by sound law, not expected to act as a substitute for it.

Where cases are referred to the FOS, there is a statutory obligation for any determination by an ombudsman under the compulsory jurisdiction to be made "by reference to what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case" [7]. In practice this means that the FOS routinely disregards many of the basic principles of insurance contract law. For example, it does not accept that there is a duty of disclosure on consumers; if an insurer requires information from a proposer it must ask an appropriate question [8]. However, most cases are not considered by the FOS, and its decisions do not act as precedents which insurers are obliged to follow [9].

This confused and multilayered position inevitably leads to oddities. For example, insurance intermediaries are required by ICOB to inform consumers of the duty of disclosure, a duty which is not recognised by the FOS.

The difficulty for consumers is that there is no easy way of assessing at the point of purchase how they will be treated at the point of claim. This is equally an issue for those insurers which treat their customers fairly. How do they distinguish themselves from their less ethical competitors?

Why, then, has there never been reform of insurance contract law? It has been suggested that the industry has succeeded in avoiding statutory intervention through agreements with successive governments – in some cases by offering self-regulatory codes as an alternative to legislation. Certainly there are some grounds for thinking that this analysis is fair.

To start with, there is the sheer number of codes. Although there is no public list, an internal paper produced by the Association of British Insurers (ABI) in 1999 identified 55 codes, many of which have direct or indirect implications for the consumer [10]. Then there is the failure to implement the reforms recommended by the Law Reform Committee in 1957 [11] and the Law Commission in 1980 [12]. It is also notable that the industry achieved an exemption from the Unfair Contract Terms Act 1977 and that in 1994 the Department of Trade and Industry (DTI) explained how it had worked in association with the ABI to reduce the impact of the Unfair Contract Terms Directive on insurance policies [13].

This paper considers the background to two of these pacts between industry and government:

- the agreement which led to the exemption of insurance policies from the provisions of the Unfair Contract Terms Act 1977 – a decision described in 1984 by the Director-General of Fair Trading as "amazing" [14];
- the agreement which led to the abandonment of the recommendations for law reform made by the Law Commission in 1980 – a move described by the commissioner responsible for the preceding review as "a disgraceful way to proceed and a clear waste of public money" [15].

The link between these two arrangements is the price paid by the industry – the statements of practice agreed by the British Insurance Association (BIA) in 1977 and strengthened by the ABI in 1986 [16].

Unfair Contract Terms Act 1977

In 1977 the Law Commission and the Scottish Law Commission published a joint report on exemption clauses. The recommendations in the report formed the basis of the Unfair Contract Terms Act 1977. It had been intended that any legislation would apply to insurance contracts. The Law Commission believed that there were good reasons for not excluding any class of contracts and the Scottish Law Commission specifically stated that the inclusion of insurance contracts was justified.

Insurers, however, wanted an exemption. The BIA and Lloyd's entered into negotiations with the Department of Trade (DoT) [17]. It was agreed that in return for an exemption, the BIA would promulgate a self-regulatory code – the *Statement of general insurance practice*. This would set out how certain aspects of the law would not be relied upon by insurers in consumer cases. On 4 May 1977 the agreement was announced [18] to the House of Commons in a written answer from the parliamentary under-secretary of state for trade, Stanley Clinton Davis [19]. The statement included terms relating to proposal forms, claims and renewals, including the following

provision setting out the consequences of non-disclosure:

Except where fraud, deception or negligence is involved, an insurer will not unreasonably repudiate liability to indemnify a policyholder:
(i) on the grounds of non-disclosure or misrepresentation of a material fact when knowledge of the facts would not materially have influenced the insurer's judgement in the acceptance or assessment of the insurance;

This wording appears to restrict the rights of insurers only in cases of innocent non disclosure or misrepresentation. Even then it seems to contemplate that there may be some circumstances in which it is reasonable to repudiate liability. One academic assessed the statement and concluded that "it all seems a rather pointless exercise" [20].

Mr Clinton Davis also indicated that the Life Offices' Association had written to him stating that the three life associations [21] were willing to consider producing a parallel code for life assurance "within the next few weeks" [22]. In the event it was 28 July 1977 before he was able to present the *Statement of long-term insurance practice* to the House of Commons [23]. Within the DoT the limitations of the statements were always recognised [24]:

... the Statements of Practice are statements by the insurers themselves. It is true that they were discussed with the Government when being drawn up; but by their nature they state only what the insurers themselves were willing to acknowledge as good current practice in the market, not what they or the Government might have felt to be desirable changes in the framework of insurance contract law.

Law Commission report 1980

In 1977 the DoT was considering the fifth draft of a possible European directive [25]. The primary objective of the directive was to open up the insurance market across Europe, with obvious potential benefits for the UK. Certain articles of the directive aimed to harmonise elements of insurance contract law – that is, to provide for the same law to apply in all member states. Article 2 dealt with misrepresentation and non disclosure and would, for example, have seen the introduction of the principle of proportionality. Article 3 would have lessened the consequences of a breach of warranty for a policyholder.

On 15 December 1977 R E Clarke, assistant secretary at the DoT, raised the possibility of seeking advice on these issues from the Law Commission [26]. At a subsequent meeting it was agreed by the under-secretary, M S Morris, that an approach should be made via the Lord Chancellor's Department. The minute of that meeting gives a firm picture of what the DoT had in mind:

The Commissions could concentrate their studies on the present proposals in the draft insurance contract law directive, perhaps even making proposals for additional measures that might be included in this directive... When proposing such an enquiry to the Lord Chancellor's Office it would be helpful to emphasise the value of contributing at a reasonably early stage in the debate, thereby influencing the nature of the directive.

This request for advice was in line with one of the statutory purposes of the law commissions, namely "to provide advice and information to government departments and other authorities or bodies concerned at the instance of the Government ... with proposals for the reform or amendment of any branch of the law" [27]. After a meeting with the DoT one of the commissioners, Peter North [28], agreed that a reference could be made to the Law Commission. He indicated that the issues considered would need to be limited to non disclosure and warranties – those matters covered by the draft directive. It was envisaged that a report would be produced by the end of 1978. A formal reference followed from the Lord Chancellor's Department on 17 May 1978.

Working paper

The first sign of trouble looming was a letter dated 29 June 1978 in which Dr North informed the DoT that the Law Commission had reached the decision that the review should be handled "in a way as little different from our normal law reform exercises as possible". Dr North proposed to issue a working paper in November 1978, with a final report being submitted in April 1979.

In the event there was further slippage. In January 1979 the DoT received an advance copy of the working paper, which was formally published in the following month [29]. The DoT had already held discussions with the industry and had reached the view that insurers were ready to accept the terms of the draft directive, including the introduction of the proportionality principle [30]. Consequently the contents of the working paper caused consternation. Rather than offering an analysis which could be fed into the discussion of the directive, the Law Commission argued that the directive would cause "major difficulties" if adopted [31]. In particular, it dismissed

the principle of proportionality, suggesting that it “would not be a desirable innovation in this country” [32]. Instead, the Law Commission proposed a set of alternative reforms. These included the modification of the duty of disclosure to make it subject to a “reasonable man” test.

After reading the report, Michael Starforth, the DoT’s solicitor, recorded a key concern:

I have formed the view that there is not the slightest possibility of persuading our partners to abandon their own systems of law, on which the directive is founded, in order to adopt the English system. If we flatly reject the essential points of the directive, there can be no further progress on this particular bit of harmonisation.

The DoT decided to consult with four industry bodies – the BIA, Lloyd’s, the British Insurers’ European Committee and the Life Offices’ Association. A meeting was held at the offices of the BIA on 14 March 1979. The British Insurers’ European Committee reported that the reaction of insurers had been one of bewilderment: the working paper “seemed to ignore the fact that once the EEC Commission had initiated a draft proposal one had to consider the consequences of its possible adoption”. It felt that the industry could live with proportionality, largely on the basis that it could avoid applying it in practice. The BIA representatives had little positive to say about the Law Commission’s proposals. One insurer believed that what was suggested was “hopelessly impractical” and another thought the cost would outweigh the benefits for consumers. The BIA and Lloyd’s agreed that a distinction should be drawn between consumer and business policyholders – an option that had been rejected by the Law Commission [33].

On 4 April 1979 the DoT produced a draft response to the working paper for consideration by Mr Clinton Davis. The covering memorandum drew attention to the difficulties over the rejection of the proportionality principle, and suggested that the Law Commission should be asked to reconsider the point. In the meantime the DoT had received a copy of the BIA’s submission to the Law Commission. This extended over 15 pages and objected, sometimes in caustic terms, to almost every proposal that had been made. John Henes, assistant secretary at the DoT, accepted that some of the points made carried a lot of weight. However, the tone was such that he wrote a brief note on the copy circulating within the DoT: “To me, it seems at times to show the objective disinterestedness of a Millwall supporter.”

By April 1979 the BIA was very much on the offensive. Reports appeared in the national newspapers with headlines such as “Insurers attack law change plan” [34], “An angry reaction by insurers” [35] and “BIA disquiet at Law Commission report” [36]. Nor was there much support forthcoming from other interested parties. The British Insurance Brokers Association agreed that a technical case could be made out for reform but believed that the Law Commission’s proposals required complete reappraisal. The Consumers’ Association said that like the industry it was disappointed with the proposals. It felt they did not go far enough [37].

On 19 February 1980, Greville Janner MP [38] used the 10-minute rule to introduce the Insurance Policy Holders Protection Bill into the House of Commons [39]. This bill included two sections relating to warranties and a third which read simply: “The duty of disclosure heretofore imposed on an insured is hereby repealed.” An order for a second reading was read on 4 July 1980 [40], but the bill fell at the end of the parliamentary session [41]. Mr Janner, however, continued to press the case for fairer law with impressive tenacity over the following years.

Final report

On 20 August 1980 the chairman of the Law Commission, Mr Justice Kerr, wrote to the Lord Chancellor, Lord Hailsham, expressing concern that the recommendations in the forthcoming final report should be judged on their merits. There was particular anxiety regarding the attitude of the BIA:

Whereas the BIA was openly hostile, this was by no means the position of Lloyd’s. Our impression is that whereas the BIA is in effect prepared to wage something like a political campaign against any change, Lloyd’s are much readier to consider our recommendations on their merits without hostility.

Several days later, the DoT received a copy of the final report which contained a draft bill [42]. The Law Commission had repeated its earlier view that the relevant articles of the draft directive were “inappropriate” to English law and that the proportionality principle was “open to serious objection” and should not be introduced. It recommended detailed changes to the law relating to non-disclosure and warranties [43].

Amongst these proposals it suggested that a duty of disclosure should be retained, but that material facts should have to be disclosed only if a “reasonable man in the position of the applicant” would do so. A briefing note drafted by the DoT maintained support for reform but suggested it should be deferred so that the requirements of the proposed directive could be taken into account. Not all within the DoT supported this approach. Michael Wasilewski fought a rearguard action:

I am not in a position to take a view on how the EEC dimension should affect the timing; but I cannot help feeling that the line proposed in ... your note will be seen by many (and possibly rightly) as a polite way of

throwing the report into the lumber room.

Delay and vacillation

On 29 October 1980 Lord Hailsham wrote to Mr Henes at the DoT indicating that he felt the Law Commission's recommendations should be considered on their merits, which he regarded as "considerable". This received backing from Mr Wasilewski at the DoT, who argued that it would be unfortunate if the Law Commission's proposals were "indefinitely shelved because of the EEC angle". He also agreed with the Law Commission's assessment that the statements of practice were not an acceptable alternative to law reform [44]. However, a written parliamentary question was arranged so that Reginald Eyre, parliamentary under-secretary of state, could put matters on hold: "The Government wish to allow time for all those interested in the report to put forward views and for those views to be considered [45]."

On 11 November 1980, the secretary of state for trade, John Nott, responded to Lord Hailsham stating that the DoT supported the view of the Law Commission that reform of the law of non-disclosure and breach of warranty was necessary and desirable. However, there was a now familiar qualification:

It would not be sensible to introduce a bill to reform a branch of the law when all concerned will know that quite different changes may have to be introduced within a few years because of a draft EC directive already put to the Council of Ministers.

In February 1981 the National Consumer Council, the Consumers' Association and the National Federation of Consumer Groups all presented papers to the DoT giving their views on the Law Commission's final report. All three believed that the Law Commission's proposals did not go far enough. More surprisingly, all agreed that the proportionality principle should not be imported into English law. The National Consumer Council and the Consumers' Association argued that there should be a separate law of insurance for consumers.

Mr Janner asked two further parliamentary questions regarding possible changes to the law and on 19 March 1981 received a written answer from Mr Eyre stating that consultation was continuing. On 31 March 1981 the BIA submitted a paper to the DoT in which it put its case against the Law Commission's proposals. The BIA pointed out that the premium income of its members was £13,340m in 1979, of which 35% was derived from overseas business. It argued that any changes should be limited to consumer insurances and offered to reconsider the terms of the statements of practice. Particular anxiety was expressed about the Law Commission's rejection of the draft directive:

British insurers are widely represented in Europe and we are concerned with the possibility of increasing our participation in this market by way of both co insurance and freedom of services. An outright rejection by Her Majesty's Government of draft EEC legislation on insurance could only impair our prospects in this large and growing market.

On 1 June 1981 Mr Janner asked the secretary of state for trade to indicate when he expected to complete consultations. This was followed on 3 June 1981 by a debate in the House of Commons which covered both the Law Commission's proposals and the draft directive. Mr Janner returned to the fray in May 1982 in an adjournment debate. He recognised that "most insurers" did not take advantage of the unsatisfactory law but said he was very disturbed at a number of cases he saw and "the often wicked way in which people are deprived of their rights". He mentioned that his 10-minute rule bill would have a second reading in July 1982, but accepted it had no real prospect of success.

A response given by Gerard Vaughan, the minister for consumer affairs, referred to the existence of the Insurance Ombudsman Bureau as well as to European developments – though failed to mention that as at 31 March 1982 the bureau had just 38 members [46]. Mr Janner pushed Dr Vaughan for action and received a promising reply [47]:

I am conscious of the problems and the need to take action. A good deal of uncertainty has resulted from the Law Commission's report, the consultation paper and the replies. I am aware of the damage that can be caused by drift. We shall not delay.

In January 1983, Mr Janner asked Dr Vaughan two questions: first, whether he had any proposals to protect consumers from exclusion clauses in insurance contracts, and second, whether he would remove the exemption of insurance contracts from the Unfair Contract Terms Act [48]. Dr Vaughan indicated he was considering legislation in the light of the Law Commission's report, but had no plans to amend the Unfair Contract Terms Act. On 28 April 1983 – with an election in sight – Dr Vaughan gave a clear declaration of intent [49]:

Following extensive consultations on [the 1980 report] the Government have decided to introduce a Bill, as soon as legislative time is available, broadly on the Law Commission's proposals in Cmnd 8064, but limited to private consumer insurance contracts.

Nearly a year later, on 28 March 1984, Mr Janner asked the secretary of state for trade and industry [50] whether legislation reforming the duty of disclosure in insurance contracts would be introduced in that parliamentary session. John Butcher, parliamentary under secretary of state at the DTI, gave a firm commitment to the House of Commons and dismissed the possibility of the statements of practice being an acceptable alternative to legislation [51]:

It remains the Government's intention to introduce legislation to reform the law on non-disclosure in relation to insurance contracts affecting private consumers as soon as legislative time is available.... We have said that we wish to introduce legislation as soon as possible....The Government agree with the Law Commission that voluntary undertakings by the industry are not a substitute for reforming an unfair law.

On 25 April 1984 Mr Janner asked whether the DTI had any plans to introduce legislation to subject insurance exclusion clauses to controls like the Unfair Contract Terms Act. Alexander Fletcher, parliamentary under-secretary of state at the DTI, replied: "I have no plans for legislation on insurance contract law except along the lines recommended in the Law Commission report ... [52]".

However, on 20 December 1984 Mr Fletcher informed the House of Commons that there had been a change of heart. In answer to a written question he announced that he was embarking on discussions with the insurance industry to see whether changes could be made to the statements of practice [53]. For Dr North, who by then had left the Law Commission, this was clearly too much to stomach. He suggested that there was another question for Mr Fletcher to answer [54]:

One might ask: what on earth did he think his Department had been doing for the last four years? The suspicious observer might conclude that the insurance industry lobby has been active behind closed doors and has in fact won.

Revised statements of practice

Over the following months, the Consumers' Association and the National Consumer Council continued discussions with the DTI. By February 1986 the Consumers' Association believed an understanding had been reached that legislation would be forthcoming after all. It was therefore a shock when on 21 February 1986 the secretary of state for trade and industry, Paul Channon, announced that revisions to the statements of practice had been agreed and that there would be no reform of the law [55]. The changes in the statements of practice were very limited and ranged from the worthwhile (a bar on the use of "basis of the contract" clauses) to the meaningless: "Insurers will continue to develop clearer and more explicit proposal forms and policy documents whilst bearing in mind the legal nature of insurance contracts."

One academic concluded that the amendments displayed a "minimalist attitude to the problem of abuses" [56].

Roberts v Plaisted and after

There appear to have been few further developments until the decision of the Court of Appeal in *Roberts v Plaisted* in 1989, which suggested that certain agency aspects of non-disclosure might usefully be referred to the Law Commission [57]. The Consumers' Association wrote to the secretary of state for trade and industry stating that it continued to be dissatisfied with the 1986 decision to accept revised statements of practice in place of law reform. On 27 November 1989 the *Daily Telegraph* reported that the association would be writing to those MPs who had been successful in the recent ballot for private members' bills, asking if they would care to adopt the draft bill from the Law Commission's 1980 report. The letter was sent on 30 November 1989. John Redwood, parliamentary under-secretary of state at the DTI, replied to the association on 1 December 1989. He said he saw no reason to revise the DTI's earlier decision.

None of the MPs who succeeded in the ballot chose to adopt the Law Commission's draft legislation. They may have been discouraged by a letter sent to them on 14 December 1989 by Mike Jones, the chief executive of the ABI. He suggested that the proposals put forward by the Consumers' Association were "extremely difficult and controversial" and continued:

In our view, the Statements of Insurance Practice, compliance with which is a condition of membership of the Association of British Insurers and which are also observed by Lloyd's, provide at an economic price a level of consumer protection which is unlikely to be exceeded by primary legislation, least of all by legislation which the Law Commission itself has been unable to draft satisfactorily.

It seems therefore that there were three critical factors which led to the Law Commission's recommendations remaining unimplemented:

- There was the outright rejection by the Law Commission of the approach taken by the proposed

European directive.

- There was the vociferous hostility from the BIA, which made great play of the very substantial financial contribution that the insurance industry makes to the UK.
- The voices of consumer organisations appear to have carried surprisingly little weight to counterbalance the influence of the BIA.

The statements of practice – a brief assessment

Some provisions of the statements of practice were reasonably certain in their effect. For example, the *Statement of general insurance practice* stated that a warning should be given as to the consequences of non-disclosure and that clear questions should be asked about matters generally found to be material. Other provisions were less useful, because of the qualifications attached:

So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgement on the part of the proposer.

The opening words appear to envisage that in some circumstances insurers would ask questions which require expert knowledge beyond that which a proposer could reasonably be expected to possess or obtain. Quite what the point would be of doing so is unclear.

A number of more general criticisms of the statements may be made:

- The provisions of the statements were weak in nature. In part, this reflects their origins in a rather rushed attempt to avoid statutory intervention. Unfortunately, the statements remained in force for many years, although it is clear that the DoT only intended that they should be a stop-gap measure [58]:

[The Statements] were drawn up with some urgency during the passage of [the Unfair Contract Terms Bill] through Parliament, with a view to their being made public before the Bill was passed. It was not that the Government felt legislation to improve the protection of the public in relation to insurance contracts to be undesirable. It was clear, however, that before decisions could be taken on such legislation, detailed and expert studies of the issues were necessary; account would need to be taken of EEC developments; and, if the need for a new statutory regime was shown, it would have to be worked out, a Bill drafted, and Parliamentary time found, before it could be given effect. The Government therefore regarded the Statements of Practice not so much as a permanent substitute for legislation on insurance contracts, but rather as a way of introducing improved protection for the public in this field within the timetable set by the Unfair Contract Terms Bill.

- The statements were not legally enforceable and successive ombudsman schemes did not offer a full solution to this problem.
- There appeared to be little awareness of the existence of the statements of practice amongst consumers, who were not routinely given copies.
- The statements of practice were drafted by industry associations without independent input. Furthermore, the voluntary nature of the statements meant that they could be withdrawn by the industry without public discussion. It appears that the *Statement of general insurance practice* was withdrawn with the introduction of ICOB in January 2005 – even though ICOB did not provide a substitute for all of its terms [59]. The position with the *Statement of long-term insurance practice* is harder to establish. From the ABI website it appears that the statement was effectively withdrawn in February 2006, other than those provisions which were incorporated in the guidance *Application form design for life and health protection insurances* issued by the ABI in that month.
- There was no effective monitoring of compliance with the statements of practice.
- It is sometimes argued that codes are preferable to legislation since they can be more speedily updated. However, the statements of practice were only updated once – in 1986 – and as noted above this was again simply to avert statutory intervention. One visible result of this lethargy is to be found in the wording of the *Statement of long-term insurance practice*, carried forward into the *Application form* guidance. The text contains a reference to the Life Assurance and Unit Trust Regulatory Organisation and the Financial Services Act 1986 – but not to the successor regulators (the Personal Investment Authority from 1994 and the FSA from 2001) or the current legislation, the Financial Services and

Critical illness cover – a damaged reputation

Has it been in the best interests of insurers for law reform to be blocked? There seems little doubt that the absence of balance in the law causes reputational problems for insurers. Critical illness cover, for example, has had much publicity recently. UK insurers made claims payments of £1.6bn under critical illness contracts between 2000 and 2006. However, what has caught the headlines is the number of cases where claims have been declined for non-disclosure. In 2006 LifeSearch, a life assurance intermediary, published figures which indicated that on average 20% of claims were rejected and that the majority of these rejections were based on alleged non-disclosures. By the very nature of the cover, the rejection of a critical illness claim comes at a time which can be immensely difficult for insured and family. There has therefore been no shortage of hard cases reported by the media.

On 10 May 2006 one such case was considered by a Scottish court [60]. The insured, Mrs Cuthbertson, was diagnosed with multiple sclerosis, and made a claim under a critical illness policy issued by Friends Provident. After obtaining Mrs Cuthbertson's medical records Friends Provident rejected the claim on the grounds that various medical consultations and tests had not been disclosed. The judge was clearly concerned at the way enquiries had been conducted and disturbed that communication with the insured had not been frank:

... the only purpose of recovering the GP records was to see whether within those notes there was any entry which might give [Friends Provident] grounds for avoiding or invalidating the policy under which the claim was being made.

Earlier this year the figures obtained by LifeSearch were confirmed by those released by the chief ombudsman of the FOS, Walter Merricks. In an interview for the BBC programme *Watchdog* on 11 April 2007, Dr Merricks stated that the experience of the FOS suggested that one in five of those holding critical illness cover had policies which could be set aside for non-disclosure. Campaigns are being run on this issue by *The One Show* on BBC1 and by the *Daily Mail*. Both have reported a variety of individual cases. Jeff Prestridge, *Financial Mail* personal finance editor, has highlighted the damage caused to the reputation of the industry when enquiries are deferred until a claim is made [61]:

The right of insurers to "trawl" back through a claimant's medical records in this way is the unacceptable side of the insurance industry. Indeed, I think it is wholly counter-productive because by turning down valid claims, the insurance industry merely gives protection insurance a bad name. It puts most people off buying it.

This sustained bad publicity has an impact on the industry as a whole. In the eyes of the consumer no distinction may be apparent between those insurers which rely on the strict law and those which will not.

Do insurers need unfair rights?

The "Yucatan meteor" argument espoused by some suggests that reform would have a devastating impact on the industry – that the current law, whilst harsh, is necessary for the very survival of insurers. Would reform really carry such dangers? In commercial cases, it is not unknown for the consequences of any breach of the duty of disclosure to be modified or removed by a contractual term. Insurers apparently have no difficulty in dealing with this. On the consumer side there is also evidence that insurers can manage without such a duty. In a circular issued in December 1980 the Guardian Royal Exchange declared that it would no longer rely on the duty of disclosure in consumer non-life insurances [62]. In an explanatory letter to the *Post Magazine* in May 1981 Mike Harris, assistant general manager, took a typically robust approach [63]:

You cannot import into the way we handle bulk insurance products now the close contractual relationship derived from the time a ship or cargo owner dealt directly with an underwriter in a coffee house 300 years ago and bargained over a single voyage....

Defence of the traditional duty implies that although for many years we have handled hundreds of millions of transactions we still do not know all the right questions to ask. If this be so, then surely many of us should be seeking a living in some less demanding walk of life? I do not believe it is so.

In June 1984 the firm issued a further circular declaring that "basis of the contract" clauses would no longer be used [64]. This second circular contained a brief assessment of the impact of the first, concluding that there had been no apparent increase in the number of claims paid, but that there had been benefits for the firm's reputation [65].

More recently, in July 2007, Friends Provident announced that for critical illness claims where unrelated non-disclosure had occurred it would seek to make a proportionate payment [66]: A stronger alternative is being explored by LifeSearch, which is looking to arrange cover where as a matter of contractual term there would be no penalty for non-fraudulent non-disclosure [67].

What next?

The draft European directive was amended in 1980 [68] and finally withdrawn in 1993 [69]. Harmonisation of insurance contract law is still awaited some 27 years after the proposed directive was first put forward as a reason not to pursue domestic reforms [70].

Lobbying for change has continued. The National Consumer Council published a well-received report in 1997 setting out the case for the reform of consumer insurance contract law [71]. In an article in September 2000, Derrick Cole, vice president of the British Insurance Law Association, stated that there was “much discontent among insurance practitioners over the current state of insurance law” and indicated that the association would be conducting a review of the area [72]. The review was carried out by a subcommittee with what the Law Commission and Scottish Law Commission subsequently called “an impressive breadth of membership – academics, brokers, insurers, lawyers, loss adjusters, a self-regulatory body and trade associations”. A report was produced in the form of recommendations to the Law Commission. In the report the association stated that it was “satisfied that there is a need for reform” and argued that this should start with the implementation of the Law Commission’s 1980 proposals [73]. Lord Justice Mance contributed a foreword in which he declared that insurance law “is an area where distinguished commentators have long identified serious inequities which merit legislative attention”.

In 2005 the Law Commission and the Scottish Law Commission announced a review of insurance contract law. They later stated that the report by the British Insurance Law Association had been “a major factor in our decision to return to this area”. A first consultation paper, covering misrepresentation, non-disclosure and breach of warranty by the insured, was published in July 2007 [74]. Amongst other proposals this suggests that the duty of disclosure should be abolished for consumers and that the principle of proportionality should be adopted as one of the possible responses in cases of negligent misrepresentation. A further consultation paper is expected in 2008, with a final report and draft bill in 2010. The government will then need to decide whether time can be found in the parliamentary timetable for consideration of the commissions’ proposals.

As discussed above, there are insurers which do not rely on their strict legal rights when dealing with consumers. Instead, they provide fairer treatment for their customers, frequently by adopting the approach taken by the FOS. These insurers have little to fear from the reforms proposed in the first consultation paper. However, should they wait for the government to act or is there an interim step which could be taken immediately?

Such insurers surely have nothing to lose from putting their existing standards into a form which would contractually bind them. Indeed, if they could do so in a manner approved by consumer organisations and visible to consumers they would gain a positive marketing advantage. This would be a code, but one very different in nature to the statements of practice.

A model can perhaps be found in the establishment of the Insurance Ombudsman Bureau in 1981 [75]. The bureau was the first private sector ombudsman scheme. Mike Harris of Guardian Royal Exchange was the mastermind behind its genesis. After unsuccessfully arguing in various BIA committees for the establishment of an independent complaints organisation, he proceeded with the support of two other insurers [76]. Mr Harris recognised the importance of involving the Consumers’ Association and the National Consumer Council in the project. Indeed, he credits the former organisation with suggesting a key element of the scheme – a council predominantly comprised of public interest representatives [77].

Membership of the bureau was voluntary. In choosing to subscribe, insurers gave up the right to be “judge and jury” in their own cause – a right which had been criticised by the Law Commission in 1980. Mr Harris felt that Guardian Royal Exchange had nothing to fear. He was proud of its standards and felt that the pressure would be on those insurers which operated in a different way. The Insurance Ombudsman Bureau caught the public imagination, and gradually most of the non-members decided to join.

Could this approach work for a consumer code? As was the case with the BIA and the IOB, it is unlikely that the ABI could lead such an initiative. Whilst its support would be welcome, the ABI represents too broad a spectrum of insurers to drive through an innovation of this kind. Inevitably, it has to compromise to reflect the differing standards of its members. This problem is recognised by the ABI itself. In an internal paper, the ABI described the compromises that occurred in producing the General Insurance Claims Code [78]:

... the delays in introducing the Code vividly illustrate the realities of self-regulation. The original intention was for the Code to be made public in January 2000. As this date grew nearer, it became clear that the

bulk of the industry would not be able to meet the time periods specified in the code. ABI was faced with a choice of promulgating a Code which claims managers felt was unrealistic, and would therefore discount, or make changes in order to secure the "buy-in" of the industry. The latter option was seen as much more preferable. Once it becomes established, the standards might be raised.

On the other hand Which? (formerly the Consumers' Association) and the National Consumer Council would be invaluable allies. Some insurers may feel that working with consumer organisations is akin to supping with the devil. It appears that at the time the Insurance Ombudsman Bureau was being established both the consumer organisations and the insurers involved had similar concerns. However, all subsequently concluded that the co-operative approach had produced good results.

A number of objectives for a code may be identified:

- The code should be a spur to law reform – not an alternative. Its purpose would be to allow insurers to demonstrate their existing high standards and to allow consumers to select particular policies confident in the knowledge that those standards will apply. Insurers subscribing to the code should continue to press for law reform, applicable to all.
- The code should be legally binding. With annual policies this might be achieved by incorporating it into the terms of the contract. More ingenuity may be required to apply a code to long-term policies but the difficulties are not insurmountable.
- The provisions of the code should set high standards. It should be a bold initiative not a limp compromise. A starting point might well be the current proposals of the law commissions or the approach taken by the FOS.
- The assistance of Which? and the National Consumer Council should be sought in drafting the code. They have an invaluable perspective to contribute and their involvement would bring credibility to the project.
- There should be some form of quality mark which would enable consumers to see at a glance whether or not they will receive the benefit of the code if they purchase a particular policy.
- The code should be monitored by a standing committee of mixed industry and consumer group membership. Regular reviews should lead to amendments to the code if considered necessary.

Such a code could be put in place within months, whereas reform of the law is likely to take a number of years [79]. An insurer would not necessarily have to adopt the code for all lines of business at the same time. A staged approach might allow an insurer to assess the impact of the code and to take into account possible differences in particular lines of business. The experience of operating the code could be fed back into the law reform process – both as the law commissions' current review proceeds and in any parliamentary consideration of their final proposals.

Of course, for a code of this type to be established the industry needs another visionary like Mike Harris. Is there one out there?

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Notes

This paper is part of a wider research project being undertaken at the University of Manchester and states the position as known at 1 Nov 2007. My thanks to Saira Paruk of Quadrant Chambers for commenting on an earlier draft.

[1] The Marine Insurance Act 1906 is essentially a codifying statute.

[2] See, for example, the anomalies in the law on insurable interest in life insurance.

[3] *Carter v Boehm* (1766) 3 Burr 1905.

[4] Peter Tyldesley and Saira Paruk, *The Financial Ombudsman Service and general insurance* (London: CII Knowledge Services, 2007), available at www.cii.co.uk/knowledge/factfiles.

[5] See, for example, ICOB 7.3.6(2) and COBS 17.1.3(2)

[6] Further details are given later in the paper.

- [7] Financial Services and Markets Act 2000, s 228(2).
- [8] See, for example, *Ombudsman News*, issue 46 (2005).
- [9] ICOB 4.3.2(3) as at 1 Nov 2007.
- [10] Memorandum dated 11 Oct 1999 by David Leighton, then head of Legal and Fiscal Department at the ABI.
- [11] Law Reform Committee, *Fifth report: conditions and exceptions in insurance policies* (London: HMSO, 1957), Cmnd 62.
- [12] Law Commission, *Insurance law: non-disclosure and breach of warranty* (London: HMSO, 1980), Cmnd 8064.
- [13] Keith Long, "Unfair contract terms directive", *Journal* (British Insurance Law Association), no 87 (1995), p 72–78.
- [14] Gordon Borrie, *The development of consumer law and policy: bold spirits and timorous souls* (London: Stevens, 1984), p 110.
- [15] Peter North, "Law reform: processes and problems", *Law Quarterly Review*, v 101 (1985), p 338.
- [16] In 1985 the BIA combined with other industry bodies to form the ABI.
- [17] It is understood that the Department of Prices and Consumer Protection and the Office of Fair Trading were also involved.
- [18] *Hansard*, HC 4 May 1977, col 217–220.
- [19] Now Lord Clinton-Davis of Hackney.
- [20] John Birds, "The statement of insurance practice: a measure of regulation of the insurance contract," *Modern Law Review*, v 40, no 6 (1977), p 677–684.
- [21] The Life Offices' Association, Associated Scottish Life Offices and Linked Life Assurance Group.
- [22] There was a *Statement of industrial assurance practice*, but this was subsumed into the *Statement of long-term insurance practice* in 1986.
- [23] *Hansard*, HC 28 July 1977, col 641–644.
- [24] Memorandum dated 5 Mar 1979 by R Clarke, assistant secretary.
- [25] *Draft council directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts*, 5th revision, following the 24th meeting of the Working Group on Insurance Contracts, held on 21 and 22 June 1977.
- [26] Memorandum of that date to the under-secretary, copied to the assistant secretaries who headed the four branches within the DoT.
- [27] Law Commissions Act 1965, s 3(1)(e).
- [28] Now Sir Peter North QC.
- [29] Law Commission, *Insurance law: non-disclosure and breach of warranty* (London: HMSO, 1979), Working Paper no 73.
- [30] Memorandum dated 22 Jan 1979 by M J Starforth.
- [31] Para 160.
- [32] Para 57.
- [33] Minutes of the meeting approved by M Ingram of the DoT on 27 Mar 1979.
- [34] *Financial Times*, 25 Apr 1979.
- [35] *Guardian*, 26 Apr 1979.
- [36] *Financial Times*, 30 Apr 1979.
- [37] Letter from David Tench of the Consumers' Association, *Financial Times*, 3 May 1979.
- [38] Now Lord Janner of Braunstone.
- [39] *Hansard*, HC 19 Feb 1980.
- [40] *Hansard*, HC 4 July 1980.
- [41] My thanks to Mari Takayanagi, archivist at the House of Lords Record Office, for tracing the papers.
- [42] Law Commission, note 12.
- [43] For a summary, see p 106–114 of the report.
- [44] Memorandum dated 5 Nov 1980.
- [45] *Hansard*, HC 4 Nov 1980.
- [46] IOB annual report 1982.
- [47] *Hansard*, HC 28 May 1982, col 1199.
- [48] *Hansard*, HC 20 Jan 1983, col 188.
- [49] *Hansard*, HC 28 Apr 1983, col 376.
- [50] The DoT and the Department of Industry had merged.
- [51] *Hansard*, HC 28 Mar 1984, col 280–281.
- [52] *Hansard*, HC 25 Apr 1984, col 511.
- [53] *Hansard*, HC 20 Dec 1984, col 273–274.
- [54] Peter North, "Law reform: processes and problems", *Law Quarterly Review*, v 101 (1985), p 338.
- [55] *Hansard*, HC 21 Feb 1986, col 356–357.
- [56] A D M Forte, "The revised statements of insurance practice: cosmetic change or major surgery?", *Modern Law Review*, v 49, no 6 (1986), p 754.
- [57] *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341.
- [58] DoT memorandum from Apr 1979.
- [59] For example, there is no specific bar in ICOB on the use of "basis of the contract" clauses.
- [60] *Cuthbertson v Friends Provident Life Office* [2006] CSOH 74.
- [61] Jeff Prestridge, "A reputation that needs protection", *Financial Adviser*, 24 Sept 2007. Available at www.ftadvisor.com/dt_general.aspx?m=11195&amid=119720.
- [62] Circular GM/GLW/19/80 dated 3 Dec 1980.
- [63] S M F Harris, "Why wait for Godot?", *Post Magazine*, v 142, no 20 (1981) (letter to the editor).
- [64] Circular GM/GLW/6/84 dated 15 June 1984.
- [65] My thanks to Nick Feldman for copies of the GRE circulars.
- [66] News release dated 12 July 2007.
- [67] Helen Pow, "How do we kick non-disclosure to the kerb?", *Money Marketing*, 16 Oct 2007, available at www.moneymarketing.co.uk/cgi-bin/item.cgi?id=152227&d=340&h=341&f=342.
- [68] OJ 1980 C 355/30
- [69] OJ 1993 C 228/4 and 14
- [70] There are current developments in this area. In Dec 2007 it is anticipated that a group of European academics will

present the European Commission with draft Principles of European Insurance Contract Law under the Common Frame of Reference.

[71] National Consumer Council, *Insurance law reform: the consumer case for a review of insurance law: a report* (London: National Consumer Council, 1997).

[72] Derrick Cole, "Insurance: old law unfit for a new century", *Legal Week*, 7 Sept 2000. Available at www.legalweek.com/Articles/Article.aspx?liArticleID=101103.

[73] British Insurance Law Association, *Insurance contract law reform: recommendations to the Law Commission: a report of the sub-committee of the British Insurance Law Association* (London: BILA, 2002).

[74] Law Commission and Scottish Law Commission, *Insurance contract law: misrepresentation, non-disclosure and breach of warranty by the insured: a joint consultation paper* (London: Law Commission, 2007).

[75] Peter J Tyldesley, "The Insurance Ombudsman Bureau: the early history", *Journal of Insurance Research and Practice*, v 18 pt 2 (2003).

[76] General Accident Fire and Life Assurance Corporation and Royal Insurance Company.

[77] The suggestion was made by Rosemary McRobert, then chairman of the Consumers' Association.

[78] Leighton, note 10.

[79] Although the law commissions expect to complete their work in 2010, there is no certainty that there will be early consideration of their recommendations by Parliament.

The author

Peter J Tyldesley has worked for several insurers and as a consultant to the Insurance Ombudsman Bureau. From 2005 to 2007 he was a solicitor at the Law Commission. However, this article does not in any way represent the Law Commission's views, nor has the author made use of Law Commission records. Peter is currently a PhD student at the University of Manchester. He may be contacted at p.tyldesley@gmail.com.

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