TRANSPARENCY

Transparency of insurance contract terms
Pre-contractual information and good faith in negotiation

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It is impossible to resume in half an hour 34 national reports.

Please pardon me if my report is not exhaustive and mostly relies on examples.

Preliminary statement

Basic rules of insurance contracts are similar everywhere.

As noted by Marcel Fontaine, it is not difficult for a jurist expert to work his way through the subject in any legal system. In particular, we find everywhere the duty of disclosure of the insured.

This is not the case in the matter at hand, although the lack of transparency in insurance policies has been well known for a long time.

Many years ago, an aged layer told me that once, the first clause of a number of insurance policies began as follows: “This policy does not cover ….”.

However, the need to oblige insurers to the duty of transparency arose when insurance became a general service contract**,** in the last decades of the previous century.

The duty of transparency is usually provided for financial products and services and this regulation frequently applies to insurance investment products too.

The law providing for transparency in insurance contracts can be very different from country to country; in some countries, it is broad and detailed and in other countries, very poor or absent. This can happen for several reasons. First, because there are different rules for the protection of the weaker party in the insurance contract, like the control over insurance policies by the Supervisory Authority before they can be put on the market, or because the law either prohibits several terms that might be adverse to the insured or provides a large number of mandatory coverage requirements ("minimal terms"). However, a lack or a dearth of transparency rules may arise from a legal culture that is more orientated to contractual freedom.

Prior supervision by a regulatory body is generally required in Latin American countries and in several countries of different areas of the world (e.g. Turkey, Japan).

For instance, in Peru, the conditions of insurance policies have to be notified to the Supervisory Authority and prior approval is required whenever the Authority has stated the "minimal terms". In Argentina, all insurance schemes have to be previously approved by the Authority. In Colombia, prior approval of the policy text is required when the company is a new-comer or opens a new insurance branch.

In Turkey, General Conditions of Insurance are prepared and published by the Under-Secretariat for each specific insurance branch and are to be applied by all insurance companies in the same way.

Contractual freedom could be very restricted in the above-said legal system, because a number of mandatory clauses are frequently required by insurance contract law.

A systematic supervision by a regulatory body can enhance transparency for the policyholder, but it may jeopardize competition. On that account, according to EU legislation, Member States shall not adopt provisions requiring the prior approval or systematic notification of general and special policy conditions, in order to promote competition on the EU market.

Usually we can find many coverage requirements in civil law countries, including the EU member states, where a prior supervision over policies was in force until it was forbidden by subsequent EU legislation. A number of mandatory rules can interfere with innovation, particularly with the coverage of new risks arising from economic and technological development.

We can find transparency rules in general consumer protection law, which is common to most countries. It usually applies to insurance contracts too, but normally does not take into account the fact that insurance policies may be very complex and usually contain technical terms. This could make them difficult to understand, even by a customer who is not a "consumer". Hence the need of special transparency rules, at least for some kinds of coverage, and the need to apply general principles, like the good faith or similar clauses (fairness, honesty) in contractual relations, and the *contra proferentem* interpretation principle.

Good faith in the negotiation of insurance contracts is a principle common to most countries. It complies to a general duty of good faith in contractual relations (e.g. Italy, Germany) or it is limited to insurance contracts (e.g. in the UK, Australia and Hong Kong).

The *contra proferentem* interpretation is a common general clause too, although it sometimes only applies to consumer contracts.

Two final preliminary remarks.

In federal states, except for the United States of America, insurance contract law usually falls within the scope of competence of the central parliament and of the Supervisory Authority.

In the U.S., insurance law is governed by the States, with each State having authority over insurance-related activities within its borders or affecting its citizens and residents. There is a central insurance authority (National Association of Insurance Commissioners), which is entrusted with the role of assuring the adequacy of State regulatory systems by accrediting State regulatory authorities that meet specific accreditation standards, but it does not set State rules, regulations, and procedures.

Because of state-to-state differences, it is impossible to identify rules and regulations that apply throughout the U.S. Consequently therefore, Norma Levy relied on general principles that are common to most or all states, as well as on statutes, common law, and regulations of a particular state, and primarily of the State of New York.

In civil law countries many transparency rules are dictated by supervisory authorities, whereas, in common law countries, transparency is often governed by extra legal rules, like guidelines or codes of practice, issued by supervisory authorities or by insurers' associations. Normally these rules do not have force of law or are mandatory only for association members (the so-called self-regulation).

Transparency in insurance contract law

Transparency of the insurance contract means clarity and comprehensibility of each singular term and comprehensibility and exhaustiveness of the insurance cover on the whole. In other words, a contractual text

should be written in such a way as to enable the policyholder to be aware of all his rights and obligations.

In most European countries we find specific rules or court decisions on the matter at hand.

Some examples. Clauses laying down forfeitures, voidance, limitation of cover or costs to be borne by the insured are to be shown in highlighted characters, for example in bold or block letters (e.g. France, Italy).

The Greek Supreme Court ruled that a term is clear when it may not be reasonably questioned as for its meaning, that technical terminology be avoided (since they are not addressed as experts) and is allowed only when this is extremely necessary and no alternative equivalents are available.

According to a judgment of Poland's Court of Appeal, specialised linguistic terms only known to a small circle of people, like "insurance mathematics", when these are not explained anywhere in the contract, shall be avoided because they may enable the insurer to take arbitrary and unverifiable decisions on the benefits.

According to the UK's House of Lords, contractual terms must not contain pitfalls or traps. A similar prohibition is provided by the Italian Supervisory Authority: the term "guarantee" may be used only with reference to commitments given directly by the insurer; the term "guaranteed capital" may be used only in life policies minimizing the risk of loss of the capital (premium) invested.

The relevance of this rule was confirmed by life insurance policies linked to a Lehman Brothers bond, underlining that the bond was "guaranteed" by a parent company. Some policyholders were misled by this term.

Transparency rules are usually more detailed for life insurance policies, particularly with reference to technical provisions and financial

risks. Even more detailed rules are required for investment insurance products, particularly when they are under the supervision of a financial authority.

In common law countries transparency rules are generally focused on the insurer's pre-contractual duties, with some exceptions.

Some examples. In many U.S. States, the language used in insurance policies, or in some types thereof, must pass the Flesch Reading Ease test, which analyzes the contractual text to determine reading comprehension by grade level. Generally, the text should be "readable" for someone at an eighth- or ninth-grade reading level. According to New York State law, only policies with a Flesch Certification can be marketed.

New Zealand's Code of Conduct, to be followed by the members of the Insurance Council (a body that represents the interests of the insurance industry), requires that an insurer provide the insured with a copy of the insurance policy setting out, in plain English, what is insured, what is not insured and the insured's obligations.

Transparency in negotiation

In case of a complex insurance policy**,** the average policyholder might not be able to fully understand the contractual text, even when the insurer used his best efforts to draft terms and conditions as comprehensibly as possible. Hence the insurer's duty is to inform the policyholder on the features of the coverage prior to closing the contract.

Transparency in negotiations means the duty to inform and advise the policyholder prior to executing an insurance contract, to negotiate fairly (in good faith), to refrain from malicious or even merely reticent

behaviours, and to provide the other party with all information that is relevant to the execution of contract.

Insurance policies are usually marketed by intermediaries and in most countries transparency duties in negotiations are only provided for the intermediaries. However, it is the insurer that is the contractual counterparty of the policyholder and the contract is usually drawn up by the insurer. On that account, said duties frequently fall upon the insurer or both on the insurer and on the intermediary, although to a different extent.

Transparency in negotiations is more complex than transparency in contract law, firstly because it can include not only pre-contractual information about the coverage, but also the duties to advise and to inform the policyholder about conflicts of interests and to manage them in order to avoid any damage to the insured. Secondly because the duty to inform and the duty to advise should be performed according to the circumstances, which vary according to the type of coverage or the kind of customer.

Consequently, a number of questions arise that were thoroughly examined by Manfred Wandt and Jens Gal. According to German law, the insurer has to give to the policyholder pre-contractual information in a "timely manner" (*rechtzeitig*), an indefinite term that poses a set of queries. Furthermore, insurers could be induced to fulfil their duty to inform in a very formalistic manner, such as handing over voluminous information materials, more with the intent of covering themselves against any sort of liability than of informing the policyholder as effectively as possible. Hypertrophic information could confuse the policyholder.

It is quite impossible to solve these problems by legal rules. Only general principles can help, like good faith or fairness in negotiations.

The level of the duty of transparency in negotiations is usually different according to the risk covered. For instance, it is normally harder for an average policyholder to understand terms relating to life insurance. Moreover, there is a lesser need to require information from insurers when the policy covers a so-called large risk, because customers are normally professionally qualified undertakings.

Finally, prior supervision of insurance terms and conditions does not stand in for transparency in negotiations, because it does not serve an identical purpose. However, pre-contractual information could be presumed to be more necessary in legal systems in which contractual freedom prevails.

Indeed the duty of pre-contractual information was introduced in EU legislation with directives that forbid prior approval or systematic notification of policy conditions (Directives 92/49/EC and 92/96/EC, now 2002/83/EC), a measure that was previously in force in several European countries.

According to the above directives, the insurer shall disclose to the policyholder, who is a natural person, the law applicable to the contract and the arrangements for handling the policyholders' complaints including, where appropriate, the existence of a complaints body (e.g. an ombudsman), without prejudice to the policyholder's right to undertake legal proceedings. In addition, in the case of life insurance, the insurer shall disclose the basic features of the policy as listed in the directive. Further information can be required by the law of Member States, but "only if necessary for a proper understanding of the essential elements of the contract".

Some Member States require minimal information, as provided by the directives, while others have introduced rules that are much more

prescriptive. For instance, in Germany and in Italy, pre-contractual information about the features of the policy is also required for non-life insurance contracts.

According to the life assurance Directive, information should be given in writing. In several Member States, an information sheet must be provided according to a model issued by the Supervisory Authority.

The EU legislation at hand will very soon be modified in favour of the policyholder. According to a proposal for a new directive on insurance mediation (the so-called IMD2), now under scrutiny at the EU Parliament, much more information is required, in particular for life insurance policies and even more for insurance investment products. In addition, the information rules apply to anybody who markets insurance policies, including insurers' employees.

In Latin America, we find some insurer information duties only in a few countries, probably because of the existence of prior supervision of insurance terms of contract. However, we must take into account that the duty to inform can apply to intermediaries or at least to some categories. Moreover, the duty to inform is sometimes established at length in consumer contract law.

It is very difficult to summarize the insurer's duties in common law countries, because they arise from a number of sources of law, mostly extra-legal. It is sometimes not clear when such duties apply only to intermediaries or also to the insurer, as the supplier of the insurance products.

Some examples. In Singapore, the General Insurance Code of Practice provides that the insurer (or an intermediary) is obliged to explain all the main features of the products and services offered. Information duties

are also provided by the Monetary Authority for specific types of insurance products: life insurance, investment products, accident and health policies.

In the U.S., State laws generally impose duties on insurers to inform policyholders, which can vary to a greater or lesser extent, depending on the different type of policies. In New York, for example, information is required for life insurance, all types of Property and Casualty Insurance, accident and sickness policies.

In some countries, higher protection is granted to retail clients. In Australia an insurer has the obligation to provide retail clients with a Product Disclosure Statement which outlines the main benefits, features and terms and conditions of the insurance product.

In the UK, some basic transparency requirements are provided on long term insurances for all kind of clients (professional and retail), although additional obligations apply to retail clients. In any case, the amount of information will depend on the knowledge, experience and ability of "*a typical customer for the policy*", and on the complexity of policy terms and benefits.

Finally, the countries in the Far East.

In Korea, insurance companies' duties to inform apply to any type of insurance contract, and in Japan and Taiwan just to insurance investment products.

A duty to give the customer advice about the policy that is more appropriate to his needs usually falls upon insurance intermediaries and insurance consultants. However, in some countries, this duty is also upon the insurer.

This is what happened in the EU. According to the EU directive 2002/92 on Insurance Mediation, the duty to provide advice is upon intermediaries. However, in several member states, this duty also falls upon the insurer.

German law provides for a broad duty of the insurer to advise customers. The insurer, usually acting through his insurance agents, has the duty to query the customer about his wishes and give him objective advice. Both the query and the advice have to be documented and the documentation has to be provided to the policyholder. The extent of the duty to advise depends on the complexity of the insurance policy and on the situation of the policyholder.

The duty to query and advise is common to a number of EU countries (Belgium, Denmark, Finland, Greece, Hungary, UK, and Italy), sometimes only for particular types of insurance contracts (e.g. France).

In non-European common law countries, the duty to inform is generally provided only for some types of insurance policies: e.g. long-term insurance (South Africa), investment-linked polices (Singapore), annuity transactions (U.S.A).

The duty to inform the policyholder as to potential conflicts of interest between the insurer and the insured or between an intermediary and the insured is rather frequent. However, this duty more frequently falls upon intermediaries.

According to the EU legislation, the duty to inform about the conflict of interest is upon intermediaries. Notwithstanding, in some Member States, a similar duty also falls upon the insurer.

For example in Denmark, the insurer must inform the policyholder of the nature and the scope of a special interest before providing advice. Furthermore, the policyholder shall be informed if the insurer/employee receives a commission or other remuneration as result of providing products or services.

A similar duty is provided by the proposal of a new EU directive on insurance mediation, as mentioned above.

In Italy, the insurer also has the duty of avoiding conflicting situations; if the conflict is not avoidable, then the client has to be informed and give his consent and the insurer shall have to manage the situation in a way as to avoid any damage thereto.

In common law countries, an insurer's duty to disclose conflicts of interest can be provided for particular types of contract, e.g. life policies or investment-linked life policies (Singapore), or when dealing with an individual private policyholder (Hong Kong). In Australia, insurers of non-life and life insurance products who hold a Financial Services license must have in place arrangements to manage any potential conflicts of interest in order to minimize the potential impact that may arise with a client.

In Colombia as well the duty at hand is upon the insurance companies that are under the supervision of the Financial Authority.

A concluding remark

Transparency information in negotiations should neither make the marketing of insurance products too complex and expensive, nor should it be too detailed. It is widely known that long-winded information can distract the policyholder from the basic features of the coverage. In other

words, information should not only be clear but also proportional to the type of insurance contract and to the kind of customer.

It’s not easy to meet this goal in a market where distance selling is steadily increasing. Distance selling implies the standardisation of information and consequently a formalistic way of providing information.

However, a formalistic way of informing is consequent to the law, as it occurs in countries requiring an information sheet in line with the model issued by the Supervisory Authority. As noted by Marino Bin, a standard information sheet helps the policy seller, but it may entail a cost that is disproportionate to the benefit that can be drawn by the policyholder; a cost that, among other things, also indirectly falls upon the insured.