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Committee Secretariat
Economic Development, Science and Innovation Committee
Parliament Buildings
Wellington

Dear Committee Members,

ICNZ submission on the Fair Trading Amendment Bill

Thank you for the opportunity to submit on the *Fair Trading Amendment Bill* ('Bill'), which was introduced to Parliament on 17 December 2019.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

We wish to appear before the Committee to speak to our submission.

Please contact Andrew Saunders (andrew@icnz.org.nz) if you have any questions on our submission or require further information.

This submission is in two parts:

- Overarching comments
- Clause by clause comments on the Bill

Submission

Overarching comments

ICNZ supports improving outcomes for customers. This is why we introduced the Fair Insurance Code more than a decade ago and continue to update it, with the new Code commencing from 1 April 2020 including a strengthening of compliance and reporting obligations.

The Bill is part of a period of massive regulatory changes for financial services, and since we started working on this submission the COVID-19 crisis has emerged and created an extraordinary range of complexities and challenges for society and the financial services sector.

The provisions in the Bill come on top of conduct related changes being pursued through the *Financial Services Legislation Amendment Act* and its supporting instruments, the Review of Insurance Contract Law (which notably is comprehensively considering the specific unfair contract terms ('UCT') provisions applying to consumer insurance contracts) and the recent introduction of the *Financial Markets (Conduct of Institutions) Amendment Bill*. The result of all these reforms will be a series of conduct related and generally consumer focussed regimes. These regimes each however have a different basis and utilise different models and definitions and have different scopes and demarcations between consumer and small business, all of which add complexity.

The Insurance (Prudential Supervision) Act 2010 (IPSA) and solvency standards applying to insurers are also due to be reviewed over the next few years. Responding to and then implementing all this planned regulatory activity and change will have ongoing resourcing implications for financial services entities, creates uncertainty (until new regimes are fully developed) and will over the next few years require significant work to be undertaken on implementation (e.g. changes to systems and processes, review and changes to products, new or changed arrangements between entities etc.). It is recognised all these work programmes will likely be impacted by COVID-19 and a number of changes to timing have already been made, however, financial services entities will still be managing the aftermath of COVID-19 having diverted resources and re-prioritised business as usual activity to manage the crisis.

Introducing a prohibition on unconscionable conduct in trade

As we indicated in our submission on the early-2019 MBIE discussion paper[1], ICNZ is open to government introducing a prohibition on unconscionable conduct in trade where it operates against clearly unacceptable behaviour that may not be prohibited under existing provisions. We would however be concerned if such provisions began to intrude on robust commercial engagements or on what is already regulated by more targeted provisions, and support changes being made to focus any new provisions on egregious conduct not already controlled through the law and where a party has disadvantaged by the conduct.

Given the many matters that can be taken into account under proposed section 8, we recognise it will ultimately be the courts that will determine the meaning and application of unconscionability. Nonetheless the breadth of considerations provided in section 8 and the potential for varying applications of 'unconscionable' means this will introduce an unnecessarily high degree of uncertainty for business, at least until court decisions provide more clarity. We are concerned that the inclusion of section 8(1)(h) ('any other circumstance that the court considers relevant') introduces unnecessary subjectivity and uncertainty into the process and could encourage more speculative litigation. It is also unclear how the provisions in section 8(2) would relate to the unfair contract terms provisions in the *Fair Trading Act 1994* ('FTA') or other law such as the *Credit Contracts and Consumer Finance Act 2003* (i.e. in relation to new section 8(2)(e)).

[1] ICNZ's submission on the MBIE consultation paper 'Protecting businesses and consumers from unfair commercial practices' is available from https://www.icnz.org.nz/industry-leadership/submissions/.

The regime for unfair contract terms in standard form contracts should not be extended to non-consumer (i.e. small trade contracts) insurance contracts until after the review of insurance contract law

ICNZ does not support extending the FTA's existing protections against unfair contract terms in standard form consumer contracts to also apply to small trade (i.e. non-consumer) insurance contracts at this time. To be clear, the current law deems specific types of terms in insurance contracts to be reasonably necessary to be excluded from the FTA, but all other terms are captured by the law. In order to enable such terms to be considered and properly provided for in this context, any extension of the UCT regime should occur as part of the review of insurance contract law that is currently underway.

In our submission on the MBIE discussion document in early 2019 we outlined that we did not see there was a strong rationale for extending UCT protections to non-consumer insurance contracts as the terms of such contracts have not been identified as being an issue of particular concern and that attempts to pursue 'fairness' in this area through new legislative measures will inevitably come at a cost of increased uncertainty. We also stated, and still strongly consider, that if these protections were to be extended to some or all non-consumer contracts, there are specific factors associated with general insurance contracts that need to be provided for, and the most appropriate vehicle for considering these is as part of the current review of insurance contract law being undertaken by MBIE.

It is important to recognise that insurance contracts are fundamentally different to other contracts as the contract for the product and the product are, in effect, one and the same thing. Insurance contracts are also inherently asymmetric as the customer pays an amount to the insurer on the basis that in the unlikely event they suffer a defined loss, they could receive a much larger sum to compensate them (potentially a thousand times greater or more for some policies). There are a range of unique aspects of insurance contracts that need to be considered in the context of UCT regulation, including:

- Insurance contracts involve transfers of risk and pricing that risk, which is the basis of an insurer's promise to pay a claim (or claims), depends on finely calibrated actuarial assessments of uncertain events. Insurers use insuring clauses and contractual terms that provide benefits for the insured, to outline the risks they will accept. Insurers use exclusion clauses to outline the risks they will not accept. Both of these types of term are tools to define the risk.
- Unlike other standard form consumer contracts, in assessing the insured risk an insurer is dependent on the accuracy, completeness, and honesty of the information provided by the insured at commencement of the contract and during its life.
- The ability to control the payment and management of claims to ensure that the value of the claim is accurately assessed, and that claim resolution is managed efficiently, is critical for insurers and to providing cost-effective insurance for customers.
- Insurance contracts are generally for a period of one year and are renewed annually.

Each of the above matters is central to the provision of insurance because they affect an insurer's ability to accurately define the insured risk, price it and to manage the costs associated with claims. As well as the direct commercial effects of this, at an aggregate level these factors flow through to solvency requirements for insurers under the *Insurance (Prudential Supervision) Act 2010*.

The availability of insurance cover in New Zealand also depends on the provision of reinsurance by overseas international reinsurers to local insurers. Insurance product design is constrained by the risk appetite of reinsurers. The need for reinsurance affects the risks insurers can accept and also the limitations and exclusions that are included in insurance contracts. The potential for policy terms (particularly terms of a kind that have been standard in New Zealand and internationally for many years) to be overturned by a Court introduces uncertainty in this important area.

New Zealand is one of the riskiest countries in the world for the size of its economy (largely due to the level of exposure to earthquakes and other natural hazards). Ongoing reinsurance support is therefore critical. The onset of the COVID-19 crisis and its flow-on impacts to the global economy have also increased uncertainty to levels not known for several generations. It would be unwise and counter-productive for New Zealand to legislate in a way that could potentially discourage reinsurance support by increasing uncertainty and thereby risk.

The way insurance contracts are provided to businesses also have some unique features. Most are provided through insurance brokers (acting as agents of, and advisers to the insured and which will likely be licensed financial advice providers in future) and in some cases the wordings for the contracts are developed by the brokers rather than the insurers themselves. Where a transaction is intermediated by a licenced financial advice provider it does not seem logical for it to be considered a standard form contract within the scope of the UCT regime.

Additionally, insurance contracts provided to different sizes of businesses tend to utilise the same base wordings, which means that even with an appropriate scaled small trade exemption (see further commentary below) most will potentially be in scope, and so any requirement to review 'small trade' insurance contracts will have a much wider impact than on other sectors. Furthermore, in the insurance industry there in essence a multitude of so-called standard form contracts (because the contract is the product)[2]. This differs from other industries where you might only need one, or a small number of, standard form contracts for the different products you are selling. This in turn means the task of reviewing and amending contracts for insurers is a much bigger one.

At present, some types of terms in consumer insurance contracts are exempt from the consumer UCT regime (refer section 46L(4) of the FTA). The Bill would extend the UCT regime to standard form non-consumer insurance contracts under a specified threshold and subject to the same exemptions. As noted above the UCT provisions applying to insurance contracts are being considered in the ongoing MBIE-led review of insurance contract law, including specifically the nature and detail of these exemptions, and in late-2019 the Cabinet made decisions to change these. Two options for change to this aspect of the regime are planned to be consulted on further during 2020, both of which materially differ from the status quo in section 46L(4).

While we strongly support applying the current exemptions in section 46L(4) to non-consumer insurance contracts (in the event that the UCT provisions were extended to small trade insurance contracts), these exemptions do not assist in minimising the compliance costs and disruption associated with needing to review all policies for compliance with the UCT provisions. Regardless of whether the exemptions in section 46L(4) are provided, extending the UCT regime to non-consumer insurance contracts through this Bill will therefore impose major costs on insurers and cause disruption for insurance brokers and customers, all of which will likely need to be repeated soon after when the review of insurance contract law is given effect to through revised UCT provisions, should these apply to all insurance contracts. Noting that if they are not, there would be two regimes for

[2] For example insurers will commonly have 'standard' policy wordings for a full range of business risks across many topics including material damage to property, business interruption, contract works, machinery breakdown, cyber insurance, rural insurance products, commercial motor insurance, marine insurance, statutory and other liabilities, professional indemnity, corporate travel and more.

different types of insurance contracts and so it would be necessary to at least consider non-consumer insurance contracts at that later time in any case.

The costs and disruption resulting from all insurers being required to twice revise all their standard form non-consumer insurance contracts across all product lines (e.g. property, liability, motor, corporate travel, marine etc.) at the same time as implementing financial advice reforms and preparing to implement conduct law and changes to solvency standards would be an unacceptably high, and unnecessary, regulatory burden. This situation has been exacerbated by the additional pressures of moving into the more restrictive and uncertain COVID-19 operating environment.

We recognise the second review of such insurance contracts (i.e. following the review of insurance contract law) is likely to require greater change than the first. Nonetheless to review, update if necessary, and then distribute all standard form commercial insurance contracts against the current standard in section 46L(4) of the FTA, which is then replaced within a year or two, would be highly wasteful, provide limited benefits to customers (as likely changes would be limited and would probably apply for only a year or two and potentially less) and potentially create customer confusion and uncertainty.

For these reasons we strongly consider that the specifics of any extension of UCT provisions to business-to-business insurance contracts must be considered and implemented through the review of insurance contract law rather than via this Bill. To give effect to this we recommend either that:

- non-consumer insurance contracts are exempted from new section 26C entirely**,** with these to be included within a UCT regime only once the review of insurance contract law is complete **(preferred option)**; or
- make regulations under new section 26E to exempt non-consumer insurance contracts on the same basis.

Delaying the extension of UCT provisions to non-consumer insurance contracts until the conclusion of the review of insurance contract law would enable the specific aspects of insurance to be considered and provided for. It also avoids doubling the regulatory impact of this change at what is already a time of major disruption due to COVID-19 and with a number of other regulatory changes planned for coming years. While this would delay these protections being extended, we note that issues with standard form non-consumer insurance contracts have not been identified as being an issue of particular concern. Also and importantly, non-consumer contracts are generally brokered, that is, an experienced insurance professional acting on behalf of the insured manages the contractual arrangements with the insurer.

The proposed threshold for small trade contracts does not work for insurance contracts

If insurance contracts are not exempted from the UCT provisions being extended to small trade contracts at this time (notwithstanding that we consider such an exemption to be necessary), we support a threshold for smaller contracts being applied. In general terms a transaction value threshold places the onus on small businesses to undertake due diligence for high-value transactions (largely avoiding a moral hazard situation occurring where a small business relied solely on the UCT protections rather than undertaking due diligence) and is more transparent/certain to the parties to the contract.

Insurance contracts are based on commonly understood principles and use similar wordings (terms, exclusions etc). Consequently, essentially standard form insurance contracts are provided to different size businesses. This means the threshold for small trade contracts is arguably less relevant but the general treatment by the regime even more so. Nonetheless in principle any regime should be designed to apply fairly across different sectors and the proposed threshold in new section 26D does not work sensibly for insurance because the value does not correspond to small trade insurance pricing. There are various reasons to treat general insurance contracts differently from other contracts in terms of a transaction value threshold for demarcating small trade contracts.

First, it is difficult to identify a meaningful monetary distinction for small trade insurance contracts, as either the premium paid annually or the sum insured could arguably be used. For a small business insurance contract the annual premium would commonly be a number of thousands of dollars per annum whereas the sum insured might be tens or hundreds of thousands per annum for a vehicle or equipment but would easily be one million or more for a policy with liability protections for example. There can also be different sums insured or sub-limits within a single policy. Further complicating matters, and the application of the 'trading relationship' concept to insurance, businesses will often through an insurance broker have in place a number of insurance contracts for different risks (e.g. damage to property, public liability, business travel etc.) that are placed together as a suite, but which might be with a number of different insurers.

Given the differing nature and sums insured for insurance contracts (e.g. material damage vs public liability policies) it would be impractical to set a sum-insured level that sensibly represents a demarcation. For example, $10 million is a common level for liability insurance, even for SMEs, but would represent a significant value for a material damage policy.

For using a contract-based measure for the threshold, we consider that premium is the more logical approach of the two and this accords with how 'trading relationship' has been defined in proposed section 26D. However, if the premium were relied upon with the standard threshold level, few (if any) small business policies would get even close to the value threshold of a 'trading relationship' of more than $250,000 per annum, and this level would include insurance for some quite substantially-sized businesses. The result would be that virtually all business purchasers of general insurance policies would be included (including many large businesses), which would be inconsistent with the policy objective of applying the regime to 'small trade contracts' and mean insurance was treated inconsistently to other sectors.

Even this more logical approach is not without its complications. Some insurance policies, like motor and commercial property material damage attract a Fire and Emergency New Zealand levy. In the case of commercial property insurance, the levy is uncapped and can at times exceed the value of the premium. Broker commissions will also be included in the premium that the end customer sees. So, it is unclear if a premium paid approach was applied whether that would be the actual premium the insurer charges for the risk it takes on or the total amount the insured pays.

To act as a relevant demarcation between small and larger businesses, an annual premium based threshold would need to be much lower than the proposed $250,000 per annum provided in new section 26D for all small trade contracts. While recognising that any threshold is ultimately arbitrary, we consider that a threshold of $5,000 per annum in premium would be a much more appropriate demarcation for small trade contracts. Our members indicate that insurance contracts provided to small businesses will generally be under this level, with many being under $2,500.

We note there are also other issues with setting a threshold using insurance premiums that need to be considered and these would be better able to be considered in the review of insurance contract law. There are also issues noted above with what makes up the total premium paid, as for example:

- given the contract is between the insurer and the customer do you count the commission paid to an insurance broker acting as an intermediary (i.e. agent of and adviser to the insured),

- recognising that most non-consumer insurance contracts are placed through an intermediary and the commission could be a quarter or more of the price paid by the customer; and
- whether to include government levies collected by the insurer and paid to government, for example the Fire and Emergency New Zealand Levy?

The above are not trivial issues in the context of a threshold as for some property insurance contracts these could potentially equate to perhaps half the consideration paid to the insurer by the customer.

A further reason why it is not ideal to use premiums paid under a contract to determine application of the UCT provisions is that premiums reflect the level of risk, not the size of business paying for the insurance contract, and so the premium paid is not necessarily a direct indication of the size or sophistication of the business.

Given all this we have therefore considered alternatives to using contract-based measure, for instance using a customer's annual turnover, to better demarcate between smaller businesses and larger businesses. This would avoid some of the issues identified and better demarcate business size and sophistication, however, it would have other issues (e.g. uncertainty as insurers don't usually have turnover information) and would make the approach to insurance contracts fundamentally inconsistent to other sectors where a turnover measure could apply but has not been preferred. The challenge of applying a threshold approach that makes sense for insurance but remains consistent with the treatment of other sectors further reinforces the importance of separately considering insurance contracts through the review of insurance contract law being undertaken by MBIE.

There are also other practical issues with the approach to the threshold proposed in the Bill, such as the implications of the application of section 26D(2) and the 'substantially same terms' concept – how for instance would this apply in the context of a suite of different insurance covers/contracts (assuming they are with the same provider)? Such issues further illustrate why it would be more appropriate to consider the treatment of insurance contracts specifically through the review of insurance contract law.

Finally, we are concerned that no matter which threshold is chosen it will be yet another one for entities to apply and monitor on top of various existing consumer/non-consumer, retail/wholesale client distinctions under different pieces of existing and proposed legislation (e.g. *Financial Markets Conduct Act 2013*, *Financial Markets (Conduct of Institutions) Amendment Bill*, *Credit Contracts and Consumer Finance Act 2003* etc.).

Clause by clause comments on the Bill

Clause	ICNZ comments	Recommendation
New section 7 (unconscionable conduct)	Refer to comments in Part 1 of this submission above on 'Introducing a prohibition on unconscionable conduct in trade'.	Note comments.
New section 26C (Definition of small trade contract)	As outlined above in Part 1 of this submission, the treatment of insurance contracts by the UCT regime in the FTA is already being reconsidered in the current review of insurance contract law being undertaken by MBIE. The extension of UCT provisions to standard form business to business contracts should await the conclusion of that review to ensure insurance specific aspects can	Either: • non-consumer insurance contracts are exempted from new section 26C entirely, with these to be potentially included within a UCT regime once the insurance contract law

Clause	ICNZ comments	Recommendation
	be considered and to avoid the unnecessary costs and disruption of insurers having to review and potentially update all their standard form contracts twice in a short period of time.	review is complete (**preferred option**); or • make regulations under new section 26E to exempt insurance contracts on the same basis.
New section 26D (Small trade contracts: trading relationship, annual value threshold, and other definitions)	As outlined in Part 1 of this submission above, the standard annual threshold is uncertain and inappropriate in relation to insurance contracts. If insurance contracts are made subject to the Bill, and we consider they should not be, a threshold that makes sense for insurance contracts should be applied, and this would most logically apply to the annual premium paid and set a threshold of $5,000 for this. Beyond the specific issue of insurance contracts we note more generally that providing it is the value at the time the relationship 'first arises', will make this hard to track for larger organisations with many customers on similar contracts that change in value over time, potentially over many years where there are ongoing relationships. We also consider that it would be more logical that if a contract starts as a small trade contract and at any time later the value exceeds the threshold then it should no longer be considered a small trade contract (we therefore also don't agree with the application illustrated in Example 3), particularly given the uncertainty on what 'substantially similar terms' means, noting many business relationships extend for many years. It is possible for example in procurement contracts for the value to be small initially and then develop to be worth several million dollars, e.g., IT contract where initial scoping work is low value, but then its determined to proceed and the value becomes much higher, often into the hundreds of thousands or millions. This approach is more practical to administer over time without having to look back potentially many years to when a contract (or predecessor contract) was first entered into to establish whether a specific relationship is above or below the threshold. It would also be useful to clarify whether the values provided in new section 26D include or exclude GST.	If insurance contracts are not excluded, then add a new subclause into new section 26D providing that for insurance contracts the annual threshold is to be based on whether the premium paid exceeds $5,000. Remove the concept of 'first arises' from sections 26C and D. Remove example 3. Clarify whether the values in section 26D include GST

Conclusion

Thank you again for the opportunity to submit on the Bill. If you have any questions, please contact our Regulatory Affairs Manager by emailing andrew@icnz.org.nz.

Yours sincerely,

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Chief Executive

Andrew Saunders
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