SOME REFLECTIONS ON CONSUMER PROTECTION AND THE REQUIREMENT OF ANTICIPATING BEHAVIOUR OF A PRUDENT INSURER

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Abstract

Insurers are increasingly reminded of the fact that they are the professionals in situations where the insured risks becoming victim of the fact that he is a layperson, and may lose his insurance coverage unless the insurer takes positive action. This paper sets out some instances in which such positive action should be required from a prudent insurer, such as a duty to warn or inform the policyholder/insured, and the consequences for the insurer if he does not fulfil these duties.

Keywords: the social function of private insurance; a proactive approach of a prudent insurer; a duty to warn and to inform

1 A Growing Emphasis Is Placed on the Social Function of Insurance

In fact, private insurance forms part of a system of social security. Consequently, it has become increasingly important not only to judges – but also to legislators – that, when they consider insurance, this social function is preserved. As early as 1928, the Dutch legal scholar Dorhout Mees characterised the social function of indemnity insurance as follows: 'Indemnity insurance is the means by which the insured can place the risks of everyday life or of his business, the possible financial consequences of which he is unable or unwilling to bear, on the shoulders of another, the insurer. Thus, insurance makes businesses and undertakings possible which people would not otherwise dare to start'.[1]

There may not only be *freely chosen* risks at stake, but also risks which inevitably affect everyone. Consider the need for care as a result of disease or after an accident. Since it is a key responsibility of a government to secure the availability of an adequate level of health insurance, where a choice is made in favour of a private health insurance system on a compulsory basis, the legislator must, at the same time, guarantee that the benefits specific to the social insurance law will also apply to the private system. This implies that the private insurance system is embedded in major conditions of public law and, at the same time, that the basic principles of private insurance law apply as long as these principles do not interfere with the major conditions of public law.[2] As a consequence of this, the aleatory character of private health insurance in the Netherlands (Art. 5(5)), as well as the basic principle of private insurance law that there should be no coverage for damage intentionally caused by the insured (Art. 15(2)), are abandoned.

Insurance offers the private individual security by transferring the risks that a person takes, and which he is unable to bear himself, onto a group. If an insurer refuses cover, he disrupts this risk transfer mechanism and frustrates the social function of insurance. There is no need to spell out the severe consequences. For this reason, practice shows that the legislator, as well as the judge, stipulate (additional) conditions and limitations to the honouring of a rejection of a claim by an insurer in all fields of private insurance.

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[1] T.J. Dorhout Mees, *Schadeverzekeringsrecht* (1928), at 1.

[2] See for a private health insurance system imposed on a compulsory basis with an obligation of acceptance, the Dutch *Zorgverzekeringswet*. See N. Frenk, 'De Zorgverzekeringswet: sociale zekerheid langs privaatrechtelijke weg', in D. Busch and H.N. Schelhaas (eds.), *Vergelijkender Wijs* (2007), at 167-180.

There are four developments which are, in this respect, characteristic of the growing significance of the social function of insurance, namely:

- It demands positive action on the part of the insurer to protect the policyholder/insured;
- It limits the insurer's freedom of acceptance;
- It demands special justification for the lapse of a right to payment;
- Where the policyholder/insured fails to perform his obligations, it demands sanctions which, as far as possible, ensure the continuity of the contract;

Most of these developments are dealt with in The Principles of European Insurance Contract Law (PEICL), which were set up as an optional instrument, providing mandatory rules on behalf of the parties to a (cross border) contract of insurance and were established by the Project Group Restatement on European Insurance Contract Law, which was founded in 1999 by the late Prof. Fritz Reichert Facilides.[3]

2 The Insurer Is Increasingly Required to Adopt a Proactive Approach Towards Protecting the Interests of the Insured

In this paper we will focus on the first of the developments set out above. One of the most important aspects which have the greatest impact in this respect is that insurers are increasingly reminded of the fact that they are the *professionals* in situations where the insured could potentially become a victim of the fact that he is a layperson and thus risks losing his insurance coverage unless the insurer takes positive action.

Below are some examples of these situations:

I. The guiding function of a prudent insurer at the conclusion of a contract of Insurance

When an insurance contract is concluded, the professional insurer normally knows what information is relevant to an appraisal of the risk while, generally speaking, the policyholder has no knowledge or experience with respect to risk-assessment. This justifies placing the burden of acting as a *guide* on the insurer. In principle, the questionnaire that the insurer has drafted should set the limits of the insured's duty of disclosure. (….) This approach, which is called *the question method*, has been adopted in most European countries and is reflected in paragraph 2:101 PEICL which reads:

> When concluding the contract, the applicant shall inform the insurer of circumstances of which he is or ought to be aware, and which are the subject of clear and precise questions put to him by the insurer.[4]

II. The insurer shall provide the prospective policyholder, before entering into the contractual relationship, with all relevant information needed in order to check the prospective contract and reach an informed decision based upon comparison of a wide range of alternatives

It is not only the insurer that must have relevant information in order to assess whether, and under what conditions, he will conclude an insurance contract. At an earlier stage, the prospective policyholder also should be entitled to be provided with adequate information in order to be able to make a well-informed decision as to whether the

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[3] See the 'Introduction to PEICL' in J. Basedow et al. (eds.) *Principles of European Contract Insurance Law (PEICL)* (2009), at xlix ff and the website <http://www.restatement.info>.

[4] See id., at 78 (C3).

insurance product fits his needs. This right to be informed before taking out an insurance contract originates from EEC Insurance Directives and is laid down in paragraph 2:201 PEICL[5] which reads:

1) The insurer shall provide the applicant with a copy of the proposed contract terms as well as a document which includes the following information if relevant:
   a) the name and address of the contracting parties;
   b) the name and address of the insured and of the beneficiary;
   c) the name and address of the insurance agent;
   d) the subject matter of the insurance and the risks covered;
   e) the sum insured and any deductibles;
   f) the amount of the premium or the method of calculating it;
   g) when the premium falls due as well as the place and mode of payment;
   h) the contract period and the liability period;
   i) the right to revoke the application or avoid the contract in accordance with Article 2:303;
   j) the law applicable to the contract or, if a choice of law is permitted, the law proposed by the insurer;
   k) the existence of an out-of-court complaint and redress mechanism for the applicant and the methods for having access to it;
   l) the existence of guarantee funds or other compensation arrangements.
2) If possible, this information shall be provided in sufficient time to enable the applicant to consider whether or not to conclude the contract.
3) (…)[6]

The list of information to be provided to the policyholder is very extensive, particularly when compared with the requirements listed in the EC Directives. In this respect, an additional point should be considered: in order to determine the borders of *adequate information*, one should be aware that an overload of information may have a counterproductive effect on the decision-making process.[7]

Section 2 of paragraph 2:201 emphasises that, in principle, the information should be provided before the conclusion of the contract. By adding the phrase 'if possible', it takes into account that, in some cases, it will not be practically feasible for this to happen. Examples of such circumstances could include insurance contracts concluded by telephone or by vending machine (travel insurance at the airport). In normal instances, one of the major goals of providing pre-contractual information as early as possible is secured: the option to make a well-informed choice of product based upon a comparison of a wide range of alternatives. This option disappears in a system where – without any restriction - the insurer is always allowed to provide the required *precontractual* information after the conclusion of the contract together with the delivery of the policy, on the condition that the policyholder is granted a cooling-off period to reconsider his

[5] Par. 2:201 PEICL is modeled on Directive 73/239/EEC (as amended), Directive 2002/83/EC and Directive 2002/65/EC.

[6] Basedow et al., above n. 3, at 92 ff.

[7] M. Ebers, 'Information and Advising Requirements in the Financial Services Sector: Principles and Peculiarities in EC Law', 8 *Electronic Journal of Comparative Law* 2, (2004). See also F.M.A. 't Hart and C.E. du Perron, *De geïnformeerde consument – Is informatieverstrekking een effectief middel om consumenten afgewogen financiële beslissingen te laten nemen?, preadvies Vereniging voor Effectenrecht* (2006), at 37 ff.

choice.[8] We do not support this approach and, in addition, one may doubt whether this approach accords with European legislation, particularly Directive 2002/83/EC on life insurance and Directive 2002/65/EC on Distance Marketing. The first Directive makes clear its position regarding the provision of the option to compare alternatives in its preamble (Recital 52):

> In an internal market for assurance the consumer will have a wider and more varied choice of contracts. If he/she is to profit fully from this diversity and from increased competition, he/she must be provided with whatever information is necessary to enable him/her to choose the contract best suited to his/her needs. This information requirement is all the more important as the duration of commitments can be very long.

On the basis of the second Directive, the European Commission started infringement proceedings against the Netherlands because of an inadequate transposition of Directive 2002/65/EC concerning the distance marketing of consumer financial services into its national law. Illustrative is the following citation from an EC Press release:

> Directive 2002/65/EC concerning the distance marketing of consumer financial services grants consumers, amongst other things, the right to receive certain pre-contractual information, as well as the right to withdraw from a contract with a service provider within 14 calendar days.
>
> A consumer in the Netherlands, who has concluded a contract over life insurance, indemnity insurance or funeral service insurance, might only be provided with essential information on his contract at the moment the policy is issued. The Directive, however, foresees that he is provided with certain information in good time before he is bound by a contract or offer.[9]

III. The need for anticipation of a prudent insurer of the forgetfulness and nonchalance of the insured

A professional insurer must be prepared for the forgetfulness and nonchalance which may affect even the *prudent insured*, and which may jeopardise the security of coverage. We believe that it is the responsibility of a prudent insurer to anticipate this type of behaviour, and to take precautionary measures on behalf of the insured to neutralise the harmful effects of this forgetfulness and nonchalance. (…)

This is why - for example - where a policyholder *forgets* to pay renewal premiums after receiving the invoice, the insurer is required to send a second, separate reminder before suspending cover for non-payment. (…)

This requirement to give warning before the forfeiture of coverage is well-known in the majority of European states' legislation on insurance contract law[10] and is also explicitly laid down in paragraph 5:102 PEICL which reads:

> *Subsequent Premium*
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> (1) A clause, providing for the insurer to be relieved of its obligation to cover the risk in the event of non-payment of a subsequent premium, shall be without effect unless
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> (a) the policyholder receives an invoice stating the precise amount of premium due as well as the date of payment;
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> (b) after the premium falls due, the insurer sends a reminder to the policyholder of the precise amount of premium due, granting an additional period of payment of at least two weeks, and warning the policyholder of the imminent suspension of cover if payment is not made; and

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[8] See The Netherlands (Art. 4:20 WFT, jo 61 and 63 Bgfo).

[9] EC Press release IP/10688 3 June 2010.

[10] See Basedow et al., above n. 3, at 198-199 and, in particular, for Belgium, Art. 15(3) WLVO, for France, Art. L 113-3 C. des Ass., for the Netherlands, Art. 7:934 C.C., and for Germany, Art. 38(1) VVG.

(c) the additional period in requirement (b) has expired without payment having been made.

(2) The insurer will be relieved of liability after the additional period in para. 1 (b) has expired. Cover will be resumed for the future as soon as the policyholder pays the amount due unless the contract has been terminated in accordance with Article 5:103.

IV. The need to forewarn the insured against the temptations of fraud

Combating insurance fraud has increasingly been given priority within the insurance industry and the importance of *this struggle* is recognized by the legislator. As is explicitly stated in paragraph 6:102 (3) PEICL, the insurer shall not be obliged to pay the insurance money in the case of a fraudulent breach of the duty to cooperate with the insurer at the occurrence of an insured event. This paragraph reflects the general approach in all European countries.

A fraud is very often limited to just part of a claim for indemnity, particularly in cases of theft. In these circumstances the question arises as to whether this *partial* cheating always has the effect of negating all entitlement to benefits or, if not, under which circumstances this far-reaching sanction will not be justified. The PEICL does not refer to this type of *partial* cheating, which in our view proves that it does not leave room for *partial* payment. This is in line with the strict approach adopted under Belgian[11] and English law, which is based upon the principle of *fraus omnia corrumpit*. This is an approach which we support, because it provides an incentive for honesty.[12] Along this line of reasoning, we refer to Clarke, who, citing Lord Hobhouse in the Star Sea-case stated: 'The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain, if it is unsuccessful, I will lose nothing'.[13]

The next relevant question should be whether, given these far-reaching sanctions and the insurers' knowledge that, by nature, many people are inclined to commit small-scale types of insurance fraud (e.g. the loss of sunglasses under a travel insurance policy), a prudent insurer should explicitly provide a warning in its claims form detailing the serious sanctions imposed in cases of proven fraud. As far as we know, this duty to warn has not yet been adopted. Concerning the above question, we are inclined towards positive answer. However, at the same time, we do not wish to argue that an insurer who fails to warn should be deprived of his right to decline the fraudulent claim. This would constitute unjustified interference. However, a failure to warn could be taken into account as one of a number of relevant factors in assessing if a fraud justifies the loss of all entitlement to benefits.

V. The guiding function of a prudent insurer to specify in the policy the kind of aggravation of risk that he requires to be notified of by the policyholder

It is quite common that the policy contains a clause concerning aggravation of the risk insured, which requires notification of an aggravation. In most cases, particularly with consumer policies, the policyholder may be ignorant of matters that might influence the insurability of the risks covered. A prudent insurer should be aware of this ignorance and should act as a *guide* to the policyholder. This means that he should indicate in the policy clause which types of aggravation he wishes to be informed about. In fact the position of the policyholder here is comparable to the one he is in at the moment of applying for an insurance contract. As it is generally accepted that the prudent insurer at

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[11] See Art. 21 (2) BLVO.

[12] See for a more lenient approach Germany par. 28 (3) VVG and T. Langheid and M. Wandt, *Munchener Kommentar zum Versicherungsvertragsgesetz, Band 1* (2010), at 1341 ff. Art. 7:941 (5) Dutch C.C. stipulates a full lapse of payment in cases of fraud, when the fraud is not serious enough to justify a full lapse. However, the latter will not often be the case, as the Dutch Supreme Council has expressed very clearly that the mere fact that the fraud relates only to a small part of the entire claim does not set aside a full lapse (HR 3 December 2004, NJ 2005, 160).

[13] [2003] 1 AC 469. M.A. Clarke, *The Law of Insurance Contracts*, (2009), at 27-2c1.

that time has *a guiding function*, it is quite remarkable that, as the PEICL-project group has established,[14] a rule which elaborates this function in the field of aggravation of risk is not common in the national law of insurance in most European countries. Thus, the PEICL provides a safeguard in this respect and, more specifically, in paragraph 4:201, which reads: 'If the insurance contract contains a clause concerning aggravation of the risk insured, the clause shall be without effect unless the aggravation of risk in question is material and of a kind specified in the insurance contract'.[15]

VI. The duty of a prudent insurer to warn the insured as soon as he becomes aware of circumstances whereby the insured is not aware that he may actually have lost, or risks losing, his coverage (wholly or partially)

There is a growing trend towards imposing on the insurer a duty to warn as soon as, on the basis of his professional knowledge and experience, he is aware that the inexperienced policyholder does not recognize certain circumstances as a threat to the preservation of coverage. In such instances, a duty to warn should protect the insured against an imminent loss of coverage. Illustrative of this are the following three cases which are linked to policy clauses.

Firstly, there is the situation whereby a policyholder decides to transfer the risks insured under liability insurance on the basis of claims made to another insurer. The new insurer will accept coverage, provided that the claim of a third party is submitted against the insured for the first time during the period of insurance, and is reported in writing to the insurers during this period of insurance. However, the new insurer will *not* accept coverage if the policyholder or the insured had knowledge of the claim, or of circumstances from which an actual imminence of the reported claim could have been inferred, at the time the insurance was taken out.[16] The policyholder is indeed very often aware of such circumstances, but neither realises that he has no coverage under the new policy in respect of claims which stem from these circumstances, nor that he has to report these circumstances to the *old* insurer at the moment of transfer in order to secure coverage under the *old* policy for claims which materialise after the transfer. An example could be lead poisoning claims made against a painting company by employees who worked with lead-based paint for several years; although such claims are submitted and reported after the transfer, they are already imminent before. In these cases, a duty to warn at the moment of transfer would seem obvious and, in our view, this duty should rest on the *incoming* insurer, as the new policy will not cover the claim (thus resulting in a coverage limitation of a *serious* nature).

Secondly, there are cases in which limitation of action clauses may be invoked by the insurer. A professional insurer should take account of the reluctance of an insured to take (expensive) legal action as a last resort in circumstances where the insurer has definitively refused to pay a claim. Often the insured will continue to believe, against his better judgment, that it will be possible to reach an amicable arrangement and will disregard the contractual time limit generally included in the policy (which provides that any right to payment under the policy is lost if a summons has not been issued against the insurer within six months). It is up to the insurer to protect the insured from this and explicitly point out this clause as soon as he definitively refuses to pay a claim.

The last case refers to a situation in which the insurance policy contains a clause which ends the coverage as soon as a particular circumstance occurs and/or a condition precedent to the liability of the insurer is not fulfilled (promissory warranty). It is our view that, in such instances, there should also be a duty on the insurer to warn the insured as soon as he becomes aware of the occurrence of such a circumstance or the

[14] See Basedow et al, above n. 3, at 183.

[15] In France, a similar limitation to the duty to notify in 'circumstances aggravantes spécifiés dans la police' in Art. L 113-2 (3) C. des Ass. was deleted by loi du 31 décembre 1989.

[16] Illustrative is the following description of *circumstances*: one or more facts from which an actual imminence of a *claim* can be inferred. For these purposes, such facts shall constitute concrete information supplied by the *insured* detailing the *act, or failure to act*, which may give rise to the *claim* and the party from whom the *claim* may be expected.

non-fulfillment of such a condition. This applies particularly when the insurer should be aware of the fact that it is more than likely that the insured will not link the occurrence of such a circumstance, or the non-fulfillment of such a condition, with the loss of coverage. An example could be a motorcar policy which ends coverage as soon the motorcar is habitually based abroad.

In all cases mentioned above, the question arises as to whether the duty of the insurer expires on the sole ground that the insured is assisted by an independent insurance intermediary. By way of a general rule, we are inclined to answer in the negative. We are dealing with a basic obligation of a professional, fully-experienced insurer towards a non-professional, inexperienced insured. However, we leave room for an affirmative answer if the activity of the agent is not limited to merely providing assistance in taking out the insurance, but also comprises a continuous programme of risk management on behalf of the insured.

A clear example of a case in which one may argue that it is up to the legislator to impose a duty to warn concerns the doctrine of non-disclosure at the time of the conclusion of a contract of insurance and, more particularly, a situation in which the insurer discovers, during the lifetime of a policy, that the policyholder failed to properly fulfill his duty of disclosure when he took out the insurance. The need for a duty to warn, and to make clear to the policyholder the consequences of a breach of his duty of disclosure, is recognized in the national insurance laws of most European countries,[17] as well as in paragraph 2:102(1) of the PEICL which reads:

> (1) When the policyholder is in breach of Article 2:101, subject to paras. 2 to 5, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract. To this end the insurer shall give written notice of its intention, accompanied by information on the legal consequences of its decision, within one month after the breach of Article 2:101 becomes known or apparent to it.

3 Closing Remarks: The Legal Classification of the Duties to Warn

A final question concerns how to classify the duties to warn, as set out above, in the legal framework of civil law. Characteristic of these duties are those in the case of non-fulfillment: the policyholder neither has a right to set aside the contract, nor is he entitled to compensation for damage. In this respect, these duties differ from obligations. Under the German and Dutch doctrines, these duties are considered as *Obliegenheiten*.[18] In principle, the insurer is not obliged to fulfill these Obliegenheiten. However, such non-fulfilment undermines his legal position towards the policyholder/insured: by not fulfilling a duty to warn, he will be deprived of his right to invoke the loss of coverage against the policyholder/ insured.

[17] See for Belgium Art. 7(1) BLVO, for the Netherlands Art. 7:929(1) C.C.

[18] See in relation to contracts of insurance in Germany, M. Wandt, *Versicherungsrech*t (2009), at para. 531 ff, and in The Netherlands, F.R. Salomons, N. van Tiggele-van der Velde and J.H. Wansink, *Asser 7-IX*: Bijzondere overeenkomsten: Verzekeringen* (2012).