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Trust and Transparency in Insurance Contract Law: European Regulation and Comparison of Laws

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The aim of this paper is to examine transparency principles under English and German Law, EU *acquis* and PEICL and to answer the question whether current legal regulation reflects high standards of transparency requirements and offer adequate consumer protection. The author is particularly interested in investigating are there any typical, common or shared characteristics in the regulation of transparency requirements across these jurisdictions. The focus of this paper is on consumer insurance contracts only. The main argument is that through transparency we can build consumer's trust in insurance market and offer adequate consumer protection.

Key words: Insurance Contract Law, Transparency, Trust, Disclosure, Pre-Contractual Information Duties, Information Assymetry, Comparative, Consumer

I. INTRODUCTION

The aim of this paper is to examine transparency principles under English and German Law, the EU *acquis* and the Principles of European Insurance Contract Law ('PEICL'), and to answer the question of whether current legal regulations reflect high standards of transparency requirements and offer adequate consumer protection. The author is particularly interested in investigating whether there are any typical, common, or shared characteristics in the regulation of transparency requirements across these jurisdictions. The focus of this paper is on consumer insurance contracts only. The main argument is that through transparency we can build consumers' trust in insurance market and offer adequate consumer protection.

Transparency is one of the basic principles of law. It is continuously expressed in many areas. Legislation should be drafted transparently, administration and justice must be delivered transparently, public (state) processes should follow the principles of transparency, public and private relationships must reflect transparency requirements, EU programmes and consumer protection policies[2] are based on

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[2] Such as the 'information model' adopted by the EU in order to protect consumers. This has been accepted in Consumer Rights Directive 2011/83/EU (amended by Directive (EU) 2019/2161) and EU consumer *acquis* in general. For the consumer *acquis*, see note 37 below.

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transparency, etc.[3] Contract law and contractual relationships in particular must follow the principles of transparency as contract terms[4] must be drafted in such a way as to be clear and understandable to the parties involved.[5]

Generally, transparency is about actively disclosing information in the pre-contractual phase. In insurance contract law specifically, transparency ensures that all relevant information about the insurance policy we are buying, including fees and conditions for the payment of claims and dispute resolution mechanisms are known to the customer. The scope of transparency in insurance law often relies on several factors. First, what kind of information we need to share or want to find out.[6] Usually, this is information that is not clearly and immediately visible, but somehow hidden. This also needs to be the information relevant for making the decision on the buying/selling of insurance products and must come at the right time and in the right form. The applicant (future policyholder) usually holds information about the risk, as well as other circumstances that could influence the aggravation of risk against which he is insuring himself. Daily behaviour (risk factors) may strongly impact the increase or decrease of the risk and premium (for example fast drivers have increased risk). On the other hand, the insurer is aware of ways that the premium is calculated: specific risk factors per groupings of policyholders; statistical probabilities of risk occurrence; and/or the mandatory and voluntary elements of the insurance contract. Thus, both parties hold information relevant to the decision of the other party and the performance of the contract. Second, the scope of transparency requirements depends on the type of the insurance product (life insurance policies are often more complex) and the market structure and regulation. The less competitive and regulated an insurance market is, the stronger the position of the insurance companies in negotiation.

Looking at the legal theory, it is difficult to find the exact definition of transparency. Different legal regimes approach the topic differently.[7] Generally this means that for something to be transparent, it must be clear, understandable, legible, and unambiguous.[8] However, there is difference between: (1) transparency as a general principle of insurance law, which is focused on the exchange of information between contracting parties;[9] (2) transparency in insurance mediation, which is focused on

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[3] S Wöss, 'Transparency in the Insurance Contract, Law of Austria' in P Marano and K Noussia K (eds), *Transparency in Insurance Contract Law* (Springer, 2020), p 4. The book offers overview of country reports in the EU and wider.

[4] Particularly pioneer Directive 93/13/EEC on Unfair Terms in Consumer Contracts.

[5] Ibid, n 3.

[6] Wöss, n 3.

[7] For the overview of common law and civil law, see *Transparency in Insurance Contract Law*, note 3 above.

[8] 'Transparency', *Oxford Dictionary*, https://www.oxfordlearnersdictionaries.com/definition/english/transparency.

[9] M Wandt 'Transparency as General Principle of Insurance Law' in *Transparency in Insurance Law* (AIDA, 2012).

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transparency in the relationship between the insurer and the intermediary;[10] and (3) transparency in insurance supervisory law with a focus on the transparency of the regulatory requirements of the insurance business.[11] This Article focuses on the first.

Another element of the insurance contract is trust.[12] If the aim of insurance is to offer protection to the policyholder against a specific event (car accident, fire, or illness). Both parties need to trust each other in order to build a well-balanced and credible relationship. This is mostly built through open and transparent pre-contractual disclosure for all: consumers, insurers, and underwriters.[13] The more trust there is in a contractual relationship, the more trust there is in the financial system as a whole.

The UK Financial Conduct Authority's (FCA) *Financial Lives 2020* Survey shows that the 'lack of trust and confidence can result in consumers not engaging with the financial services industry, or failing to address their own financial needs'.[14] In February 2020, only 42% of adults had confidence in the UK financial services industry, and just 35% agreed that financial firms are honest and transparent.[15] The report confirms that 'people with characteristics of vulnerability and the over-indebted were more likely than average to lack confidence in the industry'.[16]

In order to tackle this problem, and looking comparatively across all three jurisdictions, the regulation of transparency and pre-contractual information duties has undergone many reforms and changes in the last ten years. In the UK, the Law Commission has proposed the new Consumer Insurance (Disclosure and Representation) Act 2012[17] ('CIDRA'), which is applicable to consumer insurance, and the new Insurance Act 2015[18] ('IA'), which is applicable to business insurance, thus setting two parallel regimes for the regulation of insurance contracts and transparency requirements. Both Acts, in parts, replaced the old Marine Insurance Act ('MIA')[19] from 1906, which contained the codification of insurance practice beyond marine insurance. In Germany, there has also been significant change as the old Insurance Contract Act 1908[20] ('VVG 1908') was replaced in 2008 by the new

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[10] Ibid, pp 16–20.

[11] Ibid, pp 20–21.

[12] A Van Rossum, 'Ethics, Governance, Trust and Customer Relations' (2004) 29(1) The Geneva Papers on Risk and Insurance — Issues and Practice, pp 52–55.

[13] See M Zboron, *Insurance Underwriting and Broking in the London Insurance Market: The Role of Reputation and Trust in the Insurance Decision Making Process* (PhD thesis, University of Southampton, 2015).

[14] 'Financial Lives Survey 2020 Key Findings', *FCA*, p 140. https://www.fca.org.uk/publications/research/financial-lives-2020-survey-impact-coronavirus.

[15] Ibid, p 140.

[16] Ibid, p 141.

[17] Consumer Insurance (Disclosure and Representations) Act 2012, https://www.legislation.gov.uk/en/ukpga/2012/6?view=extent.

[18] Insurance Act 2015, https://www.legislation.gov.uk/en/ukpga/2015/4/contents.

[19] Marine Insurance Act 1906, https://www.legislation.gov.uk/en/ukpga/Edw7/6/41/contents.

[20] Gesetz über den Versicherungsvertrag (VVG), 30 Mai 1908 (RGBl. S. 263).

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Insurance Contract Act[21] ('VVG') followed by the Regulation on Pre-contractual Information Duties in Insurance Contracts 2008[22] ('VVG-InfoV'). The former regulates both consumer and business insurance contracts, while the latter regulates transparency requirements and information duties for consumers particularly. Finally, at the EU level, one can witness publication of some relevant directives on transparency, such as Solvency II Directive[23] and Directive (EU) on Insurance Distribution[24] and the first EU soft law instrument in the area of insurance, PEICL.[25] This instrument is trying to establish a voluntary insurance contract law regime across the EU and find middle ground for rules on transparency and pre-contractual disclosure.[26]

This Article provides comparative and functional overview of the transparency requirements in all three jurisdictions under investigation and hopes the ideas will feed into discussions about the themes in future.

II. MAIN LEGISLATIVE INTERVENTIONS TOWARDS ENSURING TRANSPARENCY

This Part examines some of the main legislative interventions aimed at ensuring transparency in insurance contract law. They are mostly shaped by long-term insurance practice and the relevant case law. In the last ten years, the conduct of the insurance business was impacted by the EU consumer *acquis*. The issues addressed are: change of the insurer's pre-contractual duty of disclosure (under 1); the fundamental change of the concept of the pre-contractual duty of disclosure and replacement of spontaneous disclosure with the questionnaire (under 2.1); the scope of the policyholder's knowledge (under 2.2); structure of the legal remedies for the breach of the duty of disclosure (under 2.3). These issues will be examined by taking a comparative and functional approach and the conclusions will be bolstered with economic reasoning.

Before we get into the analysis, some brief observations regarding the choice of legal orders are needed. This paper will focus on English and Welsh law (hereinafter, collectively, English law) and German law for several reasons. Firstly, they are both renowned representatives of common law and civil law, respectively. It is important to observe how different legal traditions approach the same issue. Secondly, the

[21] Gesetz über den Versicherungsvertrag (VVG), 23 November 2007 (BGBl. I S. 2631), https://www.gesetze-im-internet.de/vvg_2008.

[22] VG-Informationspflichtenverordnung (VVG-InfoV), 18 Dezember 2007 (BGBl. I S. 3004), https://www.gesetze-im-internet.de/vvg-infov.

[23] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the Taking-Up and Pursuit of the Business of Insurance and Reinsurance (Solvency II) [2009] OJ L335, 17, 12.2009.

[24] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on Insurance Distribution [2016] OJ L26, 02.02.2016.

[25] PEICL (ed), *Principles of European Insurance Contract Law* (Sellier European Law Publishers, 2009). Many resources are available on www.peicl.org.

[26] Ibid, p lii.

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number of German and English companies carrying out insurance activities together hold more than thirty percent of the European insurance market,[27] making them important players in the field. Thirdly, they are prominent examples of the changing legal environment in recent years. After many years of discussion and some failed attempts for reform, Germany completed the reform of its consumer insurance contract law ('VVG Reform') in 2008 and England completed theirs in 2012. Analysis of the EU insurance *acquis communuautaire* (in particular the Insurance Distribution Directive) and corresponding legislative initiatives (PEICL) is important for the creation of one single European market for insurances. Although PEICL is a soft law instrument, at the moment it is the only piece of legislative initiative that sets forth common rules and principles on insurance contracts across Europe.[28] This set of rules is based on a considerable amount of comparative research performed by numerous respectable researchers in the field and since it is backed up by the European Commission, it holds credibility in the field.[29] For these reasons, this paper will also address legislative proposals of PEICL.

A. *Insurer's Pre-Contractual Duty of Disclosure*

1. *Legal Framework and General Remarks*

The main duty of an insurer is to make open and transparent pre-contractual disclosures to the consumer (policyholder) during negotiations. Such an obligation is clearly acknowledged in all jurisdictions under survey.

German law displays very detailed provisions on this issue. The basic disclosure rule is prescribed in Section 7 VVG 2008 (Insurance Contracts Act) and is further elaborated by Sections 1 and 4 VVG-InfoV 2008 (Regulation on Pre-contractual Information Duties in Insurance Contracts). Insurers' pre-contractual disclosure obligation consists of duty to inform consumers about the elements of the contract (identity of the parties, beneficiaries, insurance agent), the commitment (risk covered, sum insured, premium and method of calculation, consequences of failure to pay premium), consumer right to revoke the contract, the applicable law, dispute resolution mechanisms, the name of competent supervisory body, and insurance terms and conditions.[30] Additional requirements are further laid out for special types of insurance,

[27] See 'European Insurance in Figures', *Insurance Europe Statistics* (2020), https://insuranceeurope.eu/publications/2569/european-insurance-in-figures-2020-data. The numbers are showing that Germany and the UK have the highest number of insurance companies and employees by country (p 60) and are among the countries with the highest total premiums per capita by country (density, p 39).

[28] For dissussion, see H Heiss and U Mönnich, 'Pre-contractual Duties in European Insurance Contract Law' in Y Q Han and G Pynt (eds), Carter v Boehm *and Pre-contractual Duties in Insurance Law – A Global Perspective after 250 Years* (Hart Publishing, 2018), pp 382–387.

[29] See 'Insurance Contracts', European Commission, https://ec.europa.eu/info/business-economy-euro/doing-business-eu/contract-rules/insurance-contracts_en.

[30] For dissussion, see M Wandt and K Bork, 'Pre-contractual Duties under the German Insurance Law', in Carter v Boehm *and Pre-Contractual Duties in Insurance Law – A Global Perspective after 250 Years*, note 28 above, pp 279–286.

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such as life assurance, health insurance, or insurance concluded via telephone (Sections 2–5 VVG-InfoV 2008).[31] The content of information is shaped by EU *acquis* in particular the third generation of Life and Non-Life Insurance Directives,[32] the Solvency II Directive,[33] and the EU consumer protection *acquis*.[34] Article 2:201 PEICL follows the same pattern as German law and the EU *acquis*.[35] In order for the law to be suited to consumer contracts, insurers are required to display information in an additional pre-contractual 'information document', in a clear and transparent way and in writing (Section 7 VVG, Article 2:201 PEICL). Serving consumers with the information document is considered to be one of the most efficient mechanisms of ensuring transparency and consumer protection on the EU level in general.[36] It is also clearly reflected in the EU consumer *acquis*.[37] The information document is not a standard form document, but needs to be tailored to meet the individual requirements of each consumer and the insurance contract under negotiation. Such duty is also independent of the obligation of the insurer to issue an insurance policy after the conclusion of the contract (Section 4 VVG-InfoV, Article 2:501 PEICL).

Another mechanism for ensuring transparency and consumer protection is regulatory separation between the consumer and business insurance. Both Germany and England are good examples. The Consumer Insurance (Disclosure and Representation) Act 2012 (CIDRA, England) and VVG-InfoV (Germany) apply to consumer insurance, the Insurance Act 2015 (IA) applies to business insurance, and VVG (Germany) applies to both. As already mentioned, this Article will be dealing with consumer insurance only.

English CIDRA however works in a different way from German and EU regulation. CIDRA does not regulate an insurer's pre-contractual disclosure, the Act is focused on easing the position of the consumer by introducing new lighter rules

[31] This follows from the EU *acquis*. For example, additional information is also provided in Article 36 of Directive 2002/83/EC Life Insurance (Consolidation Directive) [2002] OJ L345 19.12.2002 Article 8 of Directive 2009/103/EC Fourth Motor Vehicle [2009] OJ L263, 16.09.2009, or Article 3 of Directive 2002/65/EC of the European Parliament and of the Council Concerning the Distance Marketing [2002] OJ L271, 09.10.2002.

[32] Particularly by Article 31 of the Third Non-Life Insurance Directive (92/49/EEC) and Article 36(2) of the Life Assurance Consolidation Directive (2002/83/EEC).

[33] Particularly by Preamble 79 and Articles 183–186 of the Directive 2009/138/EC, note 23 above.

[34] In Germany, Section 7 VVG was very much influenced by the Third Consolidated Life Directive (2002/83/EEC) and the Non-Life Directive (92/94/EEC), but major influence may be awarded to the Distance Marketing Directive (2002/65/EC). In England, the most noticeable influence on the consumer insurance contract is made by the Unfair Contract Terms Directive (93/13/EEC).

[35] For an overview in PEICL, see Heiss and Mönnich, note 28 above.

[36] PEICL Art 2:201, Comment C1.

[37] The same approach to information duties is evidenced by the Package Travel Directive (90/314/EEC, Arts 3–4), Distance Contracts Directive (97/7/EC, Arts 4–5), Distance Marketing Directive (2002/65/EC, Art 3), Timeshare Directive (2008/122/EC, Arts 3(1), 4(1), 5(2)), Consumer Credit Directive (2008/48/EC, Art 5), but also in the proposal for a Directive on Consumer Rights (Art 5) and the Unfair Contract Term Directive (93/13/EEC).

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on consumers' information duties only.[38] In theory, the insurer's duty is still based on the old (and sometimes considered unjust and harsh) concept of the *utmost good faith* from Section 18 of the Marine Insurance Act 1906. Historically, the duty of *utmost good faith* derives from the statements of Lord Mansfield in the landmark decision *Carter v Boehm*[39] in 1776. Both parties to an insurance contract have a duty to disclose all material facts as part of their pre-contractual disclosure,[40] in addition to the general obligation for all contracts not to make false statements during pre-contractual negotiations.[41] This duty, together with the general law of misrepresentation as developed in the nineteen century, led to a 'significant body of case law on the nature and scope of the duty of utmost good faith and the consequences of its breach'.[42] The latter were particularly harsh on the insured. Even if the misrepresentation was innocent, the insurer had the right to avoid the contract fully and refuse to pay all claims. With the development of the consumer protection policies streaming from the EU in the 1970s, it became apparent that such law was not well suited for consumers. CIDRA abolished the *utmost good faith* rule for the insured and replaced it with the duty not to make misrepresentations (Clause 2 CIDRA),[43] whereas the *utmost good faith* rule still associates to the insurer's pre-contractual disclosure and both parties' post-contractual disclosures. The reason the Law Commission was not overly concerned with this issue in the Draft Bill of CIDRA is because insurance practice clearly displayed different behaviour by following different codes of conduct rather than strict rules of law.

Practice often pursued principles of transparency and fairness laid out in the self-regulatory instruments and the rules of the insurance industry.[44] The most influential instrument is the Association of British Insurers ('ABI') Statement of General Insurance Practice ('ABI Statement'),[45] which has been used in the market for more than 40 years. The ABI Statement provides that the insurers must warn

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[38] CIDRA is a short and targeted Act (only twelve provisions) and it only deals with the consumer insurance contracts. CIDRA is based on The Law Commission, Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation, Draft Bill (LAW COM No 319), December 2009 [hereinafter Draft Bill].

[39] *Carter v Boehm*, (1776) 3 Burr 1905, 1909–1910.

[40] Same, J Birds, *Birds' Modern Insurance Law* (Sweet & Maxwell/Thomson Reuters, 2019), pp 156–58.

[41] R Merkin, *Lowry, Rawlings and Merkin's Insurance Law – Doctrines and Principles* (Hart, 2022), p 86.

[42] R Merkin (ed), *Colinvaux's Law of Insurance* (Sweet & Maxwell/Thompson Reuters, 2022), para 7-001.

[43] CIDRA Clause 2(1–3); *Carter v Boehm and Pre-Contractual Duties in Insurance Law – A Global Perspective after 250 Years*, note 28 above.

[44] They are very influential documents, often mandatory for the members of the insurance associations.

[45] The first ABI Statement of General Insurance Practice and Statement of Long-Term Insurance Practice was published in 1957, amended in 1986, and in force until 2005. Text available at: www.lawcom.gov.uk/insurance_contract_law_issues_paper_1.pdf; www.scotlawcom.gov.uk/downloads/cpinsurance_issue1.pdf.

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consumers about the duty to disclose material facts, but they also must explain which facts the insurer would regard as material (Section 1(c)(i) ABI Statement). The ABI Statement was withdrawn on 15 January 2005 and replaced by the ICOBS Rules of the Financial Services Authority ('ICOBS Rules').[46] The latter practically repeat the rules from the ABI Statement. In addition, they prescribe the duty of insurers to ask clear questions about any matter material to the insurance undertaking (Rule 5.1.4 ICOBS). The ICOBS rules were replaced by the *ICOBS Insurance: Conduct of Business Sourcebook* ('ICOBS')[47] as part of the *Financial Conduct Authority Handbook* made under the Financial Services Act 2021. All insurers must provide product information to the consumer by way of a Standardised Insurance Information Document (ICOBS 6 ANNEX 3). Although ABI Statements and ICOBS 2005 are no longer in force, they had considerable impact on shaping CIDRA as it is today because of their softer approach towards consumers. Such approach was also greatly supported by the Financial Ombudsman Service ('FOS') created in 1981.[48] FOS interpreted applicable common law rules very restrictively in its decision making, to the extent that if an insurer fails to ask questions, it cannot complain later that the information was not disclosed.[49] By correcting the harsh principle of *utmost good faith* and mitigating the full avoidance of contract, FOS offered great comfort to consumers.[50] When drafting CIDRA, the Law Commission followed the FOS approach, thus ensuring more widespread protection of individual consumers.[51]

In 2018, the EU Insurance Distribution Directive[52] and the corresponding EU Commission Implementing Regulation[53] made another step towards ensuring

[46] The Financial Services Authority (FSA) was established by the Financial Services Markets Act in 2000 as the single statutory regulator for financial services. FSA published a *Handbook* containing special rules for consumer insurance: *Insurance Conduct of Business Sourcebook - Rules on Non-disclosure and Misrepresentation* (*FSA Handbook - ICOBS Rules*), https://fsahandbook.info/FSA/html/handbook/ICOBS. See R Purves, 'The Impact of FSA Regulation' in P J Tyldesley (ed), *Consumer Insurance Law: Disclosure, Representations and Basis of Contract Clauses* (Bloomsbury, Professional, 2013), pp 91–129.

[47] 'FCA Handbook', *Financial Conduct Authority*, https://www.handbook.fca.org.uk/handbook.

[48] M Collet, 'The Financial Ombudsman Service, The History and Development of Its Approach to Non-disclosure' in *Consumer Insurance Law*, note 46 above, pp 129–165.

[49] See Recommendations for the Draft Bill, note 38 above, para 2.48.

[50] J Birds, *Insurance Law in the United Kindom* (Kluwer Law International, 2015), p 27; *Birds' Modern Insurance Law*, note 40 above, p 126.

[51] The Law Commission has taken the practice of FOS as the starting point to draft the proposals for a reform because in most cases the consumers are able to obtain justice from the FOS and not from the court. But the FOS cannot decide all cases. The compulsory jurisdiction is limited to awards of £100.000 and the FOS declines cases that require witnesses to be cross-examined. See Recommendations for the Draft Bill, note 38 above, para 3.2; P J Tyldesley, 'Consumer Insurance and the Duty of Disclosure' (2011) 123 *British Insurance Law Association Journal*, p 48.

[52] Directive (EU) 2016/97, note 24 above, p 19.

[53] Commission Implementing Regulation (EU) 2017/1469 of 11 August Laying Down a Standardised Presentation Format for the Insurance Product Information Document, http://eur-lex.europa.eu/eli/reg_impl/2017/1469/oj.

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transparency of information for consumers. All insurers must now provide product information to the consumer by way of a Standardised Insurance Information Document (Art 20(9) Directive 2016/97, ICOBS 6 Annex 3). All three jurisdictions under survey need to comply with this requirement. The Document needs to summarise the key elements of the insurance product offered (eg life, car, fire insurance) and key elements of Standard Terms and Conditions of that particular insurer (Arts 1–5 Implementing regulation, ICOBS 6, Annex 3, 2.1). But, unlike the information document under German Law and PEICL, such Document is not tailored to the specific needs of that particular consumer nor forms part of the insurance contract. The specifics of the actual (individual) pre-contractual and contractual information can be found only in the insurance cover and must be submitted separately (Article 20 Directive 2016/97, ICOBS 6, Annex 3, 2.6). The aim of such regulatory approach is for the insurers to be transparent about the insurance product they offer on the market and their terms and conditions, in order to facilitate the consumer decision-making process.

2. *Functions*

Fundamentally, insurers' pre-contractual disclosures have two basic functions: (1) ensuring transparency; and (2) securing consumer protection. The first function, informing the consumer about the information relevant for the conclusion of the contract, helps to ensure transparency for the prospective policyholder. The written document containing all relevant information will put the policyholders in such a position that they will be able to check all relevant elements of the future contract and thus make an informed decision about the contract they are about to conclude.[54] This also helps build trust in the consumer-business relationship. The second function consequently develops from the previous one. Presenting the pre-contractual document protects the policyholder from the insurer's non-disclosure, which might be material or relevant for the policyholder decision. As the insurance relationship works both ways, pre-contractual document also protects the insurer from possible future consumer complaints that some facts were not disclosed during negotiations. In business practice, the consumers may later say 'but I did not know this information' and may try to exercise the right to withdraw from the insurance contracts based on that argument. The written information documents act as a shield against such complaint. Otherwise, the policyholder may withdraw from the contract.

3. *Economic Reasoning*

Law and economics theories generally offer economic justification for the proposed law regulation. The aim here is not to provide full overview of the law and economic approaches but just to add additional arguments regarding the benefits of the

[54] PEICL Art 2:201, Comment C1; MüKo 2010/Prölss, Versicherungsvertragsgesetz, § 7, Rdn 2.

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information document. One of the main sources of market failure is information asymmetry,[55] and the information document helps to scale down the consequences of such asymmetry. Asymmetric information, as the name implies, means differing, disproportionate, or partial information.[56] This also means that one party regularly knows more or less than the other party. When negotiating an insurance contract, the consumer knows more about the risk and other factors surrounding the risk (their drinking or driving habits, lifestyle, frequency of health checks, which kind of insurance they want, etc). On the other hand, the insurer knows more about the statistical data, the ways of calculation of premium, and enforcement of claims. There is clear asymmetry here as one party always knows more than the other. In order for the contract to meet the expectations of both parties, there must be full and adequate disclosure on both sides. When there is no adequate exchange of information, consumers will simply leave the market.[57] Usually, information asymmetry can be remedied via voluntary exchange of information (eg the seller is willing to provide a warranty for the goods), but in cases of serious market disruption or if the industry is subject to state supervision (such as insurance), state intervention is needed.[58] All jurisdictions under survey responded to the issue of information asymmetry by clearly regulating insurers' pre-contractual disclosure and by introducing the pre-contractual information document. In England this is even regulated as public law duty through ICOBS (product information document).[59]

Another benefit of pre-contractual information document is minimisation of transactional cost. Very simplified, and on a very basic level, if the law requires that standard information be communicated to the consumer, insurers do not have to lose time and money investigating which facts are material to that particular consumer in order to make a decision. Additional investigation would only increase the costs of the insurer, which would consequently increase the premium, which then might cause a decrease in the demand for insurance and the policyholders would again leave the market.[60] My argument here is that the document containing relevant information makes sense from the transaction cost economics perspective.

Finally, the information document also helps consumers to process information. Behavioural economics or rational choice theory[61] assumes that decisionmakers

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[55] R Cooter and T Ulen, *Law and Economics* (Barkley Law Books, 2016), p 41.

[56] The term 'information asymmetry' was established by G Akerlof, 'The Market for "Lemons": Quality, Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics*, pp 488–500.

[57] PEICL Art 2:201, Comment C1.

[58] Cooter and Ulen, note 55 above, p 41.

[59] 'FCA Handbook', note 47 above, ICOBS, https://www.handbook.fca.org.uk/handbook/ICOBS/6/?view=chapter.

[60] See one of the pioneers: E Mackaay, *Economics of Information and Law* (Kluwer, 1982), p 177.

[61] The body of literature inspired by the work of Daniel Kahneman and Amos Tversky captured the name of behavioural economics. See also E Zamir and D Teichman (eds), *The Oxford Handbook of Behavioral Economics and the Law* (Oxford University Press, 2016); T Baker, *Uncertainty - Risk:*

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are rationally self-interested.[62] The central insight of behavioural economics is that 'humans beings make predictable errors in judgement, cognition and decision making'[63]—meaning that people are 'predictably irrational'.[64] The insurance information document relies on these assumptions and tends to eliminate predictably irrational behaviour. Largely simplified, the assumption is that if the consumers have adequate information at the right time and in the right form, they will make adequate decisions regarding insurance contracts.[65] Again, any further law and economics analysis is beyond the scope of this Article.

4. *FCA's New Consumer Duty Instrument 2022 and Duty to Advise*

In July 2022, the English Financial Conduct Authority ('FCA') announced its plan to introduce the new 'Consumer Duty Instrument 2022' ('Duty'),[66] which will raise the standard of care that businesses give to consumers in the area of financial services. This indirectly indicates that there was clearly a certain level of dissatisfaction with the transparency requirements. Under Principle 12, the 'Firm must act to deliver good outcomes for retail customers'.[67] This principle is based on the wider FCA consultation process,[68] followed by the Parliamentary discussion on the Financial Services Act 2021[69] where the current standard of consumer protection in financial services was not satisfactory and required further interventions. FCA explains that under this new Duty, 'the firms will need to assess and evidence the extent to which and how they are acting to deliver good outcomes for the consumer'.[70]

The focus is on new requirements for businesses to 'ensure that their products and services are fit for purpose and offer fair value, and to help consumers make effective choices or act in their interests'.[71] The increased supervision will help to ensure the

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(F'note continued)
Lessons for Legal Thought from the Insurance Runoff Market (Faculty Scholarship at Penn Carey Law, 2021), p 2141.

[62] This theory has been under attack for the past 30 years based on mainly empirical evidence. See more, Cooter, Ulen note 55 above, p 50.

[63] Ibid.

[64] D Ariely, *Predictably Irrational: The Hidden Forces that Shape Our Decisions* (Harper Collins, 2016).

[65] See C K Kunreuther, M V Pauly, and S McMorrow, *Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry* (Cambridge University Press, 2013).

[66] FCA, 'A New Consumer Duty Feedback to CP21/36 and Final Rules', Policy Statement PS22/9, July 2022, https://www.fca.org.uk/publication/policy/ps22-9.pdf.

[67] FCA, 'A New Consumer Duty Feedback to CP21/36 and Final Rules', Made Rules (Legal Instrument), Appendix 1, para 2.1.1, https://www.fca.org.uk/publication/consultation/cp21-13.pdf.

[68] See FCA, 'A New Consumer Duty', First Consultation Paper CP 21/13, May 2021, https://www.fca.org.uk/publication/consultation/cp21-13.pdf.

[69] Financial Services Act 2021, https://www.legislation.gov.uk/ukpga/2021/22/contents/enacted.

[70] FCA, 'A New Consumer Duty Feedback to CP21/36 and Final Rules', Policy Statement, note 66 above, para 1.6.

[71] Ibid, para 1.14.

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required level of consumer protection and this measure, being more 'consumer-focused', will also stimulate competitiveness between businesses in order to attract more consumers.[72]

FOS aims for all information to be transparent and empower consumers to make informed decisions about financial products and services. According to FOS, 'consumers are to be given the information they need, at the right time, and presented in a way they can understand'.[73] This applies in particular to transparency of product governance, price and value, consumer understanding, and supporting consumers in reaching their financial objectives and buying financial products.[74] FOS clearly acknowledges the need to introduce such a Duty because consumers have a weaker bargaining position—they are often subject to cognitive and behavioural biases and lack experience and specialized knowledge in relation to the financial products and usually there is some type of information asymmetry in the consumer-business relationship.[75] The Duty is to be implemented starting 31 July 2023 without retrospective effect.[76] The success of the proposal will be monitored via Financial Ombudsman Service decisions and through the FCA Financial Lives Survey.[77]

Looking comparatively, neither German law, PEICL, nor the EU *acquis* explicitly regulate such a Duty. However, there is the insurer's general duty to advise the policyholder (Germany, Section 6 VVG) or to assist the policyholder (Articles 2:202 and 2:203 PEICL) when taking out insurance.[78] Under German law, the insurer is under a duty to inquire about the wishes and needs of the prospective policyholder and to provide advice and justify reasons for it (Section 6 VVG, Art 2:202 PEICL). Providing advice is usually recorded, in order to avoid any potential future claims and facilitate the burden of proof. Similarly, under the EU Insurance Distribution Directive and PEICL, an expert should warn consumers about the inconsistencies between the cover and the consumer requirements (the elements of the proposed risk)[79] and about the commencement of the cover, as this proved to be an issue in the insurance practice.[80] For breaches of the duty to advise/warn consumers, insurers will be liable for damages (Section 6.5 VVG, Article 20 Insurance Distribution Directive, Article 2:202 paragraph 2a PEICL).

[72] Ibid.

[73] Ibid, para 8.1.

[74] FCA, 'A New Consumer Duty Feedback to CP21/36 and Final Rules', Made Rules, note 67 above, Appendix 1, para 2A 1.10(3).

[75] Ibid, para 2A 1.9.

[76] And for closed products and services from 31 July 2024: FCA, 'A New Consumer Duty Feedback to CP21/36 and Final Rules', Policy Statement, note 66 above, para 1.57.

[77] Ibid, paras 1.21, 1.22.

[78] The exception is insurance against mass risks and insurance negotiated via insurance broker (§6.4–6 VVG)

[79] See Art 20 Directive (EU) 2016/97 on Insurance Distribution, note 24 above; PEICL Art 2:202, Comment C1–3.

[80] See PEICL Art 2:202, Comment C2.

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I believe that functionally, the duty to advise under German law and the duty to warn under PEICL do not follow the same concept as English conduct of business nor do they have such a broad application as the new Consumer Duty to deliver good outcomes under English law. Since 2008 and the German insurance contract reform, there have not been many court decisions on the insurer's duty to advise.[81] Some authors believe that the provision was deliberately drafted 'softly to keep up the opportunity for the court to consider the circumstances of each individual case'.[82] Also, when deciding, the German courts are not keen to develop and apply the special standard for the insurer's duty to advise, but rather base their decisions on the general principles of contract law, in particular provisions on good faith and fair dealings.[83] This is similar under the Insurance Distribution Directive and PEICL. Insurers' pre-contractual duties do not entitle consumers to expect any assistance from the insurers and the duty to warn will be less extensive where there is no direct negotiation between the consumer and the insurer (either because it is online or there is an agent or broker involved).[84] The new Duty under English law clearly indicates that there is still a real need to raise the standard of transparency and consumer protection in practice.

B. Policyholder's Pre-Contractual Duty of Disclosure

1. Spontaneous Disclosure Versus Questionnaire (Modifying the Test of Materiality)

a. Legal framework

Before April 2013 when CIDRA came into force, a well-established principle of the English insurance law was that the consumer (policyholder) needed to volunteer all information material to the risk (disclosure by the assured, Article 18 MIA). The insurer was not obligated to inquire nor to ask any questions. If the material information was not disclosed, the insurer was entitled to avoid the contract fully and refuse the payment of the claim.[85] In England, this principle is believed to derive from the Lord Mansfield opinion in the landmark case *Carter v Boehm* 1666[86] and the

[81] M Wandt and K Bork, *Disclosure Duties in German Insurance Contract Law* (ZVersWiss 109, 2020), p 89.

[82] Ibid. With regard to risks related to premature terminations of existing life insurance contracts and the conclusion of new life insurance contracts: cf BGH, VersR 2015, pp 107–09; cf OLG Hamm, r+s 2013, pp 523–24; OLG München, VersR 2012, pp 1292–95; OLG Hamm, VersR 2016, pp 394–97 (change of health insurance); OLG München, VersR 2016, pp 318–20. With regard to risks resulting from underinsurance if a reduction of the respective sum insured is intended: OLG Karlsruhe, VersR 2013, pp 885–88; cf BGH, VersR 2014, pp 625–28.

[83] *Disclosure Duties in German Insurance Contract Law*, note 81 above, p 89.

[84] PEICL Art 2:202, Comment C4(c)–(d).

[85] For details, see J Birds, B Lynch, and P Simon (eds); *MacGillivray on Insurance Law* (Sweet & Maxwell/Thompson Reuters, 2022), p 478; *Birds' Modern Insurance Law*, note 40 above, p 126.

[86] *Carter v Boehm*, note 39 above.

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doctrine of *utmost good faith* was also established there. As discussed in the previous chapter, this doctrine is applicable to both insurer and insured pre-contractual disclosures. It is also well reflected in Sections 18 and 20 of the Marine Insurance Act 1906, which has shaped English insurance practice for more than 100 years, up until CIDRA. For many years, the rationale behind the 'spontaneous disclosure' approach relied on the understanding that the policyholder knows everything about the risk (eg life style, driving habits, consummation of alcohol, etc) and the insurer nothing, so it is the policyholder's duty to disclose.[87] The dilemma around this approach relates to the basics of human cognitive perception.[88] How can one party (the consumer) know which facts are relevant for the risk assessment made by the other party (the insurer)? Consumers simply cannot know which information is relevant for calculating the risk and the premium as this is technical knowledge. In English insurance practice, such regulatory approach was considered unjust and burdensome for the consumer. The insurer could avoid the contract and refuse to pay all claims no matter the culpability of the policyholder (even for an innocent breach). Because of such draconian consequences this approach was softened in English insurance practice.[89] As it will be discussed in detail later, FOS, the main body in the UK dealing with consumer insurance disputes, disregarded the requirement of the spontaneous disclosure and based its decision on the culpability of the policyholder's behaviour instead.[90]

CIDRA made significant changes and embraced the FOS approach to ease the position of the consumer.[91] It abolished the existing pre-contractual duty of a policyholder to volunteer information and the concept of *utmost good faith* for pre-contractual disclosure from MIA[92] and replaced it with the duty 'to take reasonable care not to make a misrepresentation' (Clause 2 CIDRA).[93] In other words, the consumer has a duty to avoid misrepresentation. This change plays a central role in the consumer disclosure reform and assurance of transparency under English law. As the insurer now needs to ask relevant questions, it is presumed

[87] This was established in the landmark English case *Carter v Boehm*, note 39 above.

[88] About human processing of information, see Mackaay note 60 above, pp 119 *et seq*.

[89] Draft Bill, note 38 above, para 2.29 *et seq*.

[90] Ibid, para 2.48.

[91] *Insurance Law in the United Kindom*, note 50 above, p 27; *Birds' Modern Insurance Law*, note 40 above, p 126.

[92] It must be noted that CIDRA did not regulate the consumer post-contractual duties, nor insurer's pre- and post-contractual duties. Thus, in principle, the common law and MIA 1906 are capable of extending to those. However, Insurance Act 2015 amended Section 17 of MIA 1906 by removing the remedy of avoidance. As a result it is not possible for insurers to ask for the avoidance of a contract for breach of duty of utmost good faith nor for the breach of post-contractual disclosures. *Colinvaux's Law of Insurance*, note 42 above, p 308.

[93] CIDRA Clause 2(1–3). For further discussion, see Explanatory Notes – Clause 2; A. 8–10, Recommendations for the CIDRA Draft Bill, note 38 above, paras 5.33–40. See Y Q Han, 'Pre-contractual Duties in the UK Insurance Law after 2015: Old (or New?) Wine in New Bottles?' in Carter v Boehm *and Pre-Contractual Duties in Insurance Law – A Global Perspective after 250 Years*, note 28 above, p 150.

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that material circumstances are the ones explicitly asked for.[94] The new duty is also acknowledged in the case law.[95]

Interestingly, a functionally similar approach was taken in many other European countries in order to ensure transparency and fairness in insurance contractual relationship. For example, in Germany the insurer's questionnaire (*Fragebogen*),[96] replaced insured spontaneous disclosure. After German Insurance Contracts Law reform (VVG Reform) in 2008, consumers must only answer questions from the questionnaire, to the best of their knowledge, even if they do not know or cannot estimate which facts are material (Section 19(1) VVG). That is why the policyholder is under obligation to answer questions fully and accurately and is not permitted to state: 'I think this question is not important thus I will not answer'.[97]

Many European legislations (eg Poland, The Netherlands),[98] as well as PEICL, followed the same trend. The consumer 'shall inform the insurer about the circumstances material to the risk … which are subject to a clear and precise questions put to him by the insurer' (Article 2:101 PEICL).[99] The consumer (applicant) will be relieved of such duty only when the questions have been answered fully and honestly.[100] The requirement of 'clear and precise' questions plays an important role in performing the pre-contractual disclosure. If the insurer's question is abstract: 'Have you been ill in the last five years?', it is unclear whether the insurer is interested to know about any illness in the last five years (eg simple cough, headache) or about a more serious illness—if yes, which one? The questionnaire method thus clearly enhances the transparency of the insurer's behaviour.[101] The insurer needs to specify clearly and transparently what he wants to know. If the insurer requires the consumer (policyholder) to make a decision which illness to report/not to report, we are

[94] CIDRA Clause 2(1), Recommendations for the CIDRA Draft Bill, note 38 above, para A8.

[95] As of the date of the preparation of this text, there has been only a restricted number of cases acknowledging CIDRA, including: by the Court of Session (Outer House) in *Southern Rock Insurance Co Ltd v Hafeez* [2017] CSOH 127; [2017] Lloyd's Rep IR 207; [2021] EWHC 1320 (Comm); by HHJ Cotter QC in *Ageas Insurance Ltd v Stoodley* [2019] Lloyd's Rep IR.1; by HHJ Pelling in *Jones v Zurich Insurance PLC* [2021] EWHC 1320 Comm; and by HHJ Simpkiss in *Tesco Underwriting Ltd v Achunche* [2016] EWHC 3869 QB; appeal *in Asfaq v International Insurance Co of Hannover Plc* [2017] EWCA Civ 357; [2018] Lloyd's Rep IR 228 briefly referred to CIDRA; as did Court of Session (Outer House) in *Young v Royal and Sun Alliance Plc* [2019] CSOH 32; and Judge Jay in R on the application of *Aviva Life and Pensions (UK) Ltd v Financial Ombudsman Service* [2017] EWHC 352 (Admin); Judge Akenjead briefly mentioned CIDRA (without deciding on the latter) at pp 35 and 38 in *Genesis Housing Association Ltd v Liberty Syndicate Management Ltd* [2012] EWHC 3105 (TCC); [2012] 2 CLC 837; brief mention by the Supreme Court also in *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG* [2016] UKSC 45; [2017] AC at 102; *MacGillivray on Insurance Law*, note 85 above, p 597 n 5.

[96] For the notion of "old" and "new" regimes, see H A Cousy, 'The Principles of the European Insurance Law: The Duty of Disclosure and the Aggravation of Risk' (2008) 9 *ERA Forum* 119, p 120.

[97] MüKo 2010/Langheid, *Versicherungsvertragsgesetz,* § 19(1), Rdn 57.

[98] *Transparency in Insurance Contract Law*, note 3 above, p 288.

[99] For dissussion, see Heiss and Mönnich, note 28 above, pp 389–91.

[100] PEICL Art 2:201, Comment C1.

[101] *Transparency in Insurance Contract Law*, note 3 above, p 289.

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practically returning into the old regime of spontaneous disclosure, which was abandoned as harsh and unjust to the consumer.

b. Modifying the test of materiality: The test of reasonable care

Change from consumer spontaneous disclosure to a questionnaire had an important effect—it modified the test of materiality, thus bringing us one step closer to ensuring transparency. The test of materiality is about the question of *who* is making the decision on which risk factor is material/decisive for an insurance contract and under which conditions. For example, two heart operations in the last two years is a material fact for the insurer as he is calculating the premium and the value of claim.

Under all regimes under investigation (English and German law and PEICL), the materiality (relevance) of information is determined by the judgement of the *insurer* (not insured as it was before reforms). Under German law, the fact is material if it would influence the judgment of an actual insurer to conclude that a particular contract (Section 19 VVG, actual insurer test).[102] With a questionnaire, the circumstance is deemed to be material without further inquiry if the insurer asked a clear question about it. PEICL takes the same approach. The material fact is the one the insurer put down as a clear and precise question (Section 2:101 PEICL).[103] The EU Directive on Insurance Distribution has no explicit provisions. However, the Directive imposes a duty on the insurer to take appropriate arrangements and consider the demands and needs of the customer before the proposal of the contract (see Article 1). Accompanying comparative study to PEICL showed that some EU countries, such as Croatia, Austria, Belgium, and Luxembourg, still rely on the consumer to volunteer material information, while others, such as Finland, France, Greece, Poland, Spain, and Switzerland, rely on the insurer questions.[104] The drafters of PEICL clearly opted for the latter, as volunteering information was considered unjust and burdensome for consumers.[105]

For years, under English law, the MIA offered interpretation of the materiality of information by applying a 'prudent insurer test'. Every circumstance was material if it would influence the judgment of a hypothetical prudent insurer in fixing the premium or determining whether he will take the risk (Section 18(2) MIA). In the past, this test in practice was usually softened by the ABI Statements, ICOBS Rules, and the practice of the FOS, as the test was considered unjust and burdensome for the consumer.[106] CIDRA introduced significant changes in that respect. CIDRA abolished the duty of pre-contractual disclosure and the concept of 'material circumstance' and replaced it with the consumer duty 'to take reasonable care not to make the misrepresentation to the insurer' (Clause 2(2) CIDRA). This section applies

[102] Although this provision of the § 19(1) sentence 1 VVG altered the old § 16 sentence 2 VVG 1908, the actual insurer test could still be taken into consideration. For explanation of § 19(1) VVG, see MüKo 2010/Langheid, *Versicherungsvertragsgesetz*, note 97 above, § 19(1), Rdn 8.

[103] For discussion, see Heiss and Mönnich, note 28 above, pp 389–91.

[104] PEICL, Art 2:101, Notes 1–6.

[105] Ibid.

[106] Draft Bill, note 38 above, para 2.29 *et seq*.

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to both the application for a new policy and the amendment or renewal of the existing one. The Law Commission thinks 'it is right to take a wide and flexible approach to the issue of what amounts to a misrepresentation. … The Draft Bill therefore preserves the concept of misrepresentation as interpreted through the case law'.[107] CIDRA does not attempt to define the term 'misrepresentation' thus leaving it to the common law.[108] Generally, misrepresentation is a statement of fact made by or on behalf of the insured (consumer) before the contract is concluded, which must be governed by the requirement of reasonableness. Looking at Section 2(2–3) of CIDRA, there are three possibilities where misrepresentation may occur. First, misrepresentation takes place in response to the insurer's questionnaire. This will be the most usual scenario in practice. Second, misrepresentation takes place independent of the insurer's questionnaire. Under CIDRA, consumers have no duty to volunteer information but if they do, there is no prohibition in CIDRA not to treat those statements as misrepresentation. Thirdly, misrepresentation takes place while varying or renewing the existing contract.[109] 'A failure by the consumer to comply with the insurer's request to confirm or amend particulars previously given is capable of being a misrepresentation' (Section 2(3) CIDRA). This provision very likely relates to the situation of amendments or renewal of the policy where the consumer was specifically asked by the insurer to confirm or modify information provided earlier and was warned about the consequences of such omission.[110] The Law Commission in the CIDRA Report clarified and confirmed that a consumer failure to reply to such a request may be considered a misrepresentation for the purposes of the Act.[111] Whether failure to reply to an insurer's request actually amounts to misrepresentation will depend on the facts of the case.[112]

Section 3 of CIDRA explains the test of reasonable care. Whether the consumer acted with reasonable care to avoid misrepresentation is judged in the light of 'all the relevant circumstances' and not in accordance with the opinion of the actual/reasonable consumer (Section 3(1) CIDRA).[113] In order to help with an assessment as to whether reasonable care was taken, CIDRA provides examples of some relevant circumstances: (1) the type of consumer contracts in question and its target market; (2) any relevant explanatory material publicly produced or authorised by the insurer; (3)

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[107] Examples of cases are given in the Draft Bill, note 38 above, paras 5.42–5.44: *English v Dedham Vale Properties Ltd* [1978] 1 WLR 93; *Roberts v Avon Insurance Co*, [1956] 2 Lloyd's Rep 240; *Winter v Irish Life Assurance PLC*, [1995] 2 Lloyd's Rep 274.

[108] Ibid.

[109] *Colinvaux's Law of Insurance*, note 42 above, p 309; R Merkin, *Lowry, Rawlings and Merkin's Insurance Law – Doctrines and Principles* (Hart, 2022), p 91.

[110] *Colinvaux's Law of Insurance*, note 42 above, p 309.

[111] Draft Bill, note 38 above, paras 5.52–5.54; Birds J; Lynch B; Simon P (eds); *MacGillivray on Insurance Law*, note 85 above, p 605.

[112] *MacGillivray on Insurance Law*, note 85 above, p 605

[113] *Birds' Modern Insurance Law*, note 40 above, p 127.

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how clear and how specific the questions were; (4) on renewal or variation of contract, how clearly the insurer communicated to the consumer the importance of answering questions and the possible consequences to not doing so; and (5) whether or not an agent was acting for the consumer (Section 3(2) CIDRA).[114] This list is open, as other circumstances may be taken into account. The Law Commission only mentioned that these are the cases where misrepresentation might be reasonable.[115] Misrepresentation done in dishonesty will always be considered as acting without reasonable care (Section 3(5) CIDRA).

The test is primarily objective, and the standard of care is that of a reasonable consumer (Section 3(3) CIDRA). As it will be discussed more in the next Section, the concept of 'reasonableness' is not strange to English law. The 'reasonable consumer' is an average consumer without any particular or specific skillset. The exception is where the actual consumer 'was, or ought to have been, aware of any particular characteristics or circumstances and they were not disclosed, those are to be taken into account' (Section 3(4) CIDRA).[116] The attestation whether a consumer's statement of fact is a misrepresentation is on the insurer. The insurer must show that without the misrepresentation, he would not have entered into the contract (or variation of the contract) or would have done it only under different terms (Section 4(1) CIDRA).

Looking comparatively and functionally, although German, European, and English approaches differ in the drafting technique, the final outcome is not so different. If the insurer needs to set forth a clear question about circumstances deemed to be material, the insurer is the one determining the test of materiality (or the test of a reasonable care in England). The function of such provision(s) is to shift the burden of proof of materiality/misrepresentation from the consumer onto the insurer, and this was clearly achieved in all jurisdictions under investigation.

c. *Economic reasoning*

This Section address basic economic arguments as support of the questionnaire method. From the law and economics perspective, the questionnaire method helps address some of the main obstacles in the insurance market, such as: information asymmetry (one party knows more than the other); insurance rate differentiation (calculating the rate for that particular consumer); adverse selection (extending coverage to substantially higher risks); and ultimately leads to costs reduction.[117]

In practice, in the pre-contractual phase, the insurer makes the assessment of each single risk it is about to undertake. This assessment largely depends on the

[114] For a stimulating analysis of these factors, see G Charkham, 'Reform of Insurance Law: The Consumer Insurance (Disclosure and Representations) Act 2012' (2013) 25 *Insurance Law Monthly*, p 41; *Consumer Insurance Law: Disclosure, Representation and Basis of Contract Clauses*, note 46 above, para 6.9.; *Birds Modern Insurance Law*, note 40 above, p 127.

[115] Draft Bill, note 38 above, para 5.71.

[116] For discussion, *MacGillivray on Insurance Law*, note 85 above, pp 607–608.

[117] See M Rothschield and J Stiglitz, 'Equilibrium in Competitive Insurance Market: An Essay on the Economics of Imperfect Information' (1976) 90 *The Quarterly Journal of Economics* p 629.

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characteristics, type, and nature of the risk in question (eg ensuring someone's health, life, house, specific voyage). The insurance practice shows that the range of elements and factors relevant for the insurer's decision are sufficiently well known and objectively predictable,[118] thus allowing insurers to develop standard rates for certain types of insurance as a group (for example standard rates for car insurance or home insurance).[119] This is called the pooling of risks.[120] As a result, the relative predictability of rates and costs attracts more consumers onto the market. But, in some cases there are still some other risk factors unique to that particular consumer, such as health reasons, drinking and fast driving, risky lifestyle, etc.[121] The questionnaire method is thus an adequate tool for the disclosure of the factors unique to that particular consumer. Maybe the applicant is a professional car driver or free climber and thus their lifestyle is riskier. From a legal perspective, information captured through a questionnaire allows the insurer to design the insurance contract specifically for that particular consumer. From the law and economics perspective, the questionnaire method helps to tackle some of the main problems faced by the insurance companies.[122] They will be explained very briefly here.

The main problem for insurance companies is *information asymmetry*, a concept that was discussed above. It is the situation where one party knows more (or different) information than another. The questionnaire method helps insurers to find out about the unique risk factors of that particular insured and creates a situation where both parties are informationally equal. For example, four heart operations is relevant information for the life insurance policy and disclosure of that information removes information asymmetry. Secondly, as the risk is higher (four heart operations), the insurance premium (rate) must be higher. The insurer will thus differentiate the insurance premium for that particular insured and not apply the standard rate for life insurance policies. This is called *insurance rate differentiation*.

Another major issue for insurance companies is called *adverse selection*.[123] Adverse selection refers to a situation where the insurer extends the coverage to a risk that is substantially higher than the insurer is aware of.[124] The insurer will find itself in a situation where it must pay more than anticipated.[125] This happens

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[118] B Soyer, 'Reforming Pre-contractual Duty of Utmost Good Faith in Insurance Contracts: An Economic Perspective' (2008) Journal of Business Law, pp 4–5. The author argues that pre-contractual disclosure is the more essential part of the rating process in business insurance contracts, rather than consumer insurance.

[119] Mackaay, note 60 above, p 177.

[120] Ibid.

[121] Ibid, pp 177–79.

[122] Cooter and Ulen, note 55 above, p 50.

[123] The term is established by pioneer Akerlof, note 56 above, pp 488–500.

[124] For information economics study, see H Fleischer *Informationsasymmetrie im Vertragsrecht*, (CHBeck, 2001).

[125] Cooter and Ulen, note 55 above, p 49.

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usually because the information about the risk is not accurate. Together with some other tools,[126] asking the right questions helps insurers to identify the correct risk factors and avoid exposure to adverse effects (overpaying a claim).[127] For example, a policyholder failed to disclose that he is a passionate free climber without security ropes (high-risk customer) in the questionnaire for a life insurance policy.

Finally, the questionnaire method also helps with the issue of *cost reduction*. Generally, collecting information costs time and money. Any increase of the costs of collecting information will spill over onto the consumer (policyholder) through the increase in the premium, which may give rise to an undesirable consequence—the reduction of a demand for insurance.[128] Because of the cost increase, consumers will simply leave the market and not buy insurance. To avoid these negative consequences, insurers in the consumer insurance market have a tendency to group similar risks and to develop standard rates for certain types of insurance, based on the previous statistical calculations and experience (for example for car insurance, property insurance, travel insurance, etc). Because insurers collect information for years, they know there are patterns of information, such as risk factors and consumer characteristics, that are continuously repeating as decisive for certain types of risks and for certain profiles of consumers. In order to reduce the cost of collecting information, the insurer's decision about the insurance contract is most usually based on those predictable risk factors. This is cost efficient. Furthermore, if the insurer, based on the questionnaire, finds out that the risk could be further differentiated, it is more cost efficient for the insurer to lower the premium for that particular consumer, rather than to conduct a full investigation from the beginning.[129]

2. Actual Knowledge Versus Presumed Knowledge – Is the Level of Knowledge of a Policyholder Still Relevant?

a. Legal framework and general observations

This Section follows up on the previous one and the discussion of whether the consumer (policyholder) should disclose the information known (actual knowledge) or that ought to be known to him (presumed knowledge)? Actual knowledge is a question of fact.[130] The policyholder simply cannot disclose beyond his knowledge. 'The duty is duty to disclose, and you cannot disclose what you don't know. The obligation to disclose, therefore, necessarily depends upon the knowledge one

[126] Cooter for example suggest some additional tools such as medical or psychological testing, coinsurance or deductible insurance, exclusion of benefits etc. See more, ibid.

[127] P Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat* (Research paper, University of Connecticut, 2003), https://ssrn.com/abstract=434604.

[128] N A Doherty and Schlesinger, *Rational Insurance Purchasing: Consideration of Contract Non-performance*, p 243; Soyer, note 118 above, p 5.

[129] Mackaay, note 60 above, p 177.

[130] *MacGillivray on Insurance Law*, note 85 above, p 478; *Birds' Modern Insurance Law*, note 40 above, p 116.

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possesses'.[131] It would seem unjust for policyholders to suffer repercussions for something they simply do not know. What about presumed knowledge? Should policyholders be under an obligation to disclose information they ought to know?

Under German law policyholders must disclose only 'the risk factors known to them…'[132] (Section 19(1) VVG, actual knowledge). Actual knowledge is based on the positive knowledge of that particular policyholder when answering the questionnaire in writing. The policyholder is not required to conduct research regarding which facts classify as material, he simply needs to answer the questions, even if he does not know or cannot recognise the materiality of the facts.[133] However, according to the German basic method of '*Anscheinsbeweis*' taken from German civil procedure (Section 286 ZPO), the actual knowledge of the policyholder is (rebuttably) presumed if the insurer shows that under normal conditions and on the basis of a typical course of events, the policyholder would have had actual knowledge of the relevant fact.[134]

In contrast, PEICL requires actual or presumed knowledge. The policyholder should disclose circumstances he 'is aware or ought to be aware of…' (Section 2:101 PEICL). The drafters of PEICL expressed the opinion that in most European countries, the law makes no distinction between actual and presumed knowledge.[135] Instead, individual characteristics and experience of the policyholder should be taken into consideration by courts when deciding on the breach (for example, knowledge of a firefighter is relevant when applying for home insurance against fire).[136] The policyholder has no duty to investigate facts outside his actual knowledge, but he must be honest and is expected to make reasonable enquiries and check his statements on the application.[137]

Under English law, there have been some discussions by the Law Commission regarding whether the reasonableness test should be objective (reasonable assured) or subjective (the actual insured), or some sort of synergy between both (reasonable insured in the position of the actual insured).[138] As examined in the previous Section,

[131] *Joel v Law Union and Crown Insurance Company* (1908) 2 KB 863, 884.

[132] 'Die ihm bekannten Gefahrumstände… ', § 19(1) VVG.

[133] MüKo 2010/Prölss, *Versicherungsvertragsgesetz*, § 19(1), Rdn 57. Before, the VVG Reform insurer had the right to terminate a contract if the insurer fraudulently refrained from gaining knowledge of a material fact (ex, § 16(2) Sentence 2 VVG 1908). This is very similar to the English exception for judgment of policyholder's actual knowledge. Currently, this provision is omitted from the VVG 2008. For legal consequences of this reformed provision and comparison to the English solution, see G Rühl, 'Common Law, Civil Law and the Single European Market for Insurances' (2007) 54 *International and Comparative Law Quarterly* p 892.

[134] Rühl, note 133 above, p 892.

[135] PEICL Art 2:101, Comment C4.

[136] Ibid; Cousy, note 96 above, p 79.

[137] PEICL Art 2:101, Comment C7. Heiss and Mönnich, note 28 above, p 391.

[138] For further discussion see *Colinvaux's Law of Insurance*, note 42 above, p 310.

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CIDRA clearly indicated that the standard of care is 'that of a reasonable consumer' (Section 3(3) CIDRA).[139] The reasonable care test is principally objective, looking at the typical behaviour expected of a reasonable consumer in the market. This test usually does not take individual characteristics of the actual consumer (language, age, gender, etc), although sometimes there are exceptions to this rule.[140] This implies an average consumer in the market with no special skills or knowledge. Subjective adjustment of an objective test is when an insurer was aware, or ought to have been aware, of any particular characteristics of the actual insured (subjective test), these circumstances are to be taken into account (Section 3(4) CIDRA). Similar to this is dishonest behaviour of the consumer, as this will always be considered as breach of duty (Section 3(5) CIDRA). In the Draft Bill Report, the Law Commission provides for some useful illustrations of the test. For example, the level of care expected from the consumer will sometimes depend on the way the insurance was sold (via telephone or face to face, or with the help of an agent).[141] Greater care is also expected if the insurer asked the consumer to check their records before completing the questionnaire (eg medical records), or if an insured has knowledge or understanding beyond what is average and the insurer is aware of that (eg a firefighter regarding insurance against fire or a doctor regarding medical insurance).[142]

Several conclusions could be reached on this point. Firstly, under both English and German law, the consumer's (policyholder's) pre-contractual disclosure requires actual knowledge only. PEICL requires actual and presumed (constructive) knowledge. But is the distinction between actual and presumed knowledge actually relevant in practice? First, in relation to the criterion of judgment, the judgment of the policyholder's actual knowledge is based on 'the reasonable/typical expectation of disclosure of consumers in the market' (England), or expected behaviour of the insured to disclose 'under normal circumstances and on the basis of typical course of events' (Germany). These two criteria do not differ significantly.

Secondly, looking at the legal remedies, breach or omission to disclose facts in a questionnaire gives the insurer the right to withdraw from the contract (Germany), to avoid the contract (England), to propose a reasonable variation of the contract, or to terminate the contract (PEICL). But the right to exercise these legal remedies largely depends on the distinction between deliberate, reckless, or careless misrepresentation (England) or the innocent, negligent, and fraudulent breach of the policyholder (Germany, PEICL). Legal remedies thus rely on the level of culpability of the breach and not on the differentiation between actual or presumed knowledge. I believe this issue was greatly important in the past before reforms, but today, following the requirement of insurers' questions, the distinction between actual and presumed knowledge has lost significance.

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[139] Recommendations for the Draft Bill, note 38 above, para 5.36.

[140] CIDRA Clause 3(3–4); Draft Bill, note 38 above, Clause 3(3-4), Explanatory Notes – Clause 3; A. 19, For further discussion see Recommendations for the CIDRA Draft Bill, note 38 above, para 5.67–5.90.

[141] Draft Bill, note 38 above, para 4.17.

[142] For more, see ibid, paras 5.81–5.85.

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3. Legal remedies: All-or-Nothing Principle Versus Principle of Proportionality

a. Legal framework and general observations

This Section examines the legal remedies for the breach of the policyholder's pre-contractual duty of disclosure. Failure of pre-contractual disclosure will trigger a complex system of legal remedies in all jurisdictions under comparative survey. The main characteristics of all systems is the shift from an all-or-nothing principle to the principle of proportionality. What are those principles about and how are they contributing to building trust in the consumer-insurer relationship?

An all-or-nothing principle is based on the understanding that breach of the disclosure duty leads to a defect of the consent (will) of the parties and hence to the invalidity of the contracts. The sanction could not be anything else except the nullity (avoidance) of the contract even if the non-disclosure was innocent (Section 61 VVG 1908, Section 18 MIA 1906). So, the contract could either stay in force (all) or be avoided in full (or nothing). Until a decade ago, this approach was typical for all systems under survey. For years, this approach was considered unjust and too burdensome for the consumer and had a negative impact on trust between the parties.[143] Thus, it was often softened in both English[144] and German[145] insurance practice.

The principle of proportionality, as the more modern approach applicable today, abandoned this view and replaced it with a more economical one 'based on the equilibrium between the real risk and the amount of the price'.[146] With some exceptions and depending on the nature of breach, the principle of proportionality requires the contract to be adjusted proportionally to the level of breach (Section 22 VVG, Clause 2 CIDRA, Article 2:102 PEICL). The general intention of the law was obviously to foster the trust and continuation of contract, even under modified premium or contract terms.

b. Principle of proportionality

Under English law, the insurer will have a right to a remedy against a consumer only under two conditions. If the consumer failed to 'take reasonable care not to make a misrepresentation' (Clause 4(1)(a) CIDRA) and only if it 'shows that without the misrepresentation, insurer would not have entered into the contract at all or would have done so only on different terms' (Clause 4(1)(b) CIDRA).[147] This provision is in essence codification of the requirement of inducement developed by the

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[143] About discussions in Germany VVG Abschlussbericht, pp 36–38; Wrabetz/Reusch, MüKomm VVG, § 23 Rdn. 4; Burmann/Heß, Die VVG-Reform: Alles oder Nichts – das ist (nicht mehr) die Frage, pp 159 *et seq*.

[144] Especially via self-regulatory instruments, such as ABI Statements, ICOBS Rules, or practice of FOS. For English practice, see Draft Bill, note 38 above, paras 2.29 *et seq*.

[145] For German practice, see R Koch, *Abschied von der Rechtsfigur der verhüllten Obliegenheit*, pp 285–288.

[146] Cousy, note 96 above, p 120.

[147] Under the earlier MIA 1906 regime, misrepresentation gave a right to a legal remedy only if it would influence the judgement of a hypothetical prudent insurer. CIDRA did not continue with this approach. See *MacGillivray on Insurance Law*, note 85 above, p 609.

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House of Lords in the case of *Pan Atlantic Insurance Co Ltd v Pine Tom Insurance Co Ltd*,[148] which was again acknowledged in *Jones v Zurich Insurance PLC* in 2021.[149] The test is summarised with the question regarding what would the insurer do if there was no misrepresentation.[150] If these two conditions are met CIDRA refers to it as 'qualified misrepresentation' and the insurer may resort to legal remedies specified in Clause 5 of CIDRA.

The remedy available to the insurer largely depends on the classification of the qualified misrepresentation as: (1) deliberate or reckless; or (2) careless. The Law Commission consulted extensively on these concepts with the stakeholders. In the end, the Law Commission adopted the classification of FOS and the ABI Code of Practice.[151]

A qualifying misrepresentation is 'deliberate' or reckless" if the consumer (1) knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading,[152] and (2) knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer (Clause 5(2) CIDRA).[153] Simply put, a consumer acts deliberately if they act with knowledge. A consumer acts recklessly if they act without care as to the truth of an answer (as was established in the case *Derry v Peek*[154]).[155] Where the qualified misrepresentation is deliberate or reckless, the insurer may avoid the contract, refuse all claims, and need not return any of the premiums paid, except to the extent (if any) that it would be unfair to the consumer to retain them (all-or-nothing principle) (Clause 2, Schedule 1 CIDRA). CIDRA, in principle, follows the same approach of the common law (Section 84 of MIA), where in case of fraud there is an avoidance and no need to return the premiums paid, with slight difference as to the new possibility to return premium partially due to the requirement of (un)fairness.[156] Also, return of a premium is not to be regarded as estoppel against the claim that the insurer acted deliberately or recklessly.[157] The burden of proof that the misrepresentation was deliberate or reckless is on the insurer.[158] However the insurer must operate within two additional presumptions: (1) that the consumer had the knowledge of a

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[148] *Pan Atlantic Insurance Co Ltd v Pine Tom Insurance Co Ltd* [1995] 1 AC 501; *Colinvaux's Law of Insurance*, note 42 above, p 311.

[149] *Jones v Zurich Insurance PLC*, note 95 above, p 44, also citing Lord Mustill in *Pan Atlantic*, p 551.

[150] Ibid.

[151] Draft Bill, note 38 above, paras 4.12, 6.13–6.33.

[152] *Southern Rock Insurance Co Ltd v Hafeez*, note 95 above.

[153] See also, Draft Bill, note 38 above, Explanatory Notes – Clause 5, A 29–33.

[154] *Derry v Peek* [1889] 14 App Cas 337.

[155] Draft Bill, note 38 above, Explanatory Notes, para 39; Report, paras 6.13–6.33. See more *MacGillivray on Insurance Law*, note 85 above, p 610.

[156] One example where this could be possible is a joint insurance policy where only one party acted deliberately or recklessly. *Colinvaux's Law of Insurance*, note 42 above, p 313.

[157] *Ageas Insurance v Stoodley*, note 95 above; also *Colinvaux's Law of Insurance*, note 42 above, p 313.

[158] *Southern Rock Insurance Co Ltd v Hafeez*, note 95 above, p 73.

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reasonable consumer; and (2) that the consumer knew that a matter about which the insurer asked a clear and specific question was relevant to the insurer[159] (Clause 5(5) CIDRA). The Law Commission did explain that such a burden of proof should not be too onerous or burdensome on the insurer, but something that can be reasonable expected.[160] For example, if a consumer fails to provide an answer regarding a heart attack in the last five years as a response to the insurer's clear and specific question.[161]

A qualifying misrepresentation is 'careless' if it is not deliberate or reckless (Clause 5(3) CIDRA).[162] In *Jones v Zurich Insurance PLC*,[163] the Court held that a deliberation whether conduct is deliberate or reckless is possible only if there has been an express pleading to that effect on behalf of the insurer; a Court may not reach that conclusion on the basis that the evidence speaks for itself.[164] Where the qualifying misrepresentation is 'careless' the insurer will be entitled to a compensatory remedy based on the principle of proportionality. The decision would depend on what the insurer would have done had the consumer complied with the duty to make a representation. CIDRA considers three possibilities. Firstly, if the insurer would not have entered into a contract on any terms, the insurer may avoid the contract and refuse all claims, but must return the premiums paid[165] (Clause 5, Schedule 1 CIDRA). Secondly, if the insurer would have entered into the contract but under different conditions, the contract will be treated as if had been entered under those different conditions if the insurer so requires (Clause 6, Schedule 1 CIDRA). This option does not relieve the insurer of the duty to pay the claim itself.[166] Thirdly, if the insurer would have entered into the contract but under a higher premium, the insurer may reduce proportionately the amount to be paid on the claim (Clause 7, Schedule 1 CIDRA).[167] The so called 'reduced proportionately' rule enables the insurer to pay only the proportion of a claim that it would otherwise have been under the obligation to pay under the (different) terms of the contract (Clause 8, Schedule 1 CIDRA).

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[159] This was discussed in *Tesco Underwriting Ltd v Achunche*, note 95 above, where failure to disclose an earlier conviction following a clear and specific question by the insurer was considered a deliberate or reckless omission; and *Ageas Insurance Ltd v Stoodley*, note 95 above, on the presumption that a consumer knew that a matter the insurer asked a clear and specific question about was relevant to the insurer.

[160] Draft Bill Report, note 38 above, para 4.23. For more examples and explanation see paras 6.34–6.39.

[161] Ibid, para 42.

[162] See also Draft Bill, note 38 above, Explanatory notes - Clause 5, A 29–33

[163] *Jones v Zurich Insurance PLC*, note 95 above. The claimant stated that he had lost a £190,000 watch while skiing and made a claim under the Zurich insurance policy. He also stated that he had made no such claims in the last five years, which was false. The Court held that Zurich was entitled to avoid the policy under the 2012 Act. But Zurich had to reimburse the premium paid as the Court held that misrepresentation was careless rather than deliberate or reckless.

[164] See *Colinvaux's Law of Insurance*, note 42 above, p 311.

[165] Confirmed in *Jones v Zurich Insurance PLC*, note 95 above.

[166] *Colinvaux's Law of Insurance*, note 42 above, p 313.

[167] For further discussion, see Recommendation for the Draft Bill, note 38 above, paras 6.13–6.39.

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PEICL takes a similar approach and makes differentiation between legal remedies based on the type of breach. In the case of an *innocent* breach, the insurer is not entitled to terminate the contract, but only to propose a variation of the contract, unless the insurer proves that it would not have concluded the contract had he known the information concerned (Article 2:102(4) PEICL). In other words, in the case of an innocent breach, the insurer would be entitled to terminate the contract and to refuse payment of the cover in total only in two cases: (1) if the insurer proves that the information concerned was material to his decision; and (2) if the parties were unable to agree on a reasonable variation of the contract within a one month period from the notice.[168] In the case of *negligent breach*, the principle of proportionality applies, and the contract will be adjusted, unless the insurer would not have concluded the contract at all (Article 2:102(4) PEICL). Of course, the requirement of causal connection must be met. In the case of *fraudulent* breach, the insurer has the right to avoid the contract and keep any premium due (Article 2:104 PEICL).[169]

German law offers the most complex system of all three legal regimes under investigation. This system is a combination of special rules developed for consumer insurance contracts (*lex specialis*, VVG) and the general rules under the German Law of Obligations (*lex generalis*, BGB). It also largely relies on the culpability of the consumer from the general contract law (Section 276 BGB). Innocent breach or breach in simple negligence will no longer lead to a full rejection of a claim (all-or-nothing principle)[170] but the insurer has the right to withdraw from the contract (*zurücktreten*, Section19(2) VVG)[171] in accordance with the general rules of the German Code of Obligations (Sections 346–354 BGB). Intentional breach or breach with gross negligence[172] will give the insurer the right to terminate the contract, with one month notice period (Sections 19(3), 21(2)(3) VVG).

Interestingly, these rights can be exercised only if the contract cannot be adjusted proportionally to the undisclosed facts (principle of proportionality). Unlike English law and PEICL, under German law, the principle of proportionality takes precedence over withdrawal or termination. If the insurer would have concluded the contract with knowledge about the non-disclosed facts, albeit under different terms and conditions, the insurer will amend the contract instead of terminating or withdrawing it (*Vertragsanpassung*, Section 19(4) S 1 VVG). The newly ascertained information shall then become an integral part of the contract with retroactive effect upon the request of the insurer[173] (Section 19(4) VVG).[174] It is evident that the German

[168] PEICL Art 2:101, Comment C4.

[169] For a critical overview, see Heiss and Mönnich, note 28 above, pp 393–400.

[170] As it was before the VVG Reform 2008.

[171] MüKo 2010/Langheid, *Versicherungsvertragsgesetz*, § 19(2), Rdn 114–16.

[172] '*Wenn der Versicherungsnehmer die Anzeigepflicht weder vorsätzlich noch grob fahrlässig verletzt hat* ', § 19(3) VVG, MüKo 2010/Langheid, *Versicherungsvertragsgesetz*, § 19(2), Rdn 134–36.

[173] '*Wenn er den Vertrag auch bei Kenntnis der nicht angezeigten Umstände … wenn auch zu anderen Bedingungen, geschlossen hätten*' Ibid § 19(4) VVG.

[174] MüKo 2010/Langheid, *Versicherungsvertragsgesetz*, § 19(2), Rdn 140–53.

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legislator was strongly focused on keeping the contract in force even under different terms and conditions.[175]

For the principle of proportionality to be applied under German law, two more conditions must be met: (1) there should be a causal connection/link between the undisclosed fact(s) and the risk determination; and (2) the insurer would have entered into the contract if he had known about the undisclosed facts (even if under different conditions).[176] The basis of this rule has origins in the general law of contract. To prove the latter the German insurance practice is to use the so-called 'estimation' method.[177] This method takes into consideration the general and special terms and conditions in force at the time the contract is concluded and all the insurance practice of that particular insurer until today. From the insurers' practice, one can easily estimate whether that particular insurer would have entered into that particular contract under the undisclosed facts. If necessary, the legislation also proposes using comparative analysis with a similar contract of that particular insurer.[178] Interestingly, the estimation method attributes the knowledge to the insurer that he does not have, only to keep the contract in force. By requiring the insurer to adjust the contract, the legislator actually puts the insurer in the position as if he had known about the undisclosed facts (although he had no actual knowledge about the facts).[179] This is not found in other jurisdictions.

c. Economic reasoning

Introducing the principle of proportionality in all jurisdictions under survey is also acceptable under law and economics theories, especially in terms of reduction of costs in long-term insurance policies, such as life insurance. In the case of negligent breach (Germany, EU) or deliberate or reckless misrepresentation (England), under the all-or-nothing principle, the insurers would always have the right to terminate (Germany, EU) or avoid (England) the contract and return all the premiums paid. In the case of long-term insurance, this may be even after five or ten years. This would also mean that insurers need to invest more time and money for the pre-contractual investigation of the facts to eliminate the avoidance or termination of a contract in the future. Economically, insurers also suffer loss as they did not take up other insurance contracts instead. For policyholders, the all-or-nothing principle implies insecurity as there could always be some undisclosed facts (even innocently undisclosed) because of which the contract may be avoided or terminated. It seems like the all-or-nothing principle is a 'lose-lose' situation for both parties.

The principle of proportionality brings in more contractual security and balance into a policyholder-insurer relationship. It serves as a protection mechanism for the consumers and it also reflects the reality of insurance practice. Comparative

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[175] Baumann/Sandkühler, *Das Neue VVG* (Haufe, 2009), pp 59–60; Langheid, MüKomm VVG, § 19 Rdn 150

[176] Langheid, MüKomm VVG, § 19 Rdn 147.

[177] Ibid.

[178] MüKo 2010/Langheid, *Versicherungsvertragsgesetz*, § 19, Rdn 150.

[179] Baumann/Sandkühler, note 175 above, p 60.

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analysis clearly shows that in the case of a breach, consumers will be able to recover at least some part of the claim under insurance policy. The exceptions are fraudulent (Germany, PEICL), deliberate, or reckless breach (England). This must bring great psychological relief to the consumers. Such security is also a strong incentive for the consumers to enter into insurance contracts, which is economically desirable for the insurers. The principle of proportionality thus reduces the costs for the insurer as they do not need to seek new contracts and pre-contractual disclosures. As insurers are able to adjust the contract after, finding out about new risk factors (either by proportionally reducing the payment of the claim or adjusting the premium), they are not inclined to spend time and money for the comprehensive pre-contractual investigations in order to escape the termination/avoidance of the contract.[180] The principle of proportionality seems like a 'win-win' situation for both parties.

d. Prohibition of disclosure of certain information – An exception to transparency?

An interesting tendency visible in the last few years is the legal prohibition of the exchange of certain information, with the impact of limiting or restricting the policyholder's duty of disclosure. The function is clearly to protect diverse values, depending on the area of law. One good example is the prohibition to transfer to or use an insured's genetic information, with the purpose of protection of privacy, human dignity, or non-discrimination.[181] Another example deriving from the anti-discrimination laws is prohibition to use 'sensitive information', such as gender information, with the aim of protecting the individuals in question. This prohibition is already well acknowledged in the area of life insurance and personal insurance when forming premium segmentation.[182] The same is true for numerous EU directives, which prohibit any discrimination on the grounds of gender, ethnic origin, age, sexual identity, race, religion, disability, ability of contract performance, etc.[183] In Germany, the General Act on Equal Treatment (*Allgemeines Gleichbehandlungsgesetz* ('AGG'))[184] was enacted in 2006, implementing the

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[180] B Soyer, 'Reforming the Assured's Pre-Contractual Duty of Utmost Good Faith in Insurance Contracts for Consumers: Are the Law Commissions on the Right Track?,' note 118 above.

[181] Cousy, note 96 above, p 123.

[182] For example, Council Directive 2004/113/EC of 13 December 2004 Implementing the Principle of Equal Treatment between Women and Men in the Access to and Supply of Goods and Services [2004] OJ L373. The Directive prohibits premium segmentation based on gender, but allows member states to opt out from the application, which included most of the EU member states. Cousy, note 96 above, p 123.

[183] For example, Directive 2000/43/EC Against Discrimination on Grounds of Race and Ethnic Origin; Directive 2000/78/EC Against Discrimination at Work on Grounds of Religion or Belief, Disability, Age or Sexual Orientation; Directive 2006/54/EC Equal Treatment for Men and Women in Matters of Employment and Occupation; Directive 2004/113/EC Equal Treatment for Men and Women in the Access to and Supply of Goods and Services; Directive Proposal (COM(2008)462) Against Discrimination Based on Age, Disability, Sexual Orientation and Religion or Belief beyond the Workplace.

[184] *Allgemeines Gleichbehandlungsgesetz*, 14 August 2006 (BGBl. I S. 1897).

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provisions of many of these EU directives. The Equality Act 2010 in England is similar.[185]

The mechanism of consumer protection is clearly visible. By respecting the legislation on prohibition of disclosure of certain information, the consumer is protected against non-disclosure of certain information, even if they are material to the insurer. I believe such prohibition works as the exception to the transparency requirements. The aim here is not to analyse prohibition in detail but to draw attention to yet another mechanism that could raise confidence and trust in the consumer-insurer relationship.

III. CONCLUSION

Insurance is a 'trust management business.[186] Because insurance is a complex legal product,[187] it does not have physical form and cannot be held in our hands and examined; it must be based on trust. Trust is relevant not only for consumers (that they will buy a product they actually need for a fair price) but for the insurance companies and underwriters as well in order to grow their business and keep the customers content.[188] One of the ways to build trust is certainly through transparency rules.

This paper is dealing with transparency as a general principle of insurance law, which is focused on the exchange of information between contracting parties. Insurance products are complex. Together with the complex regulatory environment made out of national and supranational legal provisions, terms, conditions, and exceptions, accompanied by the complex changing insurance market, offer and demand it is necessary to keep the transparency requirements as high as possible.[189] Basically, transparency in insurance contract law tries to 'keep the informational gap between actors involved as low as possible'.[190] This paper showed some common tendencies. The most important one being that the informational gap can be reduced through the rules on pre-contractual disclosure.

The last decade has been exciting across Europe as pre-contractual disclosure was subject to major legislative reforms (England in 2012, Germany in 2008). One of the most important interventions towards securing transparency and trust is the shift from spontaneous disclosure to a questionnaire method (Germany, EU) or an obligation not to make misrepresentation (England). For years, this was a thorn in the side of the insurance system. The advantages are numerous. Firstly, there is clear evidence in practice that in consumer insurance contracts, the factors material for the insurer's

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[185] Before the Act came into force there were several pieces of legislation to cover discrimination, including: the Sex Discrimination Act 1975; the Race Relations Act 1976; and the Disability Discrimination Act 1995. For more, see https://www.gov.uk/guidance/equality-act-2010-guidance. See more, Rühl note 133 above, p 894.

[186] Van Rossum, note 12 above, pp 52–55.

[187] Wandt, note 9 above, p 343.

[188] Zboron, note 13 above.

[189] *Transparency in Insurance Contract Law*, note 3 above, p 5.

[190] Ibid, p 6.

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assessment of risk are well known and quite predictable, thus allowing the insurer to group similar risks into risk pools and to develop standard rates for certain types of insurance. On those grounds, the insurers can easily ask a number of questions for the great majority of risks and may use general clauses for the rest. Second, the clear statutory concept of pre-contractual disclosure provides a clear platform for decision making with the avoidance and refusal of the insurer claims (especially in England). This relates to transparency of the insurers' terms and conditions. Thirdly, the tendency of 'asking questions in writing' is clearly in line with the consumer protection policies striving from the EU consumer *acquis*. In many cases, consumers are not aware that they have to disclose, and even if they are, they are unable to evaluate the relevance of information. Finally, the form of a questionnaire helps with cost reduction as well as the elimination of negative consequences of information asymmetry and adverse selection.

The next building block towards ensuring transparency (compared to earlier regimes) is the clear regulation of the insurer's duty to make all information about the contract known to the consumer (policyholder) during negotiations. Usually, this is done via a product information document. This ensures transparency about pricing, transparency about terms and conditions, and transparency about dispute resolution mechanisms. This obligation has been clearly acknowledged in all systems under comparative survey, although it takes different forms.

Finally, one more step towards ensuring transparency manifests in the regulation of legal remedies for the breach of pre-contractual disclosure. The principle of proportionality, which replaced the harsh all-or-nothing principle, led to strengthening the position of the consumer. If the information is not shared in a transparent manner (no matter the reason), depending on the nature of breach, the insurance contract might still be proportionally adjusted and binding, although under different conditions. Compared to earlier solutions where contracts could be avoided even for innocent breach, such legislative intervention certainly improves the legal position of consumers.

Overall, compared to earlier regimes, current regulation in England, Germany, and the EU corrected some harshness towards consumers and led to the increase of trust. Nonetheless, there is still room for improvement. For example, the need for further development is already clearly evidenced by the new UK Consumer Duty Instrument 2022, which imposes a new and higher standard of conduct for financial businesses (transparent marketing, duty to act in good faith, duty to avoid foreseeable harm) and has a much broader application in relation to the current practices. Comparing to German and EU insurers' pre-contractual duty to advise, the new development under English law clearly indicates that insurers need to increase transparency and discovery of what consumers actually need. Indirectly, this calls for further improvement of the precontractual disclosure.

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