Minister for Community Safety
Fergus Ewing MSP

T: 0845 774 1741
E: scottish.ministers@scotland.gsi.gov.uk

The Scottish Government

The Hon Lord Drummond Young
Chairman
Scottish Law Commission
140 Causewayside
Edinburgh
EH9 1PR

23 March 2010

Dear Lord Drummond Young

On behalf of the Scottish Government, I would like to thank you for providing the joint report of the Law Commission and the Scottish Law Commission on *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (Law Com No 319, Scot Law Com No 219). It was also very helpful that the report was accompanied by an impact assessment.

The substance of this impressive report relates to matters which are currently reserved to Westminster, by virtue of Schedule 5 to the Scotland Act 1998. Therefore, while financial services and consumer protection are of importance for devolved matters and for the central Purpose of the Scottish Government, pending any adjustment to the devolution settlement it will be for the UK Government to take forward further work. The can be little doubt, however, that further work should be a priority. The report makes it abundantly clear that this area of the law has been neglected for too long, with adverse consequences for the consumer, for the insurance industry and for the economy as a whole. The case for an overhaul of the Edwardian marine insurance legislation, which now underlies a modern and complex mass consumer market for which it was never intended, appears compelling.

It is clear from the report that today's consumer insurance market evolved over decades which were characterised by a lack of legislative action and by less than wholly successful attempts at self-regulation. The report appears to demonstrate that while self-regulation may have been well-intentioned, it did not ultimately produce an optimal business environment. The difficulties with critical illness insurance provide quite recent evidence of that. But the report illustrates that problems are more widespread.

It is disappointing that, in relation to the rules on non-disclosure and misrepresentation, the Commissions concluded that "*many of the 'warnings' given by insurers .... are misleading*". It is also disappointing that the Commissions found cases in which "*insurers had purported to avoid policies on the ground that the consumer had failed to volunteer information for which they had not been asked*", even though guidance from the Financial Ombudsman Service (FOS) states that it will not permit an insurer to avoid a policy if it failed to ask a question

about the matter under dispute. And it is disappointing too that the Commissions established that "*some insurers continue to use basis of the contract clauses on their proposal forms or policy terms*", even though modern practice decries the use of such clauses. That they appear to impact disproportionately on the more vulnerable members of our society makes such problems all the more unacceptable.

In focusing on these issues, I should emphasise that I would not wish to lose sight of the fact that in this country we have world-class insurance companies offering an excellent service to consumers. It is important to acknowledge and celebrate that success. Indeed, a desire to build on best practice and support its exemplars must be a central driver in endeavours to curtail unacceptable performance amongst other companies.

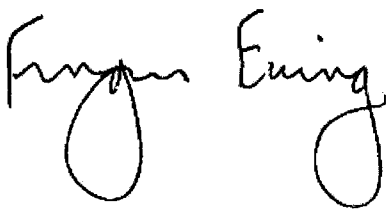
With that in mind, the Commissions' approach to reform – in large part "*to codify what the FOS already does*" – seems sensible. In abolishing the duty on customers to volunteer material facts and replacing it with a duty to take reasonable care not to make a misrepresentation, the recommended legislation would seem to bring the law into line with what is already generally accepted as good practice. The same is true of the proposed three-way classification of misrepresentations. There also appear to be sound arguments for adopting the proportionality principle for insurers' remedies in the event of misrepresentation. The case for the abolition of 'basis of the contract' clauses also seems to be a strong one. And there appear to be no immediate concerns about the proposals in relation to group insurance, life insurance on the life of another, intermediaries (which is clearly an important dimension) and contracting out.

There is good reason to suppose that, while properly enabling insurers to confront instances of wilful misrepresentation and fraud, the scheme recommended in the report will better secure consumers' rights. Consequently, it also seems probable that the Commissions are right to anticipate that "*reform will improve consumers' trust and confidence in the insurance industry which, in turn, will improve sales*".

In conclusion, acknowledging the validity of the concerns which are identified in the report, the Scottish Government supports the overall thrust of the proposals for reform. Of course, as I acknowledged at the outset, it will be for the UK Government to take forward further work on these matters. And while the report suggests that for several decades successive UK Governments have not given these particular matters the attention which they deserve, and though the Scottish Law Commission's most recent Annual Report suggests a more general concern about the attitude of UK Government Departments to the reform of Scots law in reserved areas, I hope that this work will now be accorded real priority.

I am copying this letter to Lord Justice Munby, Chairman of the Law Commission, and to Sarah McCarthy-Fry MP at HM Treasury. A copy also goes to the Rt Hon Jim Murphy MP at the Scotland Office.

Yours sincerely



FERGUS EWING