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# **Insurance Contract Law Issues Paper 3 Intermediaries and Pre-contract Information**

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**This paper should not be quoted as representing the fixed policy of either Commission.**

**The paper has been drafted by the teams working on the insurance contract law review at the English and Scottish Law Commissions and is intended simply to promote discussion before the formal consultation process begins. It has not been subject to formal scrutiny by Commissioners.**

**March 2007**

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# SUMMARY

## INTERMEDIARIES AND PRE-CONTRACT INFORMATION

### PURPOSE

- 1.1 This is the third in a series of Issues Papers produced by the teams working on the insurance contract law review at the English and Scottish Law Commissions. These papers have not been subject to formal scrutiny by the Commissioners and their content should not be quoted as representing the view of either Commission. They are intended to promote discussion before the formal consultation paper is published in summer 2007.

### THE ISSUES

- 1.2 This paper considers the position where a mistake or fraud by an insurance intermediary leads to information not being disclosed or being misrepresented to an insurer.
- 1.3 Previous papers have considered the communication of pre-contract information from policyholders to insurers. Issues Paper 1 looked at the law of misrepresentation and non-disclosure. Issues Paper 2 included a discussion of basis of the contract clauses and warranties of past and existing fact. It is clear from our survey of Financial Ombudsman Service decisions that disputes about these issues often involve allegations about what an intermediary said or did during the sales process. In this paper we consider the interaction between our previous tentative proposals on the communication of pre-contact information and the law of agency as it affects insurance intermediaries.
- 1.4 We discuss three main issues:
  - (1) *The status of intermediaries.* What should the consequences be if an applicant for insurance gives material information to an intermediary and the intermediary fails to convey that information accurately to the insurer? Under current law, the issue depends on whether the intermediary is acting as the agent for the insurer or for the insured. If the intermediary acts for the insured, the insurer may avoid the policy. If they act for the insurer, the insurer is deemed to be aware of the information. However, in many situations the legal status of an intermediary is unclear. We suggest ways in which the position can be clarified within the consumer market.

- (2) *The completion of proposal forms by intermediaries.* An intermediary may incorrectly enter information onto a proposal form that is then signed by the applicant for insurance. The current law generally treats the intermediary as the agent of the applicant when completing a proposal form even if the intermediary is the agent of the insurer for most or all other purposes. It also suggests that applicants should usually be bound by the forms they have signed. We consider whether the principles set out in the leading case on this subject, *Newsholme Brothers v Road Transport and General Insurance Co Ltd*,<sup>1</sup> should be reformed.
- (3) *Section 19 of the Marine Insurance Act 1906.* This provision imposes an independent duty of disclosure on an agent to insure. We consider whether change is needed to the scope of the duty and to the results if the duty is breached.

## **TENTATIVE CONCLUSIONS AND PROPOSALS**

### **Consumer insurance**

#### ***Clarifying the agent's status***

- 1.5 Is it agreed that an intermediary should be regarded as acting for an insurer for the purposes of obtaining pre-contract information, unless it genuinely searches the market on a consumer's behalf?
- 1.6 Should the test for whether an intermediary acts as the consumer's agent depend on whether the intermediary conducts "a fair analysis", as defined by the Insurance Mediation Directive?
- 1.7 Our tentative conclusion is that no additional protection is necessary when consumers have been given bad advice about completing proposal forms by intermediaries who are not subject to FSA regulation. We welcome views on whether this is correct.

#### ***Completing proposal forms***

- 1.8 Is it agreed that an intermediary who would normally be regarded as acting for the insurer in obtaining pre-contract information remains the insurer's agent while completing a proposal form?
- 1.9 Is it agreed that a consumer's signature on an erroneous proposal form should not be regarded as conclusive evidence of their dishonesty or lack of care in the way that a proposal form was completed?

#### ***Completing proposal forms***

- 1.10 We welcome views on whether there are any reasons to preserve section 19(b) for consumer insurance. If so, should a breach grant the insurer a right in damages against the intermediary?

<sup>1</sup> [1929] 2 KB 356.

- 1.11 We ask whether section 19(a) of the Marine Insurance Act 1906 should cease to apply in consumer cases, so that the agent to insure would have no duty to disclose matters other than those which the consumer is bound to disclose in response to questions asked by the insurer.
- 1.12 If there are reasons to preserve an extended duty under section 19(a):
- (1) Should the remedy lie in damages against the intermediary, rather than in avoidance against the insured?
  - (2) Should any information given in confidence by a third party be excepted from the scope of the duty?
  - (3) Should the duty be curtailed to information received in the course of the relevant transaction?

## **BUSINESS INSURANCE**

### ***Clarifying the agent's status***

- 1.13 Is it agreed that the tentative proposal made in respect of tied agents in the consumer market should apply equally to tied agents who deal with small businesses?
- 1.14 Is it agreed that for other businesses, the issue of whom an intermediary is acting for in respect of disclosure issues should be left to the common law?

### ***Completing proposal forms***

- 1.15 Should the tentative proposals we have made in this respect for consumers apply to business insurance?

### ***Completing proposal forms***

- 1.16 We ask:
- (1) Is it agreed that where a broker breaches section 19(a), the insurer should no longer be entitled to avoid the policy against the insured. Instead should a remedy lie against the broker in damages?
  - (2) If so, should the right to damages apply whenever insurance contracts are placed within the UK, or only where the contract is subject to the law of a part of the UK?
  - (3) Should producing brokers be obliged to pass relevant information up the chain to the placing broker?
  - (4) Should the law specifically state that an intermediary is not required to disclose information given to it in confidence by a third party?

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# **PART 1**

## **INTRODUCTION**

- 1.1 The English and Scottish Law Commissions are conducting a joint review of insurance contract law. Before publishing our first formal consultation paper in summer 2007, we are developing our ideas through a series of issues papers.
- 1.2 This paper is issued by the teams working on the project, and has not been approved by Commissioners. Its purpose is simply to promote discussion before the formal consultation process begins. The contents should not be quoted as representing the views of either Commission.

### **SCOPE OF THIS PAPER**

- 1.3 Agency issues will arise in a variety of contexts during the review. We have therefore decided that agency should not be treated as a separate area of law. Instead it will be regarded as a pervasive issue — with aspects being considered alongside other areas of insurance contract law where relevant. In Issues Paper 1 we looked at misrepresentation and non-disclosure. We now turn to consider the agency aspects of those areas. We consider the position where a mistake or fraud by the agent leads to information not being disclosed or being misrepresented, or where it leaves the insured in breach of a warranty of existing or past facts.
- 1.4 We look at three issues:
  - (1) *The pre-contractual receipt of information by intermediaries.* What should the consequences be if an applicant for insurance gives material information to an intermediary and the intermediary fails to convey that information accurately to the insurer? Under current law, the issue depends on whether the intermediary is acting as the agent for the insurer or for the insured. If the intermediary acts for the insured, the insurer may avoid the policy. If they act for the insurer, the insurer is deemed to be aware of the information. However, in many situations the legal status of an intermediary is unclear.

- (2) *The completion of proposal forms by intermediaries.* An intermediary may incorrectly enter information onto a proposal form that is then signed by the applicant for insurance. The current law generally treats the intermediary as the agent of the applicant when completing a proposal form even if the intermediary is the agent of the insurer for most or all other purposes. It also suggests that applicants should usually be bound by the forms they have signed. We consider whether the principles set out in the leading case on this subject, *Newsholme Brothers v Road Transport and General Insurance Co Ltd*,<sup>1</sup> should be reformed.
- (3) *Section 19 of the Marine Insurance Act 1906.* This provision imposes an independent duty of disclosure on an agent to insure. We consider whether change is needed to the scope of the duty and to the results if the duty is breached.

1.5 We start from the position that a clear case for reform needs to be demonstrated before change should be recommended. As we discuss in Part 2, some aspects of the insurance marketplace undoubtedly appear odd to those familiar with general principles of agency law. However, we need to be satisfied that problems are being caused in practice.

## **THE NATURE OF THE PROBLEM**

### **A consumer example**

1.6 The following case illustrates how the issues discussed in this paper impact on consumers:

Mrs A took out a critical illness policy. A sales agent took her through an application form, which asked a series of questions about her health including: “have you ever had asthma, bronchitis or other respiratory disorder”. The agent recorded a “no” against this question, and Mrs A then signed the form to say the answers were correct.

Five years later, Mrs A was diagnosed with cancer and made a claim under the policy. The insurer refused the claim and attempted to avoid the policy because she had a medical history of asthma.

<sup>1</sup> [1929] 2 KB 356.



Mrs A complained to the Financial Ombudsman Service on the grounds that the agent had told her that her asthma was irrelevant. Her account of events was that she had told the representative about her asthma and explained that it was mild and fully controlled by an inhaler. The agent then asked if she had ever been hospitalised for it or used a nebuliser and she said no. On this basis, the agent told her that it was “run of the mill”, and the form was only asking about serious matters. The agent, however, denied the conversation and said he would never tell a consumer not to disclose a health matter, however trivial.

- 1.7 This is not untypical of many cases reaching the Financial Ombudsman Service (FOS). In our survey of 190 consumer cases involving non-disclosure or misrepresentation, 25 (13%) involved allegations about what an intermediary said or did during the sales process.
- 1.8 Cases such as these pose several difficulties for ombudsmen and the courts. In addition to the practical problem of deciding where the true facts lie, the ombudsman must also decide whether the agent was acting for the insurer or for the insured. This depends upon the status of the agent: a broker is presumptively the agent of the insured; an employee of the insurers acts for them; and the position of a third party (such as a bank or building society) is uncertain. However, even if the agent was acting for the insurer, there remain difficult questions about how far the insured should be held to the form they have signed.
- 1.9 There are several variations on these facts. The intermediary may complete the form asking questions over the phone, so that the proposer does not see the form or sign it before it is submitted. In some cases it may be signed in blank by the insured. Alternatively the insured may complete the form herself but omit information, or give an incomplete answer, because the agent has told her that the information is not relevant. A third variation is that the proposer reveals information to the intermediary who simply fails to pass it on to the insurer. As we will see, because Mrs A had signed the form stating that the answer was correct, it would be less obviously unfair to leave her with no remedy (even if her version of the facts is accepted) than in the other cases just mentioned.

- 1.10 The issue is far from new. Reported cases involving agents of insurers date back to 1892,<sup>2</sup> and there has been a more recent batch of cases involving brokers.<sup>3</sup> It would appear that as long as consumer insurance has been sold through agents, there have been allegations that agents induced misrepresentations.

#### **An example from business insurance**

- 1.11 Mrs A's was a consumer case, but similar problems arise in the context of business insurance. In *Roberts v Plaisted*,<sup>4</sup> for example, Mr Roberts insured a hotel through a Lloyd's broker. The hotel operated a discotheque, which the broker was shown when he inspected the premises. Following a fire, Mr Roberts made a claim for £70,000. The underwriters sought to avoid the contract on the ground of non-disclosure of the existence of the discotheque. The Court of Appeal was able to decide in favour of Mr Roberts by finding that the disclosure of information had been waived, although the basis of such a waiver is open to question.
- 1.12 Our survey of FOS cases suggested that problems of this kind are particularly common in complaints by small businesses: they arose in 8 out of the 12 small-business complaints about non-disclosure and misrepresentation in our survey.

#### **WHO IS AN AGENT FOR THIS PURPOSE?**

- 1.13 In looking at these matters we have been conscious that the UK insurance marketplace is well-developed and complex. The term "agent" covers a wide variety of persons and firms who may act for a principal in the formation of a contract of insurance with a third party.
- 1.14 Some proposals for reform (admittedly, not detailed proposals) were very broad-brush. Thus in 1957 the Law Reform Committee recommended a solution, the application of which it believed would lead to "no legal difficulties":

That any person who solicits or negotiates a contract of insurance should be deemed, for the purposes of the formation of the contract, to be the agent of the insurers, and the knowledge of such person should be deemed to be the knowledge of the insurers.

<sup>2</sup> See *Bawden v London, Edinburgh and Glasgow Assurance Co* [1892] 2 QB 534, where an agent selling accident insurance completed a form on behalf of an illiterate one eyed man. The form contained a warranty that the proposer had no physical deformity.

<sup>3</sup> *Hazel v Whitlam* [2005] Lloyd's Rep IR 168; *Friends Provident v Sirius International* [2006] Lloyd's Rep IR 45; *Tioxide Europe v CGU International Insurance* [2006] Lloyd's Rep IR 151.

<sup>4</sup> *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341.

- 1.15 They cannot have meant this literally: it would apply to the consumer who is going on holiday with a group of friends and agrees to arrange a travel policy to cover them all. She has no connection with the insurance industry, but if the Committee's recommendation were taken literally she would be treated as an agent of the insurer.
- 1.16 In fact the preceding discussion suggests that the LRC had in mind "agents nominated by insurance companies" – meaning, presumably, people or firms who, at least for some purposes, acted as an agent of the insurer. This comes closer to the class of agents that in 1977 the Government was considering making "the responsibility of the company for whom they act". The proposal was that anyone who was not registered as an "insurance broker" but who "was used" by an insurer "to sell insurance" would be treated as the insurer's agent, at least in consumer cases.
- 1.17 When reviewing the law governing intermediaries and pre-contract information, we need to bear all the different scenarios in mind. However we should make clear at the outset that, tentatively, we are not proposing any change in relation to most categories of intermediary. Our tentative proposals are much narrower than changes that the Government was apparently contemplating in 1977.
- 1.18 Later we ask if there is a case for treating certain categories of intermediary as the agent of the insurer for the purposes of receiving pre-contract information from a customer who is a consumer or a small business. These are insurance intermediaries who offer products from a single insurer only, or only from a limited number of insurers. We do not suggest a change in relation to intermediaries who offer a range of products based on an analysis of the market as a whole.
- 1.19 In relation to business insurance (other than small businesses) we tentatively suggest that the law should remain broadly as it is, save for amendments to the independent duty of disclosure of the agent under Marine Insurance Act 1906, section 19.
- 1.20 However, we would welcome views both on whether further reform is needed and on how agents might most usefully be grouped for the purpose of defining the scope of any reforms.

#### **THE STRUCTURE OF THIS PAPER**

- 1.21 The remainder of this paper is divided into the following parts:
- (1) Part 2 outlines agency law as it applies to insurance, and considers how the law applies to some of the arrangements now seen in a rapidly changing market place.
  - (2) Part 3 deals with "the *Newsholme* problem" – the case where the agent completes the proposal form and the proposer signs it not noticing a mistake.
  - (3) Part 4 considers the agent's independent duty of disclosure under section 19 of the Marine Insurance Act 1906.

- (4) Part 5 looks at the current position for consumers, taking into account the FSA rules and the approach of the Financial Ombudsman Service.
- (5) Part 6 discusses the case for reform of the law as it applies to consumer insurance.
- (6) Part 7 considers business insurance.
- (7) Appendix A outlines the background to the current position – looking at successive measures of regulation and some of the reports which have been published.

## **PART 2**

# **AGENCY LAW, INSURANCE AND THE CHANGING MARKET PLACE**

### **INTRODUCTION**

- 2.1 Relationships between policyholders, intermediaries and insurers are governed by the general law of agency. This paper does not attempt to review general agency principles. Instead we begin this Part by outlining some of the features of the insurance marketplace which may appear surprising when viewed against such principles. We then consider when an intermediary or other agent will be treated as an agent of the insured and when they will be treated as the agent of the insurer. We then highlight some aspects of the FSA rules and conclude by considering how the law and the FSA rules apply to some current market practices.

### **Remuneration**

- 2.2 Intermediaries who act as agents of applicants for insurance are commonly remunerated by commission, which is typically expressed as a percentage of the premium payable. This commission is paid not by an intermediary's principal, the applicant, but by the third party, the insurer. The level of commission may be agreed between the intermediary and the insurer without reference to the applicant. In some cases the applicant will not be informed of the sum of commission paid.
- 2.3 Nevertheless, intermediaries are regularly regarded as agents of the insured. On general agency principles, it would be expected that an intermediary should account to its principal for any benefit received from a third party. However in insurance it is accepted that the intermediary will retain the commission - indeed this will normally be its only remuneration, with no fee being paid by the applicant.<sup>1</sup>
- 2.4 This paper is not concerned directly with the question of how intermediaries are remunerated. However, we will see that it is a relevant factor. First, the fact that the proposer does not have to pay the intermediary may give the impression that the intermediary in some sense "represents" the insurer. This may affect the proposer's understanding on questions of pre-contract information, encouraging the proposer to rely on what the intermediary has said.

<sup>1</sup> Fee based advice is available for some types of insurance, but is uncommon in both consumer and commercial markets.

## Dual Agencies

- 2.5 Intermediaries may on occasion act for both the insurer and the applicant for insurance — sometimes in the course of the same transaction. In our Scoping Paper we gave the example of an independent intermediary who acts as the agent of the applicant in identifying a suitable motor insurer, then switches to being the agent of the insurer to issue a cover note.<sup>2</sup> Outside the consumer context, it is common for an intermediary to give independent advice to a proposer and then use a binding authority to accept the risk on behalf of the underwriters. In the reinsurance market, brokers owe duties up and down the reinsurance chain, and the courts have faced difficulties in determining who the primary principal is in any one situation.<sup>3</sup>
- 2.6 The primary concern with dual agency arrangements is the potential for conflicts of interest.<sup>4</sup> In this paper we are not directly concerned with conflicts of interest. However, the “dual agency” may make it that much more difficult for an applicant to understand the agency position.

## THE STATUS OF AN INTERMEDIARY - WHOSE AGENT?

- 2.7 The issue of whether an intermediary is acting for an insurer or insured is complex. Under the general law of agency, the court would normally start by looking at any express agreement between the insurer and the intermediary: in particular, did the insurer give the intermediary actual authority to act as their agent for the purposes of receiving information or explaining the questions asked? In the absence of any express authority, the court may look for implied authority, by asking what was normal in that particular market. Finally, even if an agent was acting outside the terms of their actual authority, the insurer may still be held liable for their actions if the insurer held them out as having apparent authority to do what they did. These general principles have been interpreted and applied to different sorts of insurance intermediaries.

<sup>2</sup> See the arrangements discussed in *Drake Insurance v Provident Insurance* [2004] Lloyd's Rep IR 277, where the Court of Appeal almost summarily held that the broker was acting for insurers when issuing the cover.

<sup>3</sup> See *HIH v JLT* [2006] Lloyd's Rep IR 493.

<sup>4</sup> Under general agency law one would expect an intermediary to seek the consent of its principal before it acted for the third party. However, in the example we give of motor insurance, we are told that the intermediary will not typically seek explicit consent from the applicant before acting for the insurer.

### **The broker as agent for the insured**

- 2.8 It is long-established that brokers, including Lloyd's brokers, normally act as agents for the insured, even if they carry out specific functions for the insurer (such as arranging re-insurance or appointing loss adjusters).<sup>5</sup> The fact that the broker acts for the insurer for some limited purposes does not undermine the general proposition that for other purposes (such as receiving pre-contract information) they act as agents for the insured.
- 2.9 The case law applying to Lloyd's brokers has been applied more generally within the commercial sector. In *Arif v Excess Insurance Group*,<sup>6</sup> a hotel owner bought insurance through his bank to cover a hotel owned by a partnership he was involved with. When the insurers sought to avoid the policy on the grounds of lack of insurable interest, the policyholder argued that the bank was fully aware of the partnership arrangement and knew he was buying insurance on behalf of the partnership. The Court of Session, however, found that the bank had acted as his agent rather than the insurer's agent, and so this knowledge could not be imputed to the insurer. They dismissed the pursuer's arguments that the bank should be considered the insurer's agent because they had advised the pursuer to insure through the insurer, submitted the form and been paid a commission:

I am quite unable to hold that there is anything in these averments which takes the case out of the ordinary position in which insurance brokers or agents act for the insured. The fact that the bank already acted for the pursuer in banking matters merely confirms the view that the bank's insurance services department acted for the pursuer in arranging the insurance.<sup>7</sup>

<sup>5</sup> See, for example, *Rozanes v Bowen* (1928) 32 Lloyd's Law Reports 98; *Anglo-African Merchants v Bayley* [1970] 1 QB 311 and *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341.

<sup>6</sup> 1986 SC 317.

<sup>7</sup> *Arif v Excess Insurance Group* 1986 SC 317, at p 319.

2.10 In *Winter v Irish Life Assurance plc*,<sup>8</sup> the same principle was applied to a consumer policy. The policyholders bought life insurance through a large firm of independent insurance brokers. The brokers knew that both policyholders suffered from cystic fibrosis, but this information was not disclosed to the insurer. The case was heard in the High Court before Sir Peter Webster, who held that the brokers acted for the policyholders, not the insurers. The relationship between the brokers and the insurers was insufficient to establish an agency. It was not sufficient that the insurers paid the brokers commission, or gave them publicity material over-printed with the brokers' name, or provided guidance and training about how the forms should be filled in. The judge laid particular stress on the fact that the policyholders approached the brokers to find them insurance. He said that the position might have been different if the insurer had provided the broker with the names of various leads and asked them to approach clients to sell the insurer's products.

#### **When is the intermediary the agent of the insurer?**

2.11 Although an intermediary will usually be considered as the insured's agent for disclosure purposes, there are some instances in which the intermediary will be held to be acting for the insurer.

#### ***Employee or appointed representative of the insurer***

2.12 The insurer's own employees will normally be regarded as acting for the insurer, unless they have exceeded the terms of their authority by acting outside the scope of their employment.<sup>9</sup>

2.13 Furthermore, the Financial Services and Markets Act 2000 states that if an insurer appoints a firm or person as its "appointed representative", it is responsible for the representative's actions or omissions "for anything done by the representative in carrying on the business for which he has accepted responsibility" as if the insurer had authorised them.<sup>10</sup>

<sup>8</sup> [1995] 2 Lloyd's Rep 274. See also *Hazel (t/a KGM motor policies at Lloyds) v Whitlam* [2005] Lloyd's Rep IR 168, [2004] EWCA Civ 1600, where an insurer was permitted to avoid a policy where the broker failed to pass on the fact that the policyholder was training as a golf professional.

<sup>9</sup> Even where an employee has acted outside the scope of their authority, they may still be regarded as the insurer's agent on the grounds they had apparent authority to act as they did.

<sup>10</sup> FSMA, s 39(3).



### ***Authority to give cover***

- 2.14 Some cases suggest that an intermediary should be regarded as the insurer's agent if it has specific authority to bind the insurer to cover. In *Stockton v Mason*,<sup>11</sup> a consumer asked his broker to transfer cover from one car to another. The broker told him that was fine for a temporary period, and the consumer assumed that insurance had been issued on the same terms as before. In fact, however, the insurance only covered the insured and not other authorised drivers. The Court of Appeal held that the fact the broker had authority to bind the insurer to temporary cover meant that the representations they gave about that temporary cover were made on behalf of the insurer.

There must be every day thousands of cases, not only in motor insurance but in other forms of non-marine insurance, where persons wishing to become insured or wishing to transfer an insurance ring up their brokers and ask for cover or ask for fresh cover or ask to transfer the cover from an existing vehicle to another. In every case they rely upon the broker's statement that they are covered as constituting a contract binding upon the insurance company.... The broker, in dealing with the matter, is acting as agent for the insurance company and not as agent for the person wishing to have insurance.<sup>12</sup>

- 2.15 In *Woolcott v Excess Insurance Co Ltd*,<sup>13</sup> it was assumed that the same principle also applied to issues of disclosure. The parties agreed before the Court of Appeal that where an agent had authority to bind the insurer, the insurer was taken to know what the agent knew. Therefore, if the agent was aware of the insured's criminal history, the insurer could not avoid the policy on the grounds that the criminal history had not been disclosed.
- 2.16 It is unclear how far the principle in *Stockton v Mason* may be taken. It is likely that if the broker had authority only to issue temporary cover notes, its agency would relate only to the temporary cover. The broker would therefore be acting for the insured in respect of the main cover.

### ***Soliciting business on behalf of the insurer***

- 2.17 There are statements within the case law to suggest that if an insurer uses agents to solicit business then the insurer assumes responsibility for those agents. MacGillivray explains that an independent agent would not be regarded as acting for an insurer even if he solicits business for prospective applicants for insurance "unless the solicitation is done on the instructions of the insurers with whom the risk is placed":

<sup>11</sup> [1978] 2 Lloyd's Rep 430.

<sup>12</sup> Above, at p 432.

<sup>13</sup> [1979] 1 Lloyd's Rep 231.

The kind of case where the broker is found to be the insurers' agent is where he is employed by them or is tied to them and in that capacity, initiates the relationship between the insurers and the assured.<sup>14</sup>

2.18 This statement has received judicial support.<sup>15</sup>

**“Tied agents”?**

2.19 This raises questions about the status of a tied agent who only sells the products of one insurer, particularly if they are not told to actively solicit business from consumers. At the time of polarisation (discussed below), it was suggested that an independent agent who analysed the market “was seen as primarily the agent of the insured (or person seeking insurance) while a tied agent was essentially the agent of the insurer”.<sup>16</sup>

2.20 There is certainly authority that independent agents should be presumed to be agents for the insured.<sup>17</sup> It does not necessarily follow that a tied agent is the insurer's agent. We have not been able to find any recent cases in which a tied agent has been held to be the insurer's agent in the absence of specific authority to bind the insurer to cover. Furthermore, the early cases on the subject have been doubted.<sup>18</sup> The dividing line between intermediaries who act as agents for the insurer and those who act as agents for the insured remains unclear.

**THE REGULATORY REGIME**

2.21 Before January 2005, only investment intermediaries were regulated by the Financial Services Authority (FSA). Within the investment market, intermediaries were required to be “polarised”: they either had to be independent and offer access to the whole market place, or be tied-agents of a particular firm. Since 2005, general insurance intermediaries have come within FSA regulation, but the policy has shifted towards “depolarisation”. Firms may now be “multi-tied”, able to sell products from a range of providers, but not the whole market.

<sup>14</sup> para 18-6.

<sup>15</sup> See *Winter v Irish Life Assurance plc* [1995] 2 Lloyd's Rep 274 and *Arif v Excess Insurance Group* 1987 SLT 473.

<sup>16</sup> Malcolm Clarke, *The Law of Insurance Contracts* (5<sup>th</sup> ed 2006), p 232.

<sup>17</sup> See *Winter v Irish Life Assurance plc* [1995] 2 Lloyd's Rep 274 and *Arif v Excess Insurance Group* 1986 SC 317.

<sup>18</sup> In *Arif v Excess Insurance Group* 1986 SC 317, counsel for the insured relied on *Cruickshank v Northern Accident Insurance Co* 1895 3 SLT 167; *Bawden v London, Edinburgh and Glasgow Life Insurance Co* [1892] 2QB 534; and *Keeling v Pearl Assurance Co Ltd* (1923) 129 LT 573. However, the Court of Session said that *Cruickshank* was best explained turning on a different point; *Bawden* was no longer good law, and in *Keeling* the agent was a salaried employee of the insurers rather than a tied agent.

2.22 The FSA rules are discussed in more detail in Part 5, For the moment it is sufficient to note that an intermediary must disclose whether they provide advice or information

- (1) on the basis of a fair analysis of the market; or
- (2) from a limited number of insurers; or
- (3) from a single insurer.<sup>19</sup>

2.23 It is possible that the category into which the intermediary falls affects the issue of whether a firm acts as an insurer's agent for purposes of receiving information and explaining questions. As we saw above, an intermediary will normally be considered to be the insured's agent if it analyses the whole market, but the position of a tied agent is less certain. However, the matters required in the initial disclosure document are not necessarily decisive on this point. Intermediaries are not required to declare whether they are acting for the insured or the insurer in explaining the documentation, filling in forms or passing on information.

### **THE RAPIDLY CHANGING MARKET PLACE**

2.24 The existing case law and regulatory regime now has to be applied to a rapidly changing market place, in which there are a wide variety of different arrangements between insurers and distributors. Below we consider a few examples of current practice, and discuss how the law may apply to them.

#### **Agents for insured**

2.25 In the following range of examples, the intermediary is clearly acting for the insured.

- (1) A multi-national broker advises A plc, a telecommunications company, on policies to cover a range of risks, both in the UK and in other jurisdictions where it is operating.
- (2) A Lloyd's broker places an overseas oil rig liability risk for B Incorporated. The business originates through a chain of two further professional intermediaries, one of which is not a UK firm.
- (3) An independent intermediary searches the market and arranges motor insurance for Mr C.
- (4) An independent financial advisor assists Ms D to identify the whole-of-life policy which best suits her needs from those available across the market.

<sup>19</sup> FSA Handbook, ICOB 4.2.8R(6).

- (5) A solicitor, dealing with a house purchase for Ms E, assists her in applying for buildings insurance as required by the lender.

2.26 In other cases, however, the issue may cause more confusion.

**“White labelling”: branding insurance products with the distributors’ name**

2.27 One particular trend has been towards joint ventures between insurers and “High Street names” (such as supermarkets, banks or building societies). The insurance is branded with the name of the supermarket (for example), so that only keen readers of documentation will realise that the insurer is a different organisation.<sup>20</sup>

2.28 For insurance sold by telephone,<sup>21</sup> we have been told that these partnerships often follow two basic models. In the first, consumers will be asked to ring a call centre run by the High Street name (such as the bank). The call centre will be empowered under the terms of their agreement with the underwriter to bind the underwriter to the cover. In these circumstances, the High Street name is clearly acting as agent for the insurer in asking questions, receiving information and issuing cover.

2.29 In the second model, however, consumers are told to ring a number that takes them through to a call centre operated by the insurer (though again, the call centre may be branded with the High Street name). It will therefore be the insurer’s responsibility to ask questions and advise consumers about the standard of care required in answering them. In these circumstances, often, the distributor will be a mere “introducer” – handing out leaflets about the product, but not advising on its suitability. From the distributor’s point of view, this has the advantage that it lessens the burden of FSA regulation.

2.30 In the case of a leaflet in a supermarket this may work well. The consumer’s dealings will be entirely with the insurer and there will be no question of the distributor misleading them about the nature of the questions asked. However, things may go wrong. FSA research about investment products shows that introducers may well give advice about products, even though they should not (and equally advisers may not give advice, even though they should).<sup>22</sup> The same may occur in the insurance market.

<sup>20</sup> ICOB rule 5.6 states that the insurance intermediary must clearly communicate the identity of the insurance undertaking to the customer. Although the information is available for those who wish to read it, many consumers react to an overall branding impression rather than the specific words of policy summaries and disclosure documents.

<sup>21</sup> The same models may occur in internet sales – the website may either be hosted by the distributor on behalf of the insurer, or by the insurer themselves. However, internet sales offer less scope for human error.

<sup>22</sup> FSA, *Depolarisation disclosure – mystery shopping results*, Consumer Research Report 48. March 2006.

- 2.31 The problem is particularly acute when a consumer has already established a good relationship with an adviser in another context (for example, in applying for a mortgage). If the adviser then gives them a leaflet about associated insurance products, the consumer may well ask questions about the insurance, and it may be tempting for the adviser to say more than they should. They may for example (wrongly) attempt to reassure a worried client that mortgage protection insurance will not involve long and intrusive questioning, and that the consumer does not have to give details about a period of depression more than three years ago. If the insurer later avoids the policy for misrepresentation, difficult questions arise. Is the insurer responsible for the advice given by the adviser or does the consumer have a separate cause of action against the adviser for negligent professional advice?
- 2.32 There is no very clear answer to this question. The adviser does not have actual authority to act on behalf of the insurer by giving advice. However, this may not be apparent to the consumer. One could perhaps argue that the insurer has granted the High Street name apparent authority to deal with queries by permitting publicity material that deliberately gives the impression that the High Street name is underwriting the policy.

**A tied agent that helps with a form but has no authority to bind the insurer**

- 2.33 In some cases, a product may not be branded as the intermediary's but may nevertheless be closely tied with it, so that the intermediary only offers the insurer's product. We have considered the case where the joint arrangement between intermediary and insurer allows the intermediary to talk the consumer through the questions. If the intermediary then has binding authority to issue cover on the insurer's behalf, we think the law is fairly clear. A court would almost certainly hold that the intermediary is acting as an agent of the insurer for disclosure purposes.<sup>23</sup> However, the law is much less clear where the intermediary merely submits the completed and signed form to the insurer for a decision.
- 2.34 It is possible for this arrangement to occur in a variety of settings. The intermediary may be engaged in another business. For example, a car distributor may offer its customers insurance at the point of sale. The intermediary may be a well-known financial provider, as where a building society offers income protection through a named insurer, and authorises its financial consultants to talk customers through the form. Alternatively, the intermediary may be a small business, selling insurance under some sort of franchise arrangement.

<sup>23</sup> See *Woolcott v Excess Insurance Co Ltd* [1978] 2 Lloyd's Rep 430, where it was assumed before the Court of Appeal that where an agent had authority to bind the insurer, the agent's knowledge was attributed to the insurer. Therefore, if the agent was aware of the insured's criminal history, this had effectively been disclosed to the insurer. See also *Stockton v Mason* [1978] 2 Lloyd's Rep 430, where an agent had authority to issue temporary cover notes. The court found that the insurer was bound by the representations the agent had made about the nature of the policy.

- 2.35 Again, the law in this area is far from clear, and there is potential for confusion.

### **Multi-ties**

- 2.36 If the position in relation to intermediaries who offer only a single insurer's product is doubtful, the situation in relation to those who offer a limited number of insurer's products is completely unclear. We have to assume that under current law they do not act as agent for the insurer unless some special arrangement has been made.
- 2.37 Our study of FOS cases showed that the greatest problems over misrepresentation relate to health issues, especially in critical illness, income protection and term insurance. We were therefore interested to see research sponsored by Scottish Re in 2005 about how such products were sold.<sup>24</sup> It concluded that most intermediaries selling these forms of protection insurance remained independent and searched the market (or at least had an independent arm to their business). However, 15% of intermediaries had multi-ties, usually in addition to their independent function, and this included one very large intermediary. Multi-ties are likely to increase in the future. The report highlighted the variety of different arrangements, pointing out that intermediaries may also join insurer's "panels", which traditionally involved a looser relationship to a "tie". It commented:

Currently, we are seeing a grey area where panels and multi-tied packages appear to offer very similar benefits... The customer must be very confused. Indeed, we ourselves struggle to distinguish certain panels from multi-ties.<sup>25</sup>

### **Transcribing information to screen**

- 2.38 We were also interested to note another development in the protection market. Despite the increased use of tele-sales and websites, most protection insurance is still sold face to face, using a paper form.<sup>26</sup> Insurers are increasingly paying intermediaries additional commission to transcribe the information from paper to an electronic medium, so that it can then be submitted to the insurer electronically. Intermediaries complain that some transcription processes are time-consuming and painful, with opportunity for error.<sup>27</sup>

<sup>24</sup> CWC Research, *The Protection Report 2005* (Clive Waller Consulting in association with Peter Le Beau, Le Beau Visage),

<sup>25</sup> Above, p 8.

<sup>26</sup> Above, p 4.

<sup>27</sup> Above, pp 5-6.

2.39 We are not clear who bears responsibility for any errors that occur when an intermediary transcribes information to screen at the insurer's behest. The courts may well maintain the current rule that independent intermediaries should be considered as the agent of the insured. However, it could be argued that if an insurer is paying an intermediary to transcribe information in a specific way using the insurer's system, then the intermediary completes this particular task as the insurer's agent. The insured will not know that the task is taking place, or have any control over the process.

**Why does it matter?**

2.40 We will see later that in some ways, the issues relate to procedure rather than substance. If the insurer succeeds in avoiding the policy because the intermediary is negligent, the consumer would have a good claim against the agent for negligence. The claim may be brought either through the courts or the Financial Ombudsman Service. However, no-one's interests are served if the consumer pursues a long complaint against the insurer and is then told to start all over again against a different firm. The complainant suffers unnecessary stress and delay; the FOS has two complaints instead of one; and the industry may experience significant damage to its reputation. There is an obvious need for clarity in this area. We explore this further in Part 6.

## **PART 3**

# **INTERMEDIARIES WHO COMPLETE FORMS: THE *NEWSHOLME* PROBLEM**

### **INTRODUCTION**

- 3.1 It is common practice for intermediaries to complete proposal forms on behalf of applicants. Applicants may well be deterred by the length or complexity of proposal forms, and find it easier to be led through the questions by the intermediary, either face to face or over the telephone. Typically, the intermediary records the answers on the proposal form, which is then signed by the applicant.<sup>1</sup>
- 3.2 Problems arise when an intermediary introduces inaccuracies when completing a proposal form. Such inaccuracies may arise in different ways — for example:
- (1) The correct information is given to the intermediary, who fails to record it accurately.
  - (2) An intermediary completes the proposal form based on their own knowledge, and gives it to the applicant to sign. The answers are inaccurate or incomplete. However, the applicant either fails to check the answers, or checks but does not notice the errors.
  - (3) An intermediary asks the applicant to sign a blank proposal form, which it later completes inaccurately from its own knowledge or from information supplied by the applicant.
  - (4) The intermediary wrongly interprets a question when putting it to the applicant. Although the applicant accurately answers the question as interpreted — and the answer is correctly recorded — information required by the insurer is omitted.
- 3.3 The question then arises — who is responsible for these inaccuracies? There are two issues to consider. First, would the intermediary normally be considered as acting for the insured rather than the insurer? As we discussed in Part 2, an independent broker or intermediary is normally considered the agent of the insured. This means that any remedy the insured may have lies against the intermediary, not the insurer. The insurer is entitled to avoid the policy and leave the insured to bring an action for professional negligence against their own professional adviser.

<sup>1</sup> According to CWC Research, *The Protection Report 2005*, this remains the most common way in which protection insurance is sold. It reports that in 2005 three-quarters of applications were completed face to face, usually on paper (p 2). There is also a reluctance to abandon signatures (p 6).



- 3.4 However, the case law suggests a further complication. Even if the intermediary was the insurer's agent (because, for example, they were the insurer's employee, or appointed representative) then the insurer may still be entitled to avoid the policy for misrepresentation. The basis for this rule is not entirely clear. Some judicial statements suggest that there is a "transferred agency": the insurer's agent becomes the insured's agent for the purposes of filling out the form. Others suggest that the signature of the form may be the crucial element: applicants should be bound by the answers they give on the forms they have signed.
- 3.5 The basic rule is set out in the case of *Newsholme Brothers v Road Transport and General Insurance Co Ltd*.<sup>2</sup> However, some cases reach the opposite result, and refuse to allow the insurer to avoid a policy when its agent was at fault.

### **THE BASIC RULE**

- 3.6 In *Newsholme*, the plaintiffs had insured a motor-bus through a man named Willey, who was said to be appointed by the Road Transport and General Insurance Co Ltd to canvass and procure proposals for them. The exact terms of his appointment were not available to the court, but in the usual course of events he would have been considered the insurer's agent. He completed a proposal form, which was later approved for cover by the insurers.
- 3.7 When a claim occurred it was found that Willey had entered inaccurate answers to three of the questions on the proposal form, even though he had been given the correct information by Newsholme Brothers. The insurer repudiated liability for breach of warranty and rejected the claim.
- 3.8 The Court of Appeal held that the insurer was entitled to repudiate liability since in completing the proposal form Willey had been acting as the agent of Newsholme Brothers. Lord Justice Scrutton set out the court's reasons as follows:

If the answers are untrue, and [the agent] knows it, he is committing a fraud which prevents his knowledge being the knowledge of the insurance company. If the answers are untrue, but he does not know it, I do not understand how he has any knowledge which can be imputed to the insurance company. In any case, I find great difficulty in understanding how a man who has signed, without reading it, a document which he knows to be a proposal for insurance, and which contains statements in fact untrue, and a promise that they are true, and the basis of the contract, can escape from the consequences of his negligence by saying that the person he asked to fill it up for him is the agent of the person to whom the proposal is addressed.<sup>3</sup>

<sup>2</sup> [1929] 2 KB 356.

<sup>3</sup> As above, at pp 374-5.

- 3.9 This suggests two reasons: first the agent ceases to act for the insurer as soon as he completes a proposal form with answers which he knows to be untrue; and secondly insureds must be bound by what they sign.
- 3.10 Similar authority exists in Scotland in the case of *McMillan v Accident Insurance Company Ltd*.<sup>4</sup> Other cases suggest that the rule will apply even where the intermediary has answered questions on a proposal form without asking the applicant for the required information.<sup>5</sup>

### **POSSIBLE EXCEPTIONS**

- 3.11 A small number of reported cases reach a different result. It is unclear that any principle can or should be drawn from these exceptional cases. In *Bawden v London, Edinburgh and Glasgow Assurance Co*, the matter misrepresented was a physical infirmity that was plainly evident to the insurer's agent.<sup>6</sup> However, Professor Clarke suggests a wider rule to protect the vulnerable applicant for insurance.<sup>7</sup> Some support for this suggestion is to be found in *Stone v Reliance Mutual Insurance Society Ltd*,<sup>8</sup> where the misrepresentations related to previous policies and claims history. Lord Denning commented:

The society seek to repudiate liability by reason of the untruth of two answers in the proposal form. They seek to fasten those untruths onto the insured. They do so by virtue of a printed clause in the proposal form. They make out that it was the insured who misled them. Whereas the boot is on the other leg. The untrue answers were written down by their own agent. It was their own agent who made the mistake. It was he who ought to have known better. It was he who put the printed form before the wife for signature. It was he who thereby represented to her that the form was correctly filled in and that she could safely sign it. She signed it trusting to him. This means that she, too, was under a mistake, because she thought it was correctly filled in. But it was a mistake induced by the misrepresentation of the agent, and not by any fault of hers. Neither she nor her husband should suffer for it.<sup>9</sup>

<sup>4</sup> 1907 SC 484.

<sup>5</sup> See *Biggar v Rock Life Assurance Co* [1902] 1 KB 516; *Keeling v Pearl Assurance Co* (1923) 129 LT 573; *Life and Health Assurance Association Limited v Yule* (1904) 6F 437; and *Arif v Excess Insurance Group Ltd* 1986 SC 317..

<sup>6</sup> [1892] 2 QB 534.

<sup>7</sup> M Clarke, *The Law of Insurance Contracts*, (5<sup>th</sup> ed, 2006) at 308 [10-3A]

<sup>8</sup> [1972] 1 Lloyds Rep 469.

<sup>9</sup> As above at p 475.

However, it is not obvious that this approach will be applied beyond cases in which the applicant is blind or illiterate,<sup>10</sup> or where (as in *Stone*) the agent was authorised by the insurer to collect the information and complete the form, and for this reason remained the agent of the insurer when doing so.<sup>11</sup>

### **CRITICISMS OF THE NEWSHOLME RULE**

- 3.12 The *Newsholme* rule appears to rest on two arguments: that the agent ceases to act for the insurer as soon as he commits a fraud by entering information which he knows to be untrue; and that the insured must be bound by their signature. Both arguments may be criticised.
- 3.13 First, it is undoubtedly true that the insurer should not be bound by a contract where both the insured and the agent have committed a fraud together. The insured's fraud must taint the contract. It cannot be excused by the agent's participation because the agent has neither actual nor apparent authority to participate in a fraud. However, the situation may be different where the agent has committed a fraud on his own initiative (because, for example, he was anxious to gain his commission). If a sales representative is employed by the insurer as the insurer's agent, it might be thought that the insurer should carry greater responsibility for the fraud than the insured.
- 3.14 As far as the signature is concerned, this may be decisive in a legal regime which makes the insured strictly liable for all mis-statements, however caused. In *Newsholme*, for example, the proposal form contained a basis of the contract clause whereby the plaintiffs warranted the strict accuracy of everything they had signed. Such a rule, however, makes less sense under the reforms we have tentatively proposed, where the insurer's remedy for misrepresentation depends on the insured's state of mind and (in consumer cases) warranties of past or existing fact will not give the insurer additional rights. An insured may sign a form with a mis-statement fraudulently, or negligently without checking, or completely innocently, because they reasonably believed what the agent has told them. The signature does not necessarily determine the issue.
- 3.15 In Part 6 we discuss possible reforms to this rule.

<sup>10</sup> MacGillivray § 18-42.

<sup>11</sup> MacGillivray § 18-44.

## **PART 4**

### **MARINE INSURANCE ACT 1906, SECTION 19**

- 4.1 In this Part we consider the effect of section 19 of the Marine Insurance Act 1906, which places a duty of disclosure on an agent who effects insurance on behalf of a prospective policyholder. Section 19 is in two parts. The second part (section 19(b)) is relatively uncontroversial. It simply says that the broker must disclose everything the insured must disclose, if it comes to the broker's attention in time. However, the first part (section 19(a)) is more problematic. It appears to impose an additional duty on the broker to disclose matters that the broker knows but the insured does not know.
- 4.2 This raises several difficult issues. First, the insurer's remedy for breach is to avoid the policy, which penalises not the broker (who was at fault) but the innocent insured. Secondly, where there is a chain of intermediaries, the duty seemingly only applies to the final agent in the chain, the "agent to insure". Finally, it is unclear how far the duty extends to knowledge that the intermediary received in a different capacity.

#### **THE AGENT'S DUTY OF DISCLOSURE**

- 4.3 Section 19 reads as follows:

s19 Disclosure by agent effecting insurance.

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer--

- (a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and
- (b) Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

#### **Application of section 19**

- 4.4 It is generally accepted in the case law that section 19 applies to non-marine insurance. Even if the section is not directly applicable, it is taken to codify the common law:

The reinsurances were in part of marine risks and in part of non-marine. Nevertheless it is agreed that the law which we have to consider is to be found in the Marine Insurance Act 1906; either it is directly applicable, or else indirectly because the Act codified the common law applicable to all classes of insurance.<sup>1</sup>

- 4.5 On the same grounds we can see no reason in principle why section 19 should not apply in consumer cases. However, we are not aware of any reported consumer case where this has been an issue.

#### **Section 19(b)**

- 4.6 We have not received any criticism of this provision, which requires the agent to disclose every fact that the applicant is bound to disclose. At first sight, this seems reasonable. However, where an agent breaches the duty, the insurer's only remedy is to avoid the policy. Where an insured has failed to disclose something it should have disclosed, the insurer already has a right to avoid. Section 19(b) appears to add little to an insurer's existing remedies for non-disclosure.

#### **Section 19(a)**

- 4.7 This provision is problematic - partly because of the consequences if it is breached and partly because of uncertainties regarding its scope.

#### ***What are the consequences of breach?***

- 4.8 Section 19 does not set out the consequences if an agent to insure breaches the obligations it imposes. This is in contrast to sections 18 and 20 which state respectively that pre-contractual non-disclosure by a policyholder or misrepresentation by the policyholder or the policyholder's agent give the insurer the right to avoid the policy.
- 4.9 Nevertheless, it is well established that a breach of section 19(a) does give the insurer the right to avoid.<sup>2</sup> This seems odd, as the burden falls on the insured who, by definition, will be ignorant of the matter: if the circumstances were also known to the insured the case would fall within section 19(b).
- 4.10 This leaves the question of whether such a breach also gives the insurer a right in damages against either the agent to insure or against the policyholder. These questions received attention in the case of *HIH Casualty and General Insurance Co v Chase Manhattan Bank*.<sup>3</sup>

<sup>1</sup> *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136 at 1139.

<sup>2</sup> R Merkin, *Colinvaux's Law of Insurance*, (8<sup>th</sup> ed, 2006) at 164 [6-43].

<sup>3</sup> *HIH Casualty and General Insurance Co v Chase Manhattan Bank* [2003] 2 Lloyd's Rep 61.

- 4.11 This litigation confirmed that an agent to insure owed an independent duty of utmost good faith to the insurers but that it did not give rise to damages as such. The agent could be liable to the insurer in damages but only where the agent's conduct amounted to a negligent or fraudulent misrepresentation, assuming that the necessary common law requirements for such an action could be established. The agent to insure would not be liable for pure non-disclosure, even though the duty to disclose was imposed upon him by section 19(a).

***Who is an "agent to insure"?***

- 4.12 The section only applies to "an agent to insure", who "effects" the insurance for the insured. There is some uncertainty over the definition of an agent to insure.
- 4.13 Section 19 is based on two nineteenth century cases arising out of the reinsurance effected in respect of a steamship, the *State of Florida*.<sup>4</sup> In 1884, Blackburn Low & Co insured the *State of Florida*, sailing from New York to Glasgow. The insurers asked their Glasgow agents, Rose Murison and Thomson, to place a reinsurance contract. Rose, Murison and Thomson did this by contacting their own London agents, who placed the insurance through a Lloyd's broker. The insurers then arranged a second reinsurance contract using other (different) agents. After the ship was lost, it became known that before the first reinsurance had been placed, Mr Murison, a partner in the Glasgow firm, had spoken to the ship owners. During the conversation, the owner mentioned that there had been reports that the *State of Florida* had been lost and that some of its crew had been seen on another vessel. However, these rumours were not known to the insurer. . In *Blackburn Low v Haslam*,<sup>5</sup> the Court of Appeal found that the reinsurers could avoid the first policy, placed by the Glasgow agents through the chain of intermediaries. However, in *Blackburn Low v Vigors*,<sup>6</sup> the House of Lords found that the second policy, placed through other agents, was unaffected. The knowledge of the Glasgow agents could not be imputed to the insurers in these circumstances.

<sup>4</sup> *Blackburn Low & Co v Haslam* (1888) LR 21 QBD 144 and *Blackburn Low & Co v Vigors* (1887) LR 12 App Cas 531.

<sup>5</sup> (1888) LR 21 QBD 144.

<sup>6</sup> (1887) LR 12 App Cas 531.

- 4.14 The Blackburn Low litigation suggests that there is a distinction between an agent who is part of a chain for placing insurance, and an agent who is not part of the chain. Only the former is caught by section 19. If an agent is not involved in placing the insurance, there may be some circumstances in which that agent's knowledge is imputed to the principal, so that the principal is deemed to know it. Where this happens, the principal will be in breach of their own duty of disclosure under section 18 by failing to disclose it to the insurer. However, *Blackburn Low v Vigors* shows that knowledge may be imputed in this way only in limited circumstances.<sup>7</sup>
- 4.15 In 1995, the Court of Appeal re-examined the issue of who is an agent to insure, in *PCW Syndicates v PCW Reinsurers*.<sup>8</sup> This time two of three Court of Appeal judges took a narrower view of section 19, and held that only the final placing broker fell within the section:
- It seems to me, both from a reading of the words used in Section 19, and from an examination of the authorities upon which that Section was based, that the "agent to insure" only encompasses those who actually deal with the insurers concerned and make the contract in question.<sup>9</sup>
- 4.16 At first sight, this does not seem consistent with *Haslam*, where the information was known only to the Glasgow agents, who asked other brokers to place the re-insurance. Lord Justice Saville explained *Haslam* on the placing brokers are deemed to know every circumstances which in the ordinary course of business they ought to be communicated to them. Thus the Glasgow agents should have passed the rumours that the ship "down the line to the brokers who actually effected the cover". The placing brokers were deemed to know what the Glasgow agents knew.
- 4.17 From the current state of the authorities it appears that where there is a chain of intermediaries, section 19 imposes a duty only on the final placing broker who effects the cover.<sup>10</sup> However, placing brokers will be deemed to know everything which ought to be communicated to them.

<sup>7</sup> In *Simner v New India Assurance* [1995] LRLR 240, it was suggested that the agent's knowledge would be imputed to the assured only where the assured relied on the agent for information or where the agent was in a predominant position. See also *ERC Frankona Reinsurance v American National Insurance* [2006] Lloyd's Rep IR 157.

<sup>8</sup> *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136. See the discussion in *ERC Frankona Reinsurance v American National Insurance Co* [2006] Lloyd's Rep IR 157.

<sup>9</sup> Above, at p 1149

<sup>10</sup> For criticisms of the position, see *Colinvaux's Law of Insurance*, 8th ed, para 6-40.

- 4.18 The problem with this approach is that the issue of what ought to be communicated will depend on the arrangements between the different agents in the chain. Even if there is an implied term that agents should communicate between themselves, this must be subject to an express agreement to the contrary (which will not be known to the insurer). This means that the insurer's rights against the placing broker will depend on other agreements within the chain to which the insurer is not privy.

***What is the scope of the duty under Section 19?***

- 4.19 The reference in section 19(a) to "every material circumstance" might suggest that materiality is the only restriction on the duty of disclosure of an agent to insure. An agent to insure would then be obliged to disclose material facts even if knowledge of those facts was gained when not acting in that capacity. This was the view taken by Hoffman LJ (as he then was) in two cases, albeit that in each his comments were obiter. The first case was *El Ajou v Dollar Land Holdings plc*, a company law case decided in 1993:<sup>11</sup>

First, there are cases in which an agent is authorised to enter into a transaction in which his own knowledge is material. So for example, an insurance policy may be avoided on account of the broker's failure to disclose material facts within his knowledge, even though he did not obtain that knowledge in his capacity as agent for the insured.

- 4.20 This was followed in 1994 by the second case, *Societe Anonyme d'Intermediaries Luxembourgeois v Farex G*:<sup>12</sup>

In particular, the agent's duty to disclose material circumstances known to him in any capacity, coupled with the generous rules which exist for the attribution of the knowledge of many individuals to a corporate agent, may entitle an insurer to repudiate in circumstances which are far from any ordinary understanding of lack of good faith.

- 4.21 However, uncertainty remains and in *PCW Syndicates v PCW Reinsurers*, Staughton LJ suggested that the duty was restricted to information received as agent to insure:

I do not find in the authorities any decision that an agent to insure is required by section 19 to disclose information which he has received otherwise than in the character of agent for the assured.

<sup>11</sup> [1994] BCC 143 at 156

<sup>12</sup> [1994] CLC 1094 at 1111.



- 4.22 It is not clear how this would be applied in a case like *Blackburn Low & Co v Haslam*<sup>13</sup> where the relevant information was received at the time the broker was agent to insure, but was not received by the broker as agent to insure.

### **CONCLUSION**

- 4.23 In theory, it is possible to argue that section 19(a) applies to consumer cases. This means that if a retailer arranged product insurance for its customers, the insurer could invalidate the customers' policies on the basis of the retailer's knowledge. So, for example, if the retailer was aware that a particular brand of washing machine was prone to a particular fault, the insurer could avoid the policies it had written on those machines. This would come as a shock to the consumers who knew nothing about the faults and had paid premiums to be covered in just such an event. We are not aware that any insurer has attempted to take such a point and we doubt if it would be commercially feasible to do so. In Part 6 we propose to repeal section 19(a) in consumer insurance.
- 4.24 There is a more open question about whether section 19(a) serves a useful purpose in the commercial field. If it is to be retained, there is a need to look again at the remedy, at its effect on chains of intermediaries and on its scope. We return to these questions in Part 7.

<sup>13</sup> *Blackburn Low & Co v Haslam* (1888) LR 21 QBD 144.

# PART 5

## CONSUMERS – THE CURRENT POSITION

### INTRODUCTION

- 5.1 In this Part we look at how the strict legal rights of the consumer are supplemented by regulatory measures. In January 2005, the UK implemented the Directive on Insurance Mediation<sup>1</sup> by bringing insurance intermediaries within the ambit of the Financial Services Authority (FSA). This has made it much easier for consumers to pursue disputes against intermediaries. Authorised intermediaries are now required to carry professional indemnity insurance;<sup>2</sup> to be within the Financial Services Compensation Scheme (FSCS); and to be members of the Financial Ombudsman Service (FOS). This means that where an intermediary has acted negligently or fraudulently in misrepresenting the policyholder's position to an insurer, the policyholder has access to an independent complaints system. And if the intermediary becomes insolvent, the policyholder may pursue a court judgment or ombudsman decision against either the professional indemnity insurer or the FSCS.
- 5.2 The problem, however, is that FSA regulation has done little to clarify against whom policyholders should bring their complaints. Although the FSA requires intermediaries to make various disclosures about their status, these were not designed to address the issue of whom the agent is acting for at any given time. We have found several cases in which consumers have pursued complaints against an insurer to a final ombudsman decision: at the end of long, involved proceedings, they have been told that they brought the complaint against the wrong organisation and need to start again at the beginning. This brings insurance law – and the insurance industry – into disrepute. It is unsatisfactory for the consumer, for the insurer, and for the FOS alike. There remains a need for greater clarity in this area.

<sup>1</sup> 2002/92/EC of 9 December 2002, OJ L 009, 15/01/2003 p 0003. The ICOB rules also implement the Distance Marketing Directive and other insurance directives. The Davidson Review points out that in some respects the UK has “over-implemented” some aspects of these directives. The scope is wider (for example, by including motor warranties) and includes more extensive disclosure requirements. Whereas the Directive only requires an intermediary to establish a basic complaints system, the FSA rules require intermediaries to be members of FOS (see Davidson Review on the Implementation of EU Legislation, *Final Report*, November 2006, pp 18-23 at [http://www.cabinetoffice.gov.uk/regulation/reviewing\\_regulation/davidson\\_review](http://www.cabinetoffice.gov.uk/regulation/reviewing_regulation/davidson_review)).

<sup>2</sup> FSA Handbook, MIPRU 3.2.1.

- 5.3 Here we start by outlining the ambit of FSA regulation. We then discuss how the FSA rules do (or do not) clarify issues of agency; and consider the powers of the Financial Services Compensation Scheme. We then describe the powers and approach of the Financial Ombudsman Service and outline our findings from a sample of FOS cases.
- 5.4 As we indicated in Part 4, we are not aware of any consumer case in which an insurer has relied on section 19 of the Marine Insurance Act 1906. There are no relevant rules issued by the FSA, and no report of any case decided by the FOS. In this Part we therefore consider purely the first two issues in which we are interested – the status of an intermediary for the purposes of disclosure, and the incorrect completion of a proposal form by an intermediary.

### **THE AMBIT OF FSA REGULATION**

- 5.5 Since January 2005, insurance mediation has become a regulated activity within the ambit of the Financial Services Authority.<sup>3</sup> The starting point is that businesses need to be authorised or exempt if (for example) they complete proposal forms and send them to insurers,<sup>4</sup> or if they help policyholders fill in application forms.<sup>5</sup> Similarly, a business must be authorised or exempt if it recommends that a prospective policyholder does or does not buy a specific product.<sup>6</sup>

### **Exemptions**

- 5.6 If a business merely provides information or introduces the applicant to another provider the position is more complicated. Some forms of information provision may fall outside the regime altogether. For example, the mere passive display of advertising leaflets in reception would not be caught,<sup>7</sup> and there are special exemptions for journalism.<sup>8</sup> Similarly FSA regulation does not extend to one-off introductions that are not part of an on-going arrangement, or to introductions to people offering independent advice where the introducer has no stake in the outcome.<sup>9</sup>

<sup>3</sup> The ambit of FSA regulation is set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI No 544), as amended (referred to below as the Regulated Activities Order)

<sup>4</sup> Regulated Activities Order, art 25(1), as interpreted by the FSA in their Perimeter Guidance, PERG 5.6.1.

<sup>5</sup> Regulated Activities Order, art 25(2), as interpreted in PERG 5.6.4.

<sup>6</sup> Regulated Activities Order, art 53, as interpreted in PERG 5.8.5.

<sup>7</sup> As above. PERG 5.6.4 specifically states that “a mere passive display of literature advertising insurance (for example, leaving leaflets advertising insurance in a dentist’s or vet’s waiting room and doing no more) would not amount to the article 25(2) activity”.

<sup>8</sup> Regulated Activities Order, art 54.

<sup>9</sup> See PERG 5.6.18.

- 5.7 However, there is a spread of activities between the mere display of literature, and helping prospective policyholders to fill in forms. This might include giving advice about the sort of cover which may be required, explaining the terms of the policy, or giving consumers information about how to fill in forms.
- 5.8 For these types of activity, there is a limited exemption for professions or businesses who only provide such information or introduction incidentally to their main business.<sup>10</sup> In the FSA's view, the insurance aspect must be complementary to the main business.<sup>11</sup> For example, the exemption covers a dentist who introduces dental insurance, or a vet who introduces pet insurance. However, if a vet were to introduce dental insurance, this would not be complementary and would therefore require authorisation or exemption.
- 5.9 A much more extensive exemption applies to travel agents and tour operators who arrange travel insurance and to retailers who arrange product insurance for "non-motor" goods.<sup>12</sup> The insurance must be complementary to the goods, such as a mobile phone shop that arranged mobile phone insurance. The rationale behind this exemption is that it is limited to insurance that is relatively cheap and simple. The premium must not exceed 500 euros,<sup>13</sup> and the policy must not last longer than 5 years.<sup>14</sup> Furthermore it must be

of such a nature that the only information that [the agent] requires...  
is the cover provided by the contract.<sup>15</sup>

- 5.10 Where travel agents, tour operators<sup>16</sup> and product retailers fall within their exemption, they may arrange insurance, fill in forms and advise on insurance contracts without any form of FSA regulation. The Treasury recognised that there were concerns about this, and promised to review the exemption two years after implementation. The Treasury is currently calling for evidence on the subject.<sup>17</sup>

<sup>10</sup> Regulated Activities Order, art 72C.

<sup>11</sup> See PERG 5.6.7.

<sup>12</sup> Regulated Activities Order, art 72B.

<sup>13</sup> Regulated Activities Order, art 72B(1)(c).

<sup>14</sup> Regulated Activities Order, art 72B(1)(b).

<sup>15</sup> Regulated Activities Order, art 72B(1)(g).

<sup>16</sup> Technically, the exemption applies to insurance covering travel risks linked to travel booked with the provider. This means it may extend more widely than just travel agents and tour operators, and include airlines, ferries, holiday villa rental companies, hotels and car hire companies selling risks of loss to baggage.

<sup>17</sup> HM Treasury, *Travel Insurance Review: Call for Evidence*, November 2006. See [http://www.hm-treasury.gov.uk/media/33C/F7/travelinsurance\\_review.pdf](http://www.hm-treasury.gov.uk/media/33C/F7/travelinsurance_review.pdf).

### **The effect**

- 5.11 The effect of these provisions is that most intermediaries who misadvise consumers about their disclosure requirements or who wrongly fill in proposal forms will be within the scope of FSA regulation. For most UK organisations, they must either be authorised in their own right, or must be appointed representatives of other authorised bodies.
- 5.12 If the intermediary is authorised, a consumer or small business is able to pursue a complaint against them to the FOS. If the intermediary becomes insolvent, the consumer or small business may enforce the court or FOS award either against the intermediary's insurer, or against the FSCS (discussed below). If the intermediary is an appointed representative, the policyholder may pursue a claim or complaint against the representative's principal.<sup>18</sup>
- 5.13 Not all intermediaries will be covered, as some will fall within the exemptions. The most extensive exemption is for travel operators arranging travel insurance and for product retailers arranging product insurance. If, for example, a small travel agent mis-sells travel insurance, a consumer will not be able to complain against them to the FOS. However, travel or product insurance rarely involves lengthy proposal forms: in our survey of FOS cases involving misrepresentation and non-disclosure issues, only 3% concerned travel insurance. Travel insurance is much more likely to lead to disputes about exclusions in the policy terms,<sup>19</sup> but that raises other issues. We are not aware of any cases where consumers have been unable to bring complaints against travel agents or product retailers who have filled in proposal forms incorrectly.
- 5.14 Professions or businesses that give incidental information about insurance products are not meant to fill in forms or give advice about how to fill in forms. It is always possible that some will overstep the mark, and give advice that they are not meant to give. Where a vet exceeds their authority and mis-advises a consumer about how to fill in a form about pet insurance, the consumer would have no recourse to the FOS. However, we are not aware that this is a problem in practice.

<sup>18</sup> Under section 39(3) of the Financial Services and Markets Act, "the principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility".

<sup>19</sup> In our survey of 50 FOS cases involving disputes about policy terms, 14 (28%) involved travel insurance – the largest category in the survey: see Issues Paper 2, Warranties, Appendix B.

## **FSA REQUIREMENTS**

- 5.15 The Financial Services Authority issues a Handbook containing conduct of business rules for both investment and non-investment insurance business. For investment insurance the rules are contained in the Conduct of Business Sourcebook (“COB”) and for non-investment insurance the rules are contained in the Insurance Conduct of Business Sourcebook (“ICOB”).
- 5.16 The FSA rules require agents to disclose certain matters to their customers before concluding an initial insurance contract with them. The matters which must be disclosed include:
- (1) whether the firm is authorised and regulated by the FSA, or whether it is an appointed agent for another principal which is authorised and regulated by the FSA;
  - (2) details of any holding in the insurer, if this constitutes more than 10% of the voting rights or capital of the insurer; and
  - (3) whether the firm has or will provide advice or information
    - (a) on the basis of a fair analysis of the market; or
    - (b) from a limited number of insurers; or
    - (c) from a single insurer.<sup>20</sup>

- 5.17 The intermediary must also inform its clients if it holds money on behalf of the insurer. The relevant rule states that:

Where a firm holds, or is to hold, money as agent for an insurance undertaking it must ensure that it informs those of its clients which are not insurance undertakings and whose transactions may be affected by the arrangement (whether in its terms of business, client agreements or otherwise in writing) that it will hold their money as agent of the insurance undertaking and if necessary the extent of such agency and whether it includes all items of client money or is restricted, for example, to the receipt of premiums.<sup>21</sup>

<sup>20</sup> FSA Handbook, ICOB 4.2.8R(6).

<sup>21</sup> FSA Handbook, CASS 5.2.3(3).

- 5.18 As we discussed in Part 3, some of these issues may be relevant to whether the insurer acts for the insured or for the insurer for disclosure purposes. If an intermediary provides advice to the insured on the basis of a fair analysis of the market, they are likely to act for the insured. If, however, they act as the insurer's appointed representative they will typically be the insurer's agent. But the information disclosed will often not determine the issue. As we have seen, it is unclear whether tied agents will be regarded as the insurer's agents if they do not actively solicit business for the insurer. The position of multi-tied agents is extremely uncertain. Furthermore, the fact that the intermediary holds money on behalf of the insurer may be some evidence of an agency agreement between them, but would not be determinative. FSA regulation does not require intermediaries to say for whom they act.
- 5.19 Under ICOB 4.3.2 an intermediary is required to explain the potential impact of non-disclosure, but again there is no specific mention of the agency issue.
- 5.20 Neither COB nor ICOB address the situation where an intermediary incorrectly completes a proposal form. Thus the rule in *Newsholme* is left unchanged.
- 5.21 The FSA rules however do require that intermediaries carry professional indemnity insurance.<sup>22</sup> This provides some protection for both consumers and businesses that an intermediary will be able to meet any claims brought against them.

#### **THE FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)**

- 5.22 This is a long-stop protection for consumers and small businesses. A consumer or small business may obtain a decision from a court or the FOS<sup>23</sup> against the intermediary, but then find it unenforceable because the intermediary is insolvent. In such circumstances, the matter may be referred to the FSCS. If the FSCS assess that an intermediary is unable to meet its liabilities it may be declared "in default". This is the point at which the FSCS can receive claims for compensation.

<sup>22</sup> FSA Handbook, MIPRU 3.2.1.

<sup>23</sup> See below, para 0.000.

- 5.23 Claims are considered in accordance with the Compensation Sourcebook ("Comp"), part of the FSA Handbook. There are financial limits on compensation, which reflect the limits applicable under predecessor schemes. For investment insurance claims, an eligible investor could receive up to £48,000 towards any loss. This figure comprises 100% of the loss up to £30,000, and 90% of the loss thereafter to a limit of £50,000. For non-investment insurances, there is a distinction between compulsory insurances, such as motor insurance, and non-compulsory insurances such as household insurance. Claims in respect of compulsory insurances are met in full, whereas claims in respect of non-compulsory insurances are paid in full for the first £2,000 but are limited to 90% of any loss above this figure.

## **THE FINANCIAL OMBUDSMAN SERVICE (FOS)**

### **Powers**

- 5.24 Since 2005, the Financial Ombudsman Service has been able to investigate complaints brought against insurance intermediaries as well as against insurers. If accepted by the complainant a decision of an Ombudsman is binding on the regulated firm to a maximum cash limit of £100,000. An Ombudsman is obliged to make decisions based not solely on law but on what is "fair and reasonable in all the circumstances of the case".<sup>24</sup>

### **Agency cases**

- 5.25 We were interested to establish what line the FOS takes on the agency issues we are considering. In theory, for example, it would be possible for an ombudsman to take the view that an insurer should, in some circumstances, be liable for the acts or omissions of an independent intermediary. Such a decision could be based on what the ombudsman considered fair and reasonable, rather than on the law.
- 5.26 Certainly, this is the view taken by a predecessor to the FOS, the Insurance Ombudsman Bureau. In 1989 the then Insurance Ombudsman, Dr Julian Farrand, indicated that he would "in appropriate cases" hold an insurer liable for the acts of an independent intermediary. Subsequently he wrote in IOB News, an internal publication, expressing the view, based on *Stone v Reliance Mutual* that signed forms should not always be regarded as conclusive.
- 5.27 To date the FOS has not directly addressed these points in its Annual Reviews or in its regular publication, Ombudsman News. This may, in part, be due to the fact that it only took on responsibility for non-investment intermediaries in January 2005. With the co-operation of the FOS, we therefore undertook a survey of a selection of cases.

<sup>24</sup> Financial Services and Markets Act 2000, s 228(2).



## **Research at the FOS**

- 5.28 For the first paper on misrepresentation, the FOS very helpfully provided us with access to a sample of final ombudsman decisions on the issue, including 190 consumer cases and 12 from small businesses. As we have seen, issues of agency arose in 25 of the consumer cases (13%) and 8 small business cases (66%). For this purpose, the FOS provided us with a further sample of decisions, selected specifically because agency issues had been raised. We are very grateful for the help they have given us.

### ***Whose agent?***

- 5.29 As far as independent intermediaries are concerned, the FOS appears to follow the legal position. Independent intermediaries who search the whole market will normally be regarded as the insured's agent. If they misadvise a client in such a way that the client misrepresents their position to the insurer, the insurer will normally be able to avoid the policy. The client will then be left to bring a separate complaint against the intermediary.
- 5.30 In a typical case we saw, the policyholder had effected a life and critical illness policy through an independent financial adviser. A subsequent claim for breast cancer was declined on the ground that in her answers on the application form she had failed to disclose that she had been treated for depression and a sore throat. The policyholder complained about the insurer to the FOS, stating amongst other points that the adviser had been aware of these conditions. This latter point was addressed briefly by the ombudsman in the final decision:

With regard to the complainant's allegation that the advisor completed the application form on her behalf and was aware of her conditions, I would reiterate my adjudicator's observation that the adviser was an Independent Financial Adviser, rather than agent or representative for whom the firm was vicariously liable.<sup>25</sup>

- 5.31 This type of point appears to be raised regularly. It is, we suspect, symptomatic of the lack of understanding that exists among insureds regarding the role of an independent intermediary for disclosure purposes. Complainants are rarely legally advised, and are unlikely to understand the law of agency as it applies to insurance intermediaries.

<sup>25</sup> Case 13

5.32 It is of course possible in such cases for the complainant to raise a new complaint against the adviser rather than the insurer. The practical impact of the law may have been reduced now that the FOS has the jurisdiction to consider complaints against most intermediaries.<sup>26</sup> However, the complainant will need to return to the very start of the complaints process and contact the adviser. In the case to which we refer above, this was the advice given to the complainant by the ombudsman:

If the complainant feels that the adviser negligently completed the application on her behalf..., or failed to record material information, then she must complain to the financial adviser.

5.33 Although FOS procedures are outside the scope our current review, we would hope that more could be done to assist consumers to bring complaints against the correct organisation, if necessary considering complaints in tandem where the status of an agent is disputed.

5.34 The position with tied agents is more complex. The FOS told us that they will often consider tied agents to be acting as the insurer's agents in completing the form, and that insurers will on occasion agree with this analysis. This appeared to be borne out by the cases we saw. Often insurers were prepared to take responsibility for the intermediary's actions, but without disclosing the full nature of their agency agreement with them.<sup>27</sup> This makes it difficult to be specific about the exact nature of the relationships involved.

#### ***Completion of proposal forms***

5.35 Perhaps the most interesting findings in our survey relate to the manner in which the FOS tackles cases where the policyholder signed a proposal form that had been completed by an intermediary and which contained incorrect or incomplete information.

5.36 Where it considers it appropriate the FOS will treat the policyholder as liable for errors in a signed form. For example, we reviewed a case where an independent financial adviser had completed the proposal form. In a complaint against the adviser, it was alleged by the policyholder that medical information he had disclosed had been omitted. The ombudsman rejected the complaint as unproven:

<sup>26</sup> The most notable change being the extension of the scheme to cover general insurance intermediaries with effect from 15 January 2005.

<sup>27</sup> We did not see any cases in which the insurer had provided copies of their agency agreement with the intermediary. We have been told that these agreements are commercially sensitive, and that insurers would not disclose them lightly.

Unfortunately, the firm has contemporaneous documentary evidence in the form of a signed declaration from you in which you state that the answers recorded were true and complete to the best of your knowledge and belief. Moreover, you confirmed that you had read and understood the application. That declaration also specifically states the following:

If this application form has been filled in by someone else on your behalf you must read all of the answers to the questions on the form carefully before signing this declaration.

- 5.37 However, it is clear that in many cases the FOS will not regard signed forms as conclusive. Furthermore, where tied agents were involved we did not find any specific mention of *Newsholme* and there was evidence that the FOS regularly departs from that decision.
- 5.38 For example, one case in our survey involved a life and critical illness policy effected jointly by a husband and wife. When the wife died, a claim was made. The insurer avoided the policy on the ground of misrepresentation and rejected the claim. One of the questions in the application form required disclosure of any visit to a doctor. The answer given did not include details of various medical appointments made by the wife. Although the form was completed by the insurer's tied agent, it had been signed by both the husband and the wife.
- 5.39 In an initial assessment, an adjudicator at the FOS supported the insurer. However the husband appealed to an ombudsman. The ombudsman pointed out that the tied agent had made other mistakes in completing the form and concluded that some of the questions simply had not been put to the couple:

In view of the large number of what would seem obvious errors on the application form and the fact that several questions which appear to require a "yes" or "no" answer where either "N/A" or no answer is shown, I consider it most likely that [the tied agent] did fail to ask all the questions...and that this resulted in the complainant's late wife's failure to disclose her investigations.<sup>28</sup>

- 5.40 Under *Newsholme* such errors would, of course, have been made when the intermediary had switched from being a tied agent to being the agent of the applicants for the completion of the form. Nevertheless, the ombudsman found grounds for deciding against the insurer:

I accept that the complainant and his late wife should have read the application form before signing it, but consider it most likely that they did not do so because [the tied agent] did not make the importance of this clear to them.

<sup>28</sup> Case 10.

- 5.41 The reasoning appears to be that whatever the status of the intermediary at the time the form was completed, there was a duty on him as tied agent to explain the importance of thoroughly checking the form.
- 5.42 We were also interested to note the following case where the ombudsman was given the full tape of a telephone interview in which a sales representative took a consumer through the health questions in a critical illness application.

Mr and Mrs B had applied for cover jointly. Mrs B telephoned a call centre, where a member of staff took her through the questions; the representative then printed out a copy of her replies, which both Mr and Mrs B signed. One of the questions asked was whether either policyholder had ever suffered from stress, anxiety or depression or required tranquillisers or anti-depressants. They both answered no. In fact, Mr B had been prescribed anti-depressants for 10 months in the previous two years.

The tape showed how the questions had been asked. The representative had started by explaining that people no longer any need to fill in large forms: "we've got rid of all that side of it" and "we can actually do everything over the phone these days". For the first question she asked if "either of you" had suffered from heart attacks or cancer, but after that she stopped referring to "either of you" and asked Mrs B only about herself. Crucially, for the question about anti-depressants she asked "have *you* ever taken tranquillisers or anti-depressants?". At the end she finished by saying "there'll be two forms, we just need a signature from both of you on each and popped back in the envelope". She said nothing about checking through the form, or reading it carefully.

In light of this evidence, the ombudsman ordered the insurer to apply a proportionate remedy.

- 5.43 This case illustrates how insurance firms may be caught between the need to reassure consumers that applying for insurance is a straightforward, easy process and the need to warn them about their duty of care to ensure that all answers are accurate. The sales and the underwriting sections of an insurance company may have different priorities in this area.

#### ***Conclusion from FOS research***

- 5.44 It seems that a consumer who takes an "intermediary" case to the FOS may have a better chance of recovering from the insurer than under the strict law. However, it is not clear when the mistakes of the intermediary will, in effect, be imputed to the insurer rather than to the insured; and some decisions at least still apply the *Newsholme* doctrine. The courts have failed to reach consistent decisions where an insured blames the agent for mistakes in the form. On the one hand, contracting parties rely on the certainty of a signature, and people must usually be taken to mean what they sign. On the other hand, the reality is that consumers often sign forms that they do not understand or have not read, relying on agents to explain and clarify the questions. The same tensions can be seen within ombudsman decisions.

5.45 We think there is a need to explain and clarify how both ombudsmen and the courts should approach cases in which the policyholder has signed a form containing a misrepresentation but then adduces oral evidence about the context in which that misrepresentation was made. In Part 6 we outline how we think this issue should be approached under the new regime proposed in our first issues paper.

# **PART 6**

## **CONSUMERS – THE CASE FOR REFORM**

### **INTRODUCTION**

- 6.1 In this Part we consider whether reform of agency law in respect of misrepresentation and non-disclosure is desirable in consumer cases. We start by discussing what is at stake in issues concerning the intermediary's status. We then outline the possible justifications for making insurers responsible for their agents. We think there is a need to clarify the law in this area, but not to the extent that the Law Reform Committee recommended in 1957. We tentatively propose a more limited reform, namely that an intermediary should be regarded as acting for an insurer for the purposes of obtaining pre-contract information, unless it is genuinely searching the market on the insured's behalf.
- 6.2 We then consider whether to overturn the rule in *Newsholme*, that an insured is liable for any errors on a signed proposal introduced by an agent. We tentatively propose that where an agent would otherwise be considered the insurer's agent, they should remain the insurer's agent for the purpose of completing a proposal form. Similarly, the insured's signature to a declaration on a proposal form should not be considered conclusive of the insured's state of mind in making an erroneous representation.
- 6.3 Finally we consider the effect of section 19 of the Marine Insurance Act 1906.

### **WHAT IS AT STAKE?**

#### **Against whom should the claim lie?**

- 6.4 It is important to identify what is at stake. In many cases the question is not simply, should the consumer have a remedy or not? It is clear that if the intermediary was at fault, the consumer should have a remedy. It is also clear that the consumer will normally have a remedy against the intermediary for professional negligence. The question is whether they should be obliged to pursue that, or whether the insurer should have to pay under the policy.

#### **The tentative proposals set out in Issues Paper 1**

- 6.5 We also need to take into account the effect of adopting our earlier proposals on misrepresentation and non-disclosure, as set out in our first issues paper. The net effect of these would be
- (1) Insurers should be allowed to avoid policies where the insured has acted fraudulently at the pre-contractual stage and the insurer has been induced to enter the contract as a result. An insured would be considered to have acted fraudulently if they:
    - (a) knew that the statement was untrue (or realised that it might not be true and did not care); and
    - (b) knew that the statement was material to the insurer (or realised that it might be material and did not care whether it was or not).

- (2) If the insured acted in the way that a reasonable consumer in the circumstances would have acted, then the insurer should have no remedy for misrepresentation or non-disclosure. A misrepresentation may be reasonable if the insured had reasonable grounds for believing the truth of what they said, or failed to answer a question fully and accurately because they were told this was unnecessary by the insurer.
- (3) If a consumer proposer has made a negligent misrepresentation, the court should apply a proportionate remedy by asking what the insurer would have done had it known the true facts. In particular:
  - (a) Where an insurer would have excluded a particular type of claim, the insurer should not be obliged to pay claims that would fall within the exclusion;
  - (b) Where an insurer would have declined the risk altogether, the claim may be refused;
  - (c) Where an insurer would have charged more, the claim should be reduced proportionately to the under-payment of premium.
- (4) There would be no proactive duty of disclosure in consumer cases.

#### **The effect of an intermediary's status**

6.6 We think it would be helpful to set out how we see the issue of the intermediary's status as interacting with these proposals:

- (1) If an independent intermediary is acting for the insured then the insured bears responsibility for the fraud or negligence committed by their agent. This means that:
  - (a) *If the intermediary acts fraudulently (and the consumer does not),* the insurer may avoid the policy. The consumer must pursue a remedy against the intermediary.
  - (b) *If the intermediary is negligent (and the consumer is not),* the insurer has a proportionate remedy. The complainant must pursue the intermediary for their remaining loss.
  - (c) *If both the intermediary and the consumer are negligent,* the insurer has a proportionate remedy. The consumer may pursue the intermediary for loss, but this would be subject to a defence of contributory negligence.
  - (d) *If both the intermediary and consumer took reasonable care,* the insurer must pay the claim.
- (2) If the intermediary is the agent of the insurer (for example under a single tie or multi-tie arrangement), the intermediary's actions are considered to be the insurer's actions. This means that:

- (a) *If the intermediary acts fraudulently (and the consumer does not), the insurer must pay the claim.*
- (b) *If the intermediary is negligent (and the consumer is not), the insurer must pay the claim.*
- (c) *If both the intermediary and the consumer are negligent, the insurer has a proportionate remedy against the consumer on the grounds of their own negligence.*
- (d) If both the intermediary and consumer took reasonable care, the insurer must pay the claim.

### **JUSTIFICATIONS FOR TRANSFERRING THE RISK**

6.7 In general terms, we see four possible justifications for treating the intermediary as agent of the insurer in a broader range of cases than at present. The justifications differ in their implications, some suggesting that the insurer should be made responsible for a wider range of intermediaries, others a narrower range.

#### **Deep pockets**

- 6.8 In the past it may have seemed sensible to make the insurer accept responsibility for the intermediary simply because the intermediary was likely to be without substantial means. Now that intermediaries are required to carry professional indemnity insurance and to be members of the Financial Services Compensation Scheme, (FSCS), we no longer see any merit in this “deep pocket” argument.
- 6.9 It is true that the FSCS has rules for the calculation of compensation and limits on the payments that can be made, other than for compulsory insurances. We are not aware, however, that these limits have given rise to difficulties. They should, of course, be kept under review.
- 6.10 Some intermediaries fall outside the scope of FSA regulation. This means that if they act wrongly the consumer cannot bring a complaint against them to the FOS; and if they become insolvent there is no right to compensation from the FSCS. As we discussed in Part 5, travel operators arranging travel insurance and product retailers arranging product insurance are exempted from regulation in this way. Furthermore, other professions or businesses may give incidental information about complementary insurance products: they are not meant to give advice about completing forms, but might overstep the mark. If they do so, the consumer has no right to complain to the FOS or be compensated by the FSCS. However (as we discuss below) we are not aware that these gaps in protection cause problems in practice. We do not think they require special measures.



### **Ease of enforcement**

- 6.11 It is easier for the insured to claim on the policy than to bring an action for negligence against the intermediary. Inevitably there are delays in pursuing a complaint against an intermediary, even through the FOS. There will be further delays if the intermediary cannot pay and a claim has to be made under the FSCS. Even if a claim against an intermediary is ultimately successful, the consumer may have been left without funds at a time when they were most needed.
- 6.12 If the insurer were to be responsible for paying the insured and recouping damages from the intermediary, the consumer would be paid more quickly.
- 6.13 It would also prevent the consumer who brings a claim against the insurer on the assumption that the insurer is responsible from having to “start all over again”. That however could be avoided by procedural changes within FOS. It may, for example, be possible to introduce a system whereby a joint complaint could be made against both the insurer and the intermediary.
- 6.14 We doubt that ease of enforcement alone would justify changing the law.

### **Reasonable expectations**

- 6.15 We have already said that there appears to be a common understanding among some consumers that certain intermediaries are “representatives” of the insurer even though as a matter of law that is not the case. To most consumer insureds, the intermediary may well be seen as much “part of the industry” as the insurer itself, and they will not understand that in law the intermediary acts for them not the insurer. It is not surprising that such an insured thinks it suffices to give the relevant information to the intermediary or to follow their advice about how to answer questions. This point was put to us forcibly by the FOS:

The applicant for insurance is frequently unaware that the insurance intermediary is acting as their agent in respect of this part of the overall process of applying for and receiving insurance cover. Indeed, it appears from the experience of the Financial Ombudsman Service that most consumers applying for insurance cover believe that the intermediary is acting as the seller of the insurance policy (and they do not consider whether they act on behalf of the insurance company or on their own account). The exception is where the intermediary is expressly offering a service that reviews insurers and offers the cheapest or most suitable policy.<sup>1</sup>

<sup>1</sup> Response by Peter Hinchliffe sent on 22 January 2007.

- 6.16 The FOS points out that where the intermediary has a tied arrangement with the insurer, has control over the policy terms and retains a large proportion of the income, the consumer may reasonably see the intermediary as “acting on the other side of the transaction”.
- 6.17 In earlier issues papers we have said that much of our joint review is about bringing the law into line with the reasonable expectations of insureds. Where insurer and intermediary are, in the eyes of the reasonable insured, closely linked, it does not seem unreasonable to place the risk of mistakes by the intermediary on the insurer. And, as in other consumer contexts, it cannot be assumed that the reasonable insured “reads all the small print”. Indeed, FSA experience suggests that most consumers read very little of it. So the question has to be put in terms of the reasonable consumer’s “general impression”.
- 6.18 There are two possible approaches to this issue. One is to distinguish between different types of intermediary. The other is to require clarificatory statements by the intermediary.

#### ***Types of intermediary***

- 6.19 There are some circumstances where a well-informed consumer is less likely to get the general impression that an intermediary is “part of the insurer’s organisation”, rather than acting for them. This occurs if the intermediary is not limited in the policies it offers and therefore, in accordance with FSA requirements, has indicated that its recommendation is based on a fair analysis of the market. That seems to us to suggest that the intermediary is working for the customer, not for the insurer. In contrast, where the intermediary can only offer products from one particular insurer, we think there is a sufficient risk that the customer will think of the intermediary as working for that insurer to justify treating them as the insurer’s agent. We think the same applies when the intermediary can only offer products from a limited number of insurers.

#### ***Clarificatory statements***

- 6.20 The alternative approach is to treat the intermediary as the agent of the insurer unless steps have been taken to make it clear that this is not the case. This would suggest that the intermediary would be treated as the insured’s agent provided that it had issued clear warnings to this effect. The warnings would need to state that (1) any doubts over what is material must be resolved with the insurer and (2) that the insured must check that each and every material fact is actually communicated to the insurer, not just to the intermediary.

6.21 We think this is a less attractive approach for three reasons. First, we share the FSA's hesitations about the effectiveness of warning notices. The more warnings that are required, the less effective any of them become. The Davidson Review has argued strongly that the disclosure obligations on intermediaries should be reduced, not extended.<sup>2</sup> Secondly, we think that having to give customers a warning of this kind would hurt the reputation of intermediaries. There is a risk that consumers would infer that intermediaries are less than competent. Thirdly, the obligations of the insurer would depend on what was or was not done by the intermediary in the particular case. The insurer may be liable for an intermediary's actions without realising that it would be.

### **Market discipline**

6.22 A final justification for imposing the risk of mistakes by the intermediary on the insurer is that this is more likely than the current law to provide proper market discipline. Put bluntly, intermediaries should be strongly encouraged not to make mistakes, and those who regularly do so should not remain in business. However, individual consumer insureds will deal with intermediaries only rarely. They are in no position to influence or monitor the intermediary's business practices, and the risk of loss of their custom is unlikely to have much effect in disciplining poorly-performing intermediaries or driving them out of the market. Insurers, on the other hand, have many opportunities to monitor and influence intermediaries. The intermediary is, after all, remunerated by commission from the insurer.

6.23 We are struck by the fact that as early as 1981 insurers recognised this position by voluntarily agreeing to use their best endeavours to ensure that intermediaries complied with the provisions of a code of practice.<sup>3</sup>

6.24 This might suggest that any intermediary who is remunerated by commission from the insurer should be the insurer's responsibility. We would not go so far, however. Insurers may not have regular contact with intermediaries who offer a full range of market products. The insurers' ultimate sanction – to refuse to accept proposals made through the intermediary – has less bite when the intermediary can offer other similar products and will usually be able to avoid explaining to the client why it is not able to offer products from that particular insurer.

<sup>2</sup> Davidson Review on the Implementation of EU Legislation, *Final Report*, November 2006, at [http://www.cabinetoffice.gov.uk/regulation/reviewing\\_regulation/davidson\\_review](http://www.cabinetoffice.gov.uk/regulation/reviewing_regulation/davidson_review).

<sup>3</sup> See ABI General Insurance Business Code of Practice, withdrawn January 2005.

- 6.25 There is another reason for excluding this group of intermediaries from any change to the law. This is the likely effect on small firms of brokers. Insurers, we suspect, would find it hard to “police” lots of small independent intermediaries adequately and would want only to deal with larger firms. This would distort the market in an undesirable way, since it would drive small intermediaries out of business even though their standards were irreproachable.

#### **CLARIFYING THE AGENT’S ROLE: OUR TENTATIVE PROPOSALS**

- 6.26 We agree with the FOS that there is a need to clarify for whom an intermediary is acting in receiving pre-contract information. We do not think there is a case for making insurers responsible for their agents simply because they have deep pockets, or because it would make it quicker and easier for consumers to be paid. However, the law should, as far as possible, meet the reasonable expectations of consumers. It should also give an incentive to control intermediaries’ mistakes to the party best placed to exercise that control.
- 6.27 In this paper, we do not go as far as the recommendation made by the Law Reform Committee in 1957, namely that all intermediaries who receive commission from the insurer should be regarded as the insurer’s agents. We think this might disadvantage small independent intermediaries, who might find that insurers are no longer prepared to deal with them. However, there is a real need to clarify the law in this area.
- 6.28 Our tentative view is that the intermediary should be regarded as the insurer’s agent for the purposes of obtaining pre-contract information, unless the intermediary is genuinely searching the market on the insured’s behalf. This means that single tied agents and multi-tied agents will be taken to act for the insurer. Similarly, aggregators may also be considered as acting for the insurer if they only offer access to a limited panel of insurers. If the insurer’s own agents act fraudulently or negligently, the insurer will have to bring an action against the agent, rather than seek a remedy against the innocent insured.
- 6.29 **Is it agreed that an intermediary should be regarded as acting for an insurer for the purposes of obtaining pre-contract information, unless it genuinely searches the market on the insured’s behalf?**
- 6.30 It has been put to us that it is difficult to define concepts such as “multi-ties” and “searching the market”. Under the Insurance Mediation Directive, an intermediary must tell a customer whether their advice is based on “a fair analysis”,<sup>4</sup> a concept defined in the following terms:

<sup>4</sup> Directive 2002/92/EC, art 12.1.(i).

When the insurance intermediary informs the customer that he gives his advice on the basis of a fair analysis, he is obliged to give that advice on the basis of an analysis of a sufficiently large number of insurance contracts available on the market, to enable him to make a recommendation, in accordance with professional criteria, regarding which insurance contract would be adequate to meet the customer's needs.<sup>5</sup>

- 6.31 We would welcome views on whether the same test should be used for the purposes of distinguishing between insurer's agents and insured's agents. In other words, should only those intermediaries conducting a fair analysis of the market be treated as the consumer's agent? The advantage of aligning the tests in this way is that it is simpler: the distinction already exists (albeit for other purposes) and customers must be told whether the intermediary is providing a fair analysis. On the other hand, it has been pointed out that the duty to offer independent advice is not the same as the duty to ensure a proposal form is filled in correctly. An intermediary may offer independent advice, and then switch hats for the purposes of filling in a form. Alternatively, an intermediary may act for a consumer in completing a form without necessarily offering advice on which product to buy.
- 6.32 **Should the test for whether an intermediary acts as the consumer's agent depend on whether the intermediary conducts "a fair analysis", as defined by the Insurance Mediation Directive?**
- 6.33 As discussed above, we have considered whether special protection is needed for those dealing with intermediaries who are exempt from FSA regulation, such as travel agents selling travel insurance, product retailers selling product insurance or businesses wrongly giving advice about incidental products. Our current view is that no additional protection is required. The issue does not appear to cause problems in practice, as (for example) it is rare for travel insurance to be avoided for non-disclosure or misrepresentation. Furthermore, product retailers and travel agents rarely carry out a fair analysis of the market, so will usually be considered as agents for the insurer in any event. However, we would welcome views on this.
- 6.34 **Is any additional protection necessary when consumers have been given bad advice about completing proposal forms by intermediaries who are not subject to FSA regulation?**

<sup>5</sup> As above, art 12.2

## COMPLETION OF PROPOSAL FORMS

- 6.35 As we explained in Part 3, even if an intermediary acts for all other purposes as the agent of the insurer, if it completes a proposal form it may do so as agent of the consumer. A problem arises if the intermediary introduces errors into the form. Should a consumer sign a proposal form that has been incorrectly completed, it may lead to the policy being avoided and any claim being rejected.
- 6.36 As we explained earlier, this rule is based on a case decided in the 1920's, *Newsholme Brothers v Road Transport and General Insurance Co Ltd*. This contained two strands of reasoning: that there was a "transferred agency" and that insureds should be bound by their signature.<sup>6</sup>

### Abolishing the "transferred agency" rule

- 6.37 The *Newsholme* case appeared to suggest that even if an intermediary was otherwise an agent of the insurer, it should be considered to be an agent of the insured for the purposes of completing a form. We do not think this can be right. Insurance intermediaries routinely complete forms on behalf of consumers, and consumers expect them to do so. Even if an insurer's agent does not have explicit authority to fill in a form, he or she will have apparent authority to do so. As far as the consumer is concerned, the agent will be acting for the insurer in completing a normal part of the sales process. Unless the consumer and agent are both committing a fraud together, a tied agent will remain the insurer's agent while completing or helping to complete a proposal form.
- 6.38 We think it would be helpful to clarify the law in this area. We tentatively propose that an intermediary who would otherwise be regarded as acting for the insurer in obtaining pre-contract information remains the insurer's agent while completing a proposal form. This would be true unless both insured and the intermediary are parties to a fraud together. If the intermediary is fraudulent but the insured is not, we think the insurer should bear liability for the fraud of their own agent (and if only the insured is fraudulent, the issue of the intermediary's status does not arise).
- 6.39 **Is it agreed that an intermediary who would normally be regarded as acting for the insurer in obtaining pre-contract information remains the insurer's agent while completing a proposal form?**

### The proposer's signature

- 6.40 A more difficult problem arises where the proposer has signed the form declaring that the statements in it are correct. Insurers will want to be able to rely on the facts stated. How far should proposers be permitted to claim that the statements were incorrect because of the intermediary's mistake?

<sup>6</sup> [1929] 2 KB 356. See Part 3, above.

- 6.41 In *Newsholme*, the proposers signed a basis of the contract clause in which they warranted the truth of every statement made. Under our tentative proposals, however, the court or ombudsman will now need to focus on the consumer's state of mind: was the misrepresentation made fraudulently, negligently or innocently? In deciding this issue, the fact of a signature may be evidence, but it will not be conclusive evidence.
- 6.42 In some cases, it could be argued that a proposer who signs a declaration that the information given on the proposal form is correct should check the form, and if they do not they are acting negligently. This was the view taken by the Court of Appeal in *O'Connor v Kirby*.<sup>7</sup> The insured applied for car insurance through an independent intermediary, who made a mistake filling in the form. The intermediary then handed him the form and asked him to check through it. The insured did this rapidly and failed to notice the mistake. The court found that the insured had been negligent in failing to check the form and had caused the loss.
- 6.43 There may well be cases where, on the facts, a consumer has acted negligently in failing to check a form filled in by someone else. However, we think that to treat a signature as in anyway conclusive is simply unrealistic in a consumer case. In some cases the agent will not tell the consumer that they need to check, or may actually say that there is no need to worry about the form (as happened in the recorded conversation discussed in Part 5). We all regularly sign documents that we have not read carefully; but most of us think that in our private lives this is often excusable particularly when the other party knows "what we meant" or "what the true position is". When coupled with a general impression that the intermediary "represents" the insurer, the failure to check seems excusable.
- 6.44 It is also possible that the proposer may claim that the answers were incorrect because the intermediary had given them misleading advice as to how to answer. In this case the proposer knows what is written on the form, and claims he was misled into making that statement. The signed declaration is simply irrelevant. The insurer should be liable to pay despite the misrepresentation if the case is one in which the intermediary was "tied".
- 6.45 We tentatively propose that in deciding whether an insured has acted fraudulently, negligently, or innocently in relation to a misrepresentation, the insured's signature should not be regarded as conclusive of the insured's state of mind.

<sup>7</sup> [1972] 1 QB 90.

### Opening the floodgates?

- 6.46 We recognise the concerns of some insurers who fear that a move away from signatures being conclusive may undermine the certainty they need to operate. The fear is in particular that when making claims unscrupulous policyholders will, if convenient, be able to deny that the proposal form accurately reflects the information given to the intermediary.
- 6.47 Interestingly, these points were raised by counsel for the insurer in *Stone v Reliance Mutual* in exchanges during an unsuccessful application for leave to appeal:<sup>8</sup>

Unhappily it is I am told more or less standard practice certainly under these small industrial policies that the agent writes down the answers on these proposal forms. The findings of this Court - even though your Lordship has gone out of your way to quote the particular facts of this case - is going to have the very greatest bearing on the whole conduct in regard to industrial policies and various other insurance policies where it is the practice of an employee of the insurers to conduct the inquiries in this way...

It may well be that the insurance association will not wish to proceed with the appeal, but it is going to affect countless thousands of insurance policies which have been proposed and accepted in this way, because these are largely policies which are taken out by persons who, if I may say so, did not attend Balliol College, Oxford...

But the danger is, if I understand your Lordships' decision, that every insured is now going to say: "I dictated it and he wrote it down: it is a muddle, and I am entitled to my money."<sup>9</sup>

- 6.48 This final point met with little sympathy from Lord Denning:

No; I do not know what everyone will do; but, as we said, it really depends on its own facts.<sup>10</sup>

- 6.49 Lord Denning was, we think, correct. These cases should depend on their facts. The burden of proof will be on the policyholder to establish that the intermediary failed to correctly record the information that the proposer provided. A signature on a proposal form may not be conclusive but it will still be evidence for these purposes.

<sup>8</sup> [1972] 1 Lloyd's Rep 469.

<sup>9</sup> Above, at p 477.

<sup>10</sup> Above, at p 478.



- 6.50 **Is it agreed that the insured's signature on an erroneous proposal form should not be regarded as conclusive evidence of the insured's honesty or lack of care in the way that a proposal form was completed?**

#### **MARINE INSURANCE ACT 1906, SECTION 19**

- 6.51 As we have indicated, we are not aware of any reported case where section 19 has been applied to consumer insurance. However, it clearly applies to non-marine insurance as well as marine insurance. We therefore think that as a matter of technical law the section applies equally to consumer and to business insurance.

#### **Section 19(b)**

- 6.52 At first sight, the obligation under section 19(b) seems reasonable. After all, the insured's agent should be required to disclose those matters that the insured is obliged to disclose. However, a breach of the section does not give the insurer a right to damages against the intermediary. The insurer's only remedy lies in avoiding the policy against the insured, which they would be able to do in any event. We are therefore not sure that the section gives the insurer any additional protection.
- 6.53 Under the tentative proposals set out in Issues Paper 1, consumers will no longer be obliged to disclose everything material to a prudent insurer. Instead they will be required to answer the questions they are asked truthfully and carefully. Where an agent acts for a consumer, the agent's failure to answer questions truthfully and carefully becomes the consumer's failure. Under these circumstances, we do not think that section 19(b) would give the insurer any additional protection. Although it would be possible to preserve section 19(b) within the proposed new regime, to do so would seem otiose. The only reason for preserving it would be if it gave the insurer a right in damages against the intermediary. We ask whether a right to damages against an intermediary would be a useful additional protection to insurers.
- 6.54 **We welcome views on whether there are any reasons to preserve section 19(b) for consumer insurance. If so, should a breach grant the insurer a right in damages against the intermediary?**

#### **Section 19(a)**

- 6.55 Substantial criticisms can be made of section 19(a) in relation to consumer insurance. If it is needed at all, we think it requires substantial reform. In particular:
- (1) It seems wrong that insurers should be entitled to avoid policies with insureds because of a fault that lies exclusively with a third party. As we discuss in Part 4, this could undermine the purpose of product insurance where the retailer is aware of defects in the product.

- (2) The extent of the duty is unclear, and is difficult to reconcile with an obligation of confidentiality. Suppose, for example, an agent arranges critical illness cover first for a mother and then some time later, with a different insurer, for her daughter. The agent knows that the mother has a hereditary condition, of which the daughter is unaware. Should it be disclosed by the agent? At the very least, we do not think that the duty should extend to information provided in confidence by a third party.
  - (3) How far does the knowledge extend? Would agents to insure be obliged to make internal enquiries or search their records? If it is a national firm, what are they required to do about information held at other branches? On balance, we do not think such a duty should extend beyond the relevant transaction.
- 6.56 This question may of course be academic, since we have been unable to find an insurer who has relied on section 19(a) in a consumer case. If such cases exist, we should be interested to receive details.
- 6.57 **We ask whether section 19(a) of the Marine Insurance Act 1906 should cease to apply in consumer cases, so that the agent to insure would have no duty to disclose matters other than those which the consumer is bound to disclose in response to the questions asked by the insurer.**
- 6.58 **If there are reasons to preserve an extended duty under section 19(a):**
- (1) **Should the remedy lie in damages against the intermediary, rather than in avoidance against the insured?**
  - (2) **Should any information given in confidence by a third party be excepted from the scope of the duty?**
  - (3) **Should the duty be curtailed to information received in the course of the relevant transaction?**

## **PART 7**

# **THE POSITION OF BUSINESSES**

- 7.1 In Part 6, we dealt with three issues: the status of the intermediary; the effect of the *Newsholme* rule, and the effect of section 19 of the Marine Insurance Act. Here we approach the same three issues in the context of commercial insurance.

### **THE STATUS OF THE INTERMEDIARY: WHOSE AGENT?**

- 7.2 In Part 6 we tentatively proposed that the intermediary should be regarded as the insurer's agent for the purposes of obtaining pre-contract information, unless the intermediary is genuinely searching the market on the insured's behalf.
- 7.3 In a business context, it is relatively rare for insurance to be sold through tied or multi-tied agents. It may occur, but only for small to medium businesses. The great majority of business will be placed through independent brokers negotiating in the London market. For these types of insurance we propose no change.
- 7.4 We do not see the same justifications in business insurance for treating the intermediary as the agent of the insurer. First, the business insured is likely to be better informed as to the true position. Second, we think that in the business insurance market, where insureds are much more likely to be "repeat players", there is likely to be a fair degree of market discipline without the need to attribute the mistakes of intermediaries to insurers.
- 7.5 Moreover, we think that in some cases to do that would be positively unfair to insurers. We understand that many insurance arrangements are in effect conceived and set up by brokers, who then have to "sell" the idea to underwriters as much as they do to insureds. In such a case it may be the broker who takes a judgement about what is material to the underwriter. To visit their mistakes on the insurer would hardly be right.
- 7.6 Our tentative proposal is to treat small businesses as consumers for these purposes. The suggestions we make in respect of tied agents in the consumer market would apply equally to tied agents who deal with small businesses.
- 7.7 We have also considered whether we need to specify that tied agents dealing with medium or larger businesses should also be considered to act as agents for the insurer. Our current view is that this is unnecessary and could cause confusion: tied agents are relatively rare in this sector, and the variety of different types of agent makes it difficult to be prescriptive. We think the issue is best left to the development of common law, allowing judges to apply principles of agency law to the facts in hand. This means that for most commercial insurance, we are not proposing a change in the current law.
- 7.8 **Is it agreed that the tentative proposal made in respect of tied agents in the consumer market should apply equally to tied agents who deal with small businesses?**

- 7.9 **Is it agreed that for other businesses, the issue of whom an intermediary is acting for in respect of disclosure issues should be left to the common law?**

#### **THE NEWSHOLME RULE**

- 7.10 Some of the “completed form” cases – indeed, *Newsholme* itself – were business insurance cases. We think the re-evaluation of the effect of the customer’s signature that we suggested in relation to consumer cases in Part 6 should apply equally to business insurance cases.
- 7.11 **Should the tentative proposals made in paragraphs 6.39 and 6.46 apply to business insurance?**

#### **MARINE INSURANCE ACT 1906, SECTION 19(A)**

- 7.12 Earlier we suggested three potential problems with the agent’s independent duty to disclose under section 19(a):
- (1) The remedy for non-disclosure by the agent is avoidance of the policy rather than damages against the agent;
  - (2) Where there is a “chain” of intermediaries, the duty appears to apply only to the agent who deals directly with the insurer, not any other agent in the chain; and
  - (3) It is not clear whether the duty is to disclose any information the agent has, or only that gained in its capacity as agent for the particular insured.

#### **Remedy**

- 7.13 The subsection only bites when the information is known to the agent but not to the insured (and is not information that the insured ought to be aware of in the ordinary course of business.) By definition, therefore, the insured is not at fault. Our tentative suggestion is that in these circumstances it is contrary to the insured’s reasonable expectation that it should lose its rights under the policy and bear the burden of seeking recovery from the agent. It seems better to replace the insurer’s right to avoid by a right to claim damages from the agent.
- 7.14 This would be a significant change in the law, as section 19 does not currently provide insurers with a right to damages. We seek views from both insurers and brokers about whether this would produce fairer or more satisfactory outcomes.
- 7.15 We would also welcome views on whether the right to damages should apply to all contracts of insurance placed within the UK, or only to those governed by the law of a part of the UK.

#### **Chains**

- 7.16 An intermediary may well have material information that is not known to either the insured or the final intermediary who deals with the insurer. Under the current law there is no incentive on the middle intermediary to reveal the information. In fact, it would seem open to the parties to reach an express agreement that the information does not have to be communicated up the chain.

- 7.17 We welcome views on whether producing brokers should be obliged to pass information up the chain, so that the final intermediary should be responsible for passing it to the insurer. However, we would need to be careful to ensure that the provision did not apply too widely to remote agents (such as those in *PCW* or *ERC Frankona*)<sup>1</sup>.

#### **The scope of information covered**

- 7.18 We suggest that an agent may well have information about the risk to be insured that he did not receive in the character of agent for the insured. It seems inefficient to excuse its non-disclosure. It is also difficult to determine what information is received “in the character of agent for the insured”, or whatever test is to be used. We agree that it would be harsh on the insured were the insurer able to avoid because of such “unconnected” information, but that objection falls away if the remedy is to be damages against the intermediary rather than avoidance of the policy.

- 7.19 We would make an exception, however, for information which the intermediary is under an obligation not to divulge, for example information obtained in confidence.

#### **Conclusion**

- 7.20 **We ask:**

- (1) **Is it agreed that where a broker breaches section 19(a), the insurer should no longer be entitled to avoid the policy against the insured. Instead should a remedy lie against the broker in damages?**
- (2) **If so, should the right to damages apply whenever insurance contracts are placed within the UK, or only where the contract is subject to the law of a part of the UK?**
- (3) **Should producing brokers be obliged to pass relevant information up the chain to the placing broker?**
- (4) **Should the law specifically state that an intermediary is not required to disclose information given to it in confidence by a third party?**

<sup>1</sup> *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136 and *ERC Frankona Reinsurance v American National Insurance Co* [2006] Lloyd’s Rep IR 157.

# APPENDIX A

## PREVIOUS REPORTS, SELF-REGULATION AND STATUTORY REGULATION

- A.1 In this Appendix we provide an overview of some of the more important measures of self-regulation and statutory regulation introduced in recent years. We also consider some of the reports that have been published in this area. This background is, in our view, essential in understanding the current position.

### LAW REFORM COMMITTEE REPORT 1957

- A.2 In July 1954 the English Law Reform Committee was asked to consider:

The effect on the liability of insurance companies of special conditions and exceptions in insurance policies and of non-disclosure of facts by persons effecting such policies.<sup>1</sup>

- A.3 In the resulting report published in January 1957, the Committee drew attention to the fact that an applicant for insurance was unlikely to be aware that the duty of disclosure might not be satisfied by providing information to an intermediary:

We considered the effects of the widespread practice of negotiating insurance through agents nominated by insurance companies. This practice, whether or not it is strictly within our terms of reference, has proved on occasion directly relevant to the liability of the insurer. A proposer who negotiates his insurance through such an intermediary is apt to assume that a true and complete disclosure of facts (whether material in themselves or the subject-matter of questions in the proposal form) to the agent is disclosure to the insurer, whereas on the authorities as they stand the better opinion is that, in relation at any rate to the filling up of a proposal form, such a person must be regarded as the agent of the proposer. The result may be, and in some of the reported cases apparently has been, that insurers can repudiate liability because an agent has been allowed by the proposer to fill up the proposal form, and has carelessly or deliberately falsified therein the oral information given to him by the proposer.<sup>2</sup>

- A.4 It suggested the following solution, the application of which it believed would lead to “no legal difficulties”:

<sup>1</sup> Conditions and Exceptions in Insurance Policies (1957) Cmnd 62, p 3.

<sup>2</sup> Above, p 4.

That any person who solicits or negotiates a contract of insurance should be deemed, for the purposes of the formation of the contract, to be the agent of the insurers, and the knowledge of such person should be deemed to be the knowledge of the insurers.<sup>3</sup>

A.5 The Committee's report was not implemented.

#### **POLICYHOLDERS PROTECTION ACT 1975**

A.6 In the years leading to 1975 a significant number of insurers became insolvent. Only mergers or take-overs rescued others. Perhaps the notorious collapse was that of Vehicle & General in 1971, which left an estimated 1 million policyholders without valid motor insurance.<sup>4</sup>

A.7 The Policyholders Protection Act 1975 established a compensation scheme for the policyholders of insolvent insurers. For compulsory insurances, such as motor insurance, liabilities to private and corporate policyholders were to be met in full. In all other cases 90% of liabilities to private policyholders were to be met. Costs were met by a levy on the industry.

A.8 However, the scheme did not provide compensation for those affected by the insolvencies of intermediaries.

#### **BRITISH INSURANCE BROKERS' COUNCIL 1976**

A.9 Over this period concern was also growing about the lack of supervision of insurance intermediaries. Insurance was being sold by a wide variety of individuals, none of whom were subject to regulation comparable to that imposed on insurers.

A.10 On 21 May 1975, the Secretary of State for Trade wrote to the four main trade associations for insurance intermediaries – the Association of Insurance Brokers, the Corporation of Insurance Brokers, the Federation of Insurance Brokers and Lloyd's Insurance Brokers' Association. The letter invited these bodies to put forward proposals for the identification and supervision of insurance brokers.

A.11 In response, the trade associations proposed the creation of a register of those entitled to call themselves insurance brokers and an outline of the qualifications that would be required to use the title. To implement this self-regulatory scheme, the associations formed the British Insurance Brokers' Council ("BIBC") in January 1976. In November 1976, the BIBC published detailed proposals.

<sup>3</sup> Above, p 7.

<sup>4</sup> See the Report of the tribunal appointed to inquire into the circumstances leading up to the cessation of trading by the Vehicle and General Insurance Company (1972) HC 133.

## **DEPARTMENT OF TRADE GREEN PAPER 1977**

- A.12 In January 1977 the Department of Trade presented to Parliament a short Green Paper entitled “Insurance Intermediaries”. It accepted in principle the case made out by the BIBC for a self-regulatory scheme to register those who wish to be called “insurance brokers”, but stressed that it was essential that such a scheme should be effective.
- A.13 So far as insurance agents were concerned — that is, those who were not insurance brokers — the Department indicated that the Government had already reached a view:

The Government believes that to make insurance agents at all times the responsibility of the company for which they act would have several advantages for the consumer without laying any unreasonable burden on the insurer. These advantages include the following:

- (i) insurers and others using agents to sell insurance would need to consider in the light of their legal responsibility whether they should raise their standards of selectivity and training for their sales forces;
- (ii) policyholders would be surer of their rights under insurance policies and, unless an agent had acted outside the terms of his appointment, they would be able to get redress more easily for his failings by proceeding direct against the responsible insurance company — a more substantial target.<sup>5</sup>

## **INSURANCE BROKERS (REGISTRATION) ACT 1977**

- A.14 In the same week that the Green Paper was published, Mr John Page MP presented a Private Members’ Bill to create a statutory registration scheme for those who wished to be known as “insurance brokers”. This Bill attracted the support of the Government and, in amended form, was enacted as the Insurance Brokers’ Registration Act 1977.
- A.15 The Act established the Insurance Brokers Registration Council. It made it a criminal offence for any person or firm to use the description “insurance broker” without being registered through the Council. Registration was subject to certain requirements including qualifications or relevant experience. This structure remained in place until 30 April 2001.

<sup>5</sup> Insurance Intermediaries (1977) Cmnd 6715.



## **LAW COMMISSION REPORT 1980**

- A.16 In 1978 the English Law Commission was asked to consider certain aspects of insurance law – primarily non-disclosure and breach of warranty. It published its final report in 1980. It did not consider the position of intermediaries in detail, but urged reform:

Our terms of reference are wide enough to cover the effect on the liability of insurers of the negotiation of insurance contracts by agents or brokers. Under the present law such intermediaries are for some purposes regarded as the agents, not of the insurers but of the insured. The main problem that arises is the fact that an insured is likely to assume that a disclosure of all material facts to such an intermediary is disclosure to the insurer. An insurer may nevertheless repudiate a policy on the ground of a non-disclosure by the insured.<sup>6</sup>

- A.17 The Commission drew attention to the problems relating to insurance intermediaries that had been raised by the Law Reform Committee in 1957. It believed that reform was necessary and that the recommendations in the Department of Trade's Green Paper would, if implemented, have the effect of "substantially eliminating" these problems.
- A.18 Given that the Government was already concerned with these matters the Commission decided not to consider further the issue of intermediaries.

## **BIA GENERAL INSURANCE BUSINESS CODE OF PRACTICE 1981**

- A.19 In 1981 the British Insurance Association, forerunner to the Association of British Insurers, responded to the Department of Trade Green Paper by introducing the General Insurance Business Code of Practice. This code was intended to guide all insurance intermediaries (including employees of insurance companies) other than those entitled to call themselves brokers. Under the code those insurers who were members of the ABI were committed:

to use their best endeavours to ensure that all those involved in selling their policies observe its provisions.

- A.20 The code contained the following provisions relating to misrepresentation and non-disclosure:

c. Disclosure of Underwriting Information

The intermediary shall, in obtaining the completion of the proposal form or any other material:-

<sup>6</sup> Insurance Law: Non-Disclosure and Breach of Warranty (1980) Cmnd 8064, para 2.18.

(i) avoid influencing the prospective policyholder and make it clear that all the answers or statements are the latter's own responsibility; and

(ii) ensure that the consequences of non-disclosure and inaccuracies are pointed out to the prospective policyholder by drawing his attention to the relevant statement in the proposal form and by explaining them himself to the prospective policyholder.

A.21 This meant that where an intermediary breached the code an aggrieved policyholder might not just have a claim against the intermediary, but also a complaint against the insurer that had failed to use its "best endeavours".

### **INSURANCE OMBUDSMAN BUREAU 1981**

A.22 In 1981, four insurers established the Insurance Ombudsman Bureau ("IOB"). Membership was voluntary. The IOB investigated complaints against those insurers that had chosen to join the service, and could make awards of up to £100,000 to policyholders. Crucially, the IOB had the power to depart from the law and make decisions on the basis of what was fair and reasonable in all the circumstances.

A.23 Although the IOB was created to deal with complaints against insurers, it was relevant to the position of intermediaries in three respects:

- (1) From 1981, the IOB was able to enforce the General Insurance Business Code of Practice issued by the British Insurance Association and its successor the Association of British Insurers ("ABI").
- (2) In 1989, following the decision in *Roberts v Plaisted*, the then Insurance Ombudsman, Dr Julian Farrand, indicated that he would "in appropriate cases" hold an insurer liable for the acts of an intermediary.<sup>7</sup>
- (3) From 1998, intermediaries were able to join the IOB in their own right, though only a handful chose to do so.

### **THE GOWER REPORT 1981**

A.24 In 1981, Professor L C B Gower was commissioned by the Secretary of State for Trade to advise on the need for new legislation to protect private and business investors. The first part of his report entitled *Review of Investor Protection* was published in January 1984.

<sup>7</sup> Insurance Ombudsman, Annual Report (1989) paras 2.13 to 2.15.

A.25 Gower proposed new legislation establishing a two-tier system of regulation. The first tier would be either a new agency or the Government and would provide basic policy, overall surveillance and any residual regulation. Day-to-day regulation would be entrusted to a second tier of recognised self-regulatory bodies.

A.26 Pure protection policies, including general insurance policies were outside Gower's terms of reference. However, most life insurance products were covered by his proposals:

Life policies...normally provide both 'protection' against calamities such as death or permanent incapacity and an 'investment' whether in the form of a fixed lump sum payable on the occurrence of a future event, a present or future annuity or pension or, in the case of 'with profits' or linked-life policies or bonds, a present or future stake in, or related to, the variable worth of the insurance company's life funds or in the specific assets to which the policy or bond is linked. These clearly are investments as well as insurance and developments in recent years have emphasised the investment element, to such an extent that some insurance contracts contain virtually no 'protection' element at all.<sup>8</sup>

A.27 Not surprisingly, Gower identified the major flaw in the Insurance Brokers (Registration) Act:

It is in respect of the vast number of insurance intermediaries that the most conspicuous weakness of the present regulatory system for insurance is to be found. The Insurance Brokers (Registration) Act is a valiant attempt by the professional bodies to deal with it. But unfortunately the Act is flawed in that it does not prevent anyone from carrying on business as an insurance broker unless he and his business are registered with, and thus subject to the discipline of, the Insurance Brokers' Registration Council; it merely prevents him from describing himself as an insurance broker. Hence someone describing himself as, say, an insurance consultant or an investment broker, manager or consultant does not need to register.<sup>9</sup>

#### **FINANCIAL SERVICES ACT 1986**

A.28 In January 1985, the Department of Trade and Industry published a White Paper entitled *Financial Services in the United Kingdom*. This took into account both the Gower Report and work carried out by industry working groups and set out the framework for proposed legislation - what was to become the Financial Services Act 1986.

<sup>8</sup> Review of Investor Protection (1984) Cmnd 9125, p 83.

<sup>9</sup> Above.

- A.29 The Financial Services Act 1986 introduced the anticipated two-tier system of regulation for investment business with effect from April 1988. A lead regulator, the Securities and Investments Board ("the SIB"), provided the first tier, and the second tier comprised self-regulatory organisations ("SROs") and recognised professional bodies ("RPBs").
- A.30 Rules issued by the SIB established a system of polarisation for those advising on insurance investment products. This meant that intermediaries had to choose between being either:
- (1) an independent financial adviser ("IFA"), advising on all products and companies in the market, or
  - (2) a tied agent, representing just one company and selling only its products.
- A.31 Some firms opted for direct regulation by the SIB. However, most IFAs were regulated by the Financial Intermediaries, Managers and Brokers Regulatory Association ("FIMBRA"), an SRO. Tied agents were employees of an insurer, most of which were regulated by another SRO, the Life Assurance and Unit Trusts Regulatory Organisation ("LAUTRO"). Both IFAs and insurers could also have appointed representatives, for which they were responsible.
- A.32 Each SRO was obliged to have an effective complaints-handling service. For most of its period of operation, FIMBRA offered an arbitration service with a limit on awards of £50,000. The primary complaints-handling service for LAUTRO was the IOB with a limit on awards of £100,000.
- A.33 A new compensation mechanism was also established — the Investors Compensation Scheme ("ICS").

#### **INVESTORS COMPENSATION SCHEME**

- A.34 The ICS included protection for those investment policyholders affected by the insolvency of an intermediary. If an intermediary was declared in default by the ICS — that is, judged unable to meet its liabilities — eligible investors could receive up to £48,000 towards their losses. This figure was calculated as 100% of the loss up to £30,000, and 90% of the loss thereafter to a limit of £50,000.

#### **ABI GENERAL INSURANCE BUSINESS CODE OF PRACTICE 1989**

- A.35 The regulatory structure established under the Financial Services Act did not apply to pure protection products such as general insurance policies. In January 1989 the Association of British Insurers published a revised version of the 1981 General Insurance Business Code. This code repeated the previous provisions relating to misrepresentation and non-disclosure. The code remained in force until 14 January 2005.

## **PERSONAL INVESTMENT AUTHORITY**

- A.36 In July 1994, LAUTRO and FIMBRA were replaced by a new SRO with powers to regulate both product providers and intermediaries - the Personal Investment Authority ("PIA"). The PIA had its own rulebook and its own complaints-handling mechanism – the Personal Investment Authority Ombudsman ("PIAOB").
- A.37 For the first time, therefore, investment insurance intermediaries became subject to an ombudsman scheme. However, the PIAOB had no power to make decisions on the basis of what was fair and reasonable, and awards against intermediaries were limited to £50,000.

## **FINANCIAL SERVICES AND MARKETS ACT 2000**

- A.38 One of the early acts of the Labour Government that took office on 2 May 1997 was to announce, on 20 May 1997, that it would create a single regulator for financial firms:

It has long been apparent that the regulatory structure introduced by the Financial Services Act 1986 (FSA) is not delivering the standard of supervision and investor protection that the industry and the public have a right to expect. The current two tier system splits responsibility between the Securities and Investments Board (SIB) and the Self Regulatory Organisations (SROs), together with the Recognised Professional Bodies. This division is inefficient, confusing for investors and lacks accountability and a clear allocation of responsibilities. Reform is long overdue to simplify the delivery of financial service regulation, and this was a key commitment in our Business Manifesto.<sup>10</sup>

- A.39 On 28 October 1997 the SIB changed its name to the Financial Services Authority ("FSA"). The FSA continued to exercise all the functions which the SIB had under the Financial Services Act 1986 until midnight on 30 November 2001 (commonly known as N2) when the Financial Services and Markets Act 2000 ("FiSMA") came into operation.
- A.40 FiSMA established single-tier statutory regulation by the FSA, replacing the SROs - including the PIA. A single ombudsman scheme, the Financial Ombudsman Service ("FOS"), replaced eight existing complaints-handling mechanisms including the IOB and the PIAOB. There was also a new compensation scheme, the Financial Services Compensation Scheme, which replaced the Policyholders Protection Board and the Investors Compensation Scheme but kept the same monetary limits. Conduct of business regulation was not at this stage extended to pure protection policies.

<sup>10</sup> Gordon Brown speech in the House of Commons on 20 May 1997. Available on H M Treasury website as press notice 49/97.

- A.41 The effect was that the FOS could hear complaints against intermediaries relating to investment policies. However, for pure protection policies, complaints concerning intermediaries could only be heard by the FOS if either:
- (1) the intermediary had voluntarily joined the IOB, or
  - (2) the complaint was made against an insurer which had failed to meet its obligations under the ABI General Insurance Business Code.

#### **GENERAL INSURANCE STANDARDS COUNCIL**

A.42 As the FSA did not initially take responsibility for the conduct of business regulation of general insurers and intermediaries, the industry sought to fill the gap. It established a self-regulatory body - the General Insurance Standards Council (GISC). Membership of GISC was voluntary and was open to insurers, intermediaries and others engaged in general insurance business such as claims handlers.

A.43 GISC aimed "to regulate the sales, advice and service standards" of its members and gave its main purpose as ensuring that general insurance customers were treated fairly. It commenced operations on 3 July 2000 and had its own rulebook, with separate codes for those dealing with private individuals and those dealing with commercial concerns. Private individuals had access to a complaints-handling service, though this was not able to make binding decisions.

A.44 Rule 42 of the GISC Rulebook sought to strengthen this system of self-regulation by barring members from dealing with intermediaries who were not also members:

##### Dealing with intermediaries

Subject to any Rule waiver issued by GISC, Members shall not, and shall ensure that their Appointed Agents and Appointed Sub-Agents shall not, in the course of their General Insurance Activities, deal directly with any person in circumstances which would involve that person in engaging in General Insurance Activities as an Intermediary where that person is not a Member.

A.45 This approach was opposed by a number of bodies, most notably the Institute of Independent Insurance Brokers which proposed its own system of self-regulation. In September 2001 the matter was considered by the Competition Commission Appeal Tribunal, which found that Rule 42 was anti-competitive and breached the requirements of the Competition Act 1998.

A.46 In December 2001 GISC abandoned Rule 42. On 12 December 2001, HM Treasury announced that the Financial Services Authority would be given:

Responsibility for regulating the selling of residential mortgages and general insurance, including the advice associated with the sales process.<sup>11</sup>

#### **STATUTORY REGULATION FOR GENERAL INSURANCE**

- A.47 On 14 January 2005, the Financial Services Authority took over responsibility for the conduct of business regulation of general insurance. A new Sourcebook entitled Insurance Conduct of Business (“ICOB”) came into force. General insurance intermediaries became subject to the jurisdiction of FOS, and their clients gained potential access to the FSCS.
- A.48 The limits for FSCS were those that had applied under the Policyholders Protection Act for insurers – that is for compulsory insurances, such as motor insurance, liabilities to private and corporate policyholders were to be met in full. In all other cases 90% of liabilities to private policyholders were to be met. This contrasts with the more restricted protection given to investment policyholders.
- A.49 The old system of self-regulation was abandoned as from the same date – GISC was closed, and the ABI General Insurance Code of Business was withdrawn.

<sup>11</sup> Ruth Kelly on 12 December 2001. Available on H M Treasury website as press notice 140/01.