



**Law  
Commission**  
Reforming the law

  
**Scottish Law Commission**  
*promoting law reform*

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## **Reforming Insurance Contract Law**

### **Policy Statement: The Status of Intermediaries**

**For whom does an intermediary act in transmitting pre-contract information from consumer to insurer?**

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March 2009

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This paper follows from two previous consultation papers on the status of intermediaries when transmitting pre-contract information.

- (1) In March 2007, we published an Issues Paper 3 on Intermediaries and Pre-Contract Information.
- (2) In July 2007 we returned to the subject in Parts 9 and 10 of our Joint Consultation Paper, Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (LCCP 182/SLCDP 134).

In May 2008 we published a summary of responses to the Consultation Paper. In Part 5 we explained that we would be considering other ways to bring clarity to this area, by establishing high level principles. These would list the decisive and persuasive factors the courts would need to consider in deciding for whom an intermediary acts.

This paper describes the Law Commissions' current policy in this area. It explains the principles that should apply to this area of law, and how they would affect common types of intermediary in the market place. We also explain why we think these principles should be set out in statute.

We intend to draft a Bill along the lines set out in this paper. We are not inviting comments at this stage. However, if readers wish to make a comment on this paper, please send comments to the Law Commission either:

- (1) by email to [commercialandcommon@lawcommission.gsi.gov.uk](mailto:commercialandcommon@lawcommission.gsi.gov.uk); or
- (2) by post to: Elizabeth Waller, Law Commission, Steel House, 11 Tothill Street, London SW1H 9LJ (tel: 020 3334 0282); or
- (3) by fax to: 020 3334 0201, marked for the attention of Elizabeth Waller.

It would be helpful if, where possible, comments sent by post could also be sent on disk, or by email to the above address, in any commonly used format.

### **Freedom of information**

As the Law Commission will be the recipient of responses, the Freedom of Information Act 2000 will apply and all responses will be treated as public documents. We may attribute any comments and include a list of all respondents' names in any further report we publish. Those who wish to submit a confidential response should contact the Law Commission before sending the response. Automatic confidentiality disclaimers generated by an IT system will be disregarded.

# SUMMARY

## THE PROBLEM

- 1.1 This paper is part of the Law Commissions' joint review of consumers' obligations to give information to insurers before entering an insurance contract. It considers the legal consequences where an intermediary acts negligently or dishonestly in transmitting pre-contract information from consumer to insurer.
- 1.2 Below we give an example of the problems that might arise, taken from our survey of Financial Ombudsman Service (FOS) cases.

Mrs A took out critical illness insurance. The intermediary took her through the application form, which asked if she had ever had asthma. Mrs A told the intermediary that she had mild asthma. The intermediary then informed her that the insurer was not interested in mild asthma, and she should answer no. When Mrs A was diagnosed with cancer, the insurer purported to avoid the policy, on the grounds of misrepresentation.<sup>1</sup>

- 1.3 In law, the result of a case like this would depend on whom the intermediary was acting for at the time. If the intermediary acted as an agent for the insurer, the insurer would be responsible for their poor advice: under our general proposals for reforming consumer insurance law, the insurer would be required to pay the claim. However, if the intermediary acted for the consumer, then the consumer would be held responsible for their actions. If the intermediary acted deliberately or recklessly, then the consumer would be deemed to be acting deliberately or recklessly too. Under our scheme, the insurer could avoid the claim. The consumer would need to sue the intermediary for damages.
- 1.4 It is therefore important to know whom an intermediary acts for when helping a consumer complete an insurance application. Unfortunately, the law in this area is uncertain, as the courts and the FOS struggle to apply early 20<sup>th</sup> century cases to a rapidly changing market place.

<sup>1</sup> For a fuller account of this case, and the survey, see Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (2007) Law Commission Consultation Paper No 182; Scottish Law Commission Discussion Paper 134; p 216.

## **THE CONSULTATION PAPER PROPOSALS**

- 1.5 In our 2007 Consultation Paper,<sup>2</sup> we attempted to draft a single bright line test to determine for whom an intermediary acts in transmitting pre-contract information. We said that an intermediary should be taken to act for the insurer unless it is clearly independent. We asked whether only those intermediaries who conducted a fair analysis of the market should be considered to act for the consumer. However, most consultees disagreed with this test, on the grounds that it was uncertain.
- 1.6 We now think that it is not possible to have a single test. Whom an intermediary acts for must depend on a range of factors.

## **A NEW STATUTORY CODE**

- 1.7 In this paper we propose a new statutory code, based largely on the existing law. Where the current law does not provide clear answers, we have supplemented it by drawing upon FOS practice and industry understanding.
- 1.8 The aim is to find a balance. Insurers should bear responsibility for those intermediaries within their control, and have appropriate incentives to exercise that control in a way that prevents problems from occurring. Insurers should not, however, be liable for the actions of genuinely independent agents.
- 1.9 The statutory principles would only have a direct effect in cases concerning faults in the transmission of pre-contractual information in consumer insurance. The statute would not apply to other areas of agency (such as who an intermediary acts for in collecting premiums) or to business insurance. However, if the courts found the framework useful for its primary purpose, they may find the same principles helpful in other areas.

## **Cases where the intermediary acts for the insurer**

- 1.10 In three circumstances, an intermediary is always considered to act for the insurer. Thus an intermediary acts for the insurer if:
- (1) the intermediary has authority to bind the insurer to cover;
  - (2) the intermediary is the appointed representative of the insurer;
  - (3) the intermediary has actual express authority from the insurer to collect pre-contract information on its behalf (for example, through an express term in a terms of business agreement).

## **Weighing the factors**

- 1.11 In other cases, the intermediary acts for the consumer unless there is a close relationship between the intermediary and the insurer, so as to indicate that the insurer has granted the intermediary implied or apparent authority to act on the insurer's behalf. The issue would need to be determined by looking at all the circumstances, weighing the various factors in the case.

<sup>2</sup> Above.

1.12 We think that it would be helpful to provide an indicative and non-exhaustive list of the factors that are relevant to the decision.

- (1) Factors which indicate a close relationship between the intermediary and the insurer (so that the intermediary acts as the insurer's agent) include the following.
  - (a) The intermediary only places insurance with a limited number of insurers. (The smaller the number of insurers, the greater the indication that the intermediary acts for the insurer).
  - (b) The insurer sells that particular policy through only a limited number of intermediaries.
  - (c) The insurer permits the intermediary to brand its services with the insurer's name, thereby giving the intermediary apparent authority to act on its behalf.
  - (d) The insurer permits its policies to be branded with the intermediary's name, thereby representing that the consumer is dealing with an insurer rather than an intermediary.
  - (e) The insurer requests the intermediary to approach the consumer to market the insurer's particular product.
  - (f) The insurer exerts substantial control over the way that the intermediary conducts its business.
- (2) Factors which indicate that an intermediary acts for the consumer include the following.
  - (a) The intermediary undertakes to act in the consumer's interest by, for example, giving impartial advice or providing a fair analysis of the market.
  - (b) The consumer pays the intermediary a fee.
  - (c) The intermediary provides full disclosure to the consumer of the commission it has received from the insurer.

1.13 Note that the factors are non-exhaustive. Market practice in this area has changed recently, with the advent of depolarisation and increased technology, and may well change again. The law will need to adapt to change.

### **Dual agencies**

1.14 Finally we think it would be helpful to state explicitly that different agencies may arise in respect of different tasks. For example, an intermediary may act for the consumer in obtaining a quote from the insurer, but act for the insurer in receiving premiums.

## **THE USE OF STATUTE**

- 1.15 In Part 4 we explain why we think it would be better to place these principles within legislation, rather than in Financial Services Authority rules, industry guidance or a Law Commission report. Other approaches may lead to differences between the law of agency as strictly applied by the courts and the practice applied by the FOS.

## **NEXT STAGE**

- 1.16 This paper sets out the policy of the two Law Commissions. We intend to draft a Bill along the lines set out in this paper. We are not inviting comments at this stage. However, if readers wish to make a comment on this paper, please contact us at the address given on the inside cover.

**THE LAW COMMISSION**  
**THE SCOTTISH LAW COMMISSION**

**REFORMING CONSUMER INSURANCE**  
**POLICY STATEMENT: THE STATUS OF**  
**INTERMEDIARIES**

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# PART 1: THE NATURE OF THE PROBLEM

## INTRODUCTION

- 1.1 This paper is part of the Law Commissions' review of consumers' legal obligations to give information to insurers before entering into an insurance contract. It considers one specific aspect: what are the legal consequences when the intermediary is at fault? The central question is who should bear the consequences if the intermediary acts negligently or dishonestly in providing information to the insurer. Is the insurer required to pay the claim, and seek redress from the intermediary? Or may the insurer refuse to pay all (or some of) the claim, and leave the consumer to raise an action against the intermediary? In law, this depends on for whom the intermediary is regarded as acting when obtaining and passing on the pre-contract information requested by the insurer.
- 1.2 In our 2007 Consultation Paper<sup>1</sup> we proposed to clarify this area of law by setting a clear test to determine whether an intermediary acts for an insurer or insured. We asked if it should be based on whether the intermediary carried out "a fair analysis" of the market, within the meaning of the Insurance Mediation Directive.<sup>2</sup> Most respondents disagreed with this test.
- 1.3 We now think that it is not possible to create a single bright line test to determine for whom an intermediary is acting. That will depend partly on the nature of the intermediary and partly on the nature of the specific task in question. Given the differing nature and circumstances of both intermediaries and tasks, there are no easy answers. Furthermore the test needs to adapt to a rapidly developing market.
- 1.4 Our objective is to ensure that, where insurers have control over intermediaries, the law provides appropriate incentives for insurers to exercise that control in a way that minimises the problem. However, the law should not make insurers less inclined to deal with small, independent firms whom they have no practicable means of monitoring.
- 1.5 In this paper, we propose that there should be a new statutory code, setting out high-level principles to govern for whom an intermediary acts in transmitting pre-contract information. These principles are summarised in Part 4.<sup>3</sup> They are based largely on the existing law. However, where the current law does not provide clear answers, we have supplemented it by drawing upon Financial Ombudsman Service (FOS) practice and industry understanding.
- 1.6 We are not inviting comments at this stage. However, if readers wish to make a comment on this paper, please contact us at the address given on the inside cover.

<sup>1</sup> Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (2007) Law Commission Consultation Paper No 182; Scottish Law Commission Discussion Paper No 134.

<sup>2</sup> Insurance Mediation Directive 2002/92/EC, Official Journal L 009 15/01/2003 p 3.

<sup>3</sup> See below, paras 4.1 to 4.7.

## THE PROBLEM IN PRACTICE

- 1.7 Problems involving intermediaries and the transmission of pre-contract information are fairly common. In our survey of 190 ombudsman decisions involving disputes about pre-contract information, 25 (13%) involved allegations about what an intermediary did or said during the placing of insurance.
- 1.8 These conflicts have proved to be particularly difficult to resolve. The case law stretches back over 100 years, and ombudsmen frequently struggle to apply early 20<sup>th</sup> century cases to an ever changing and increasingly complex market. Intermediaries now come in a wide variety of forms and their relationship with the consumer and insurer varies greatly. At one extreme they may be very closely linked to the insurer – for example, the intermediary may be recruited by the insurance company to solicit customers and assist in the provision of pre-contract information. At the other extreme, the intermediary may be an independent agent, chosen and approached by the consumer with no link to any individual insurer, which is able to offer impartial advice on the market. In the middle lies a broad spectrum of diverse arrangements. Since the depolarisation of the insurance market in 2005, intermediaries are no longer required to be either independent or tied to a single insurer. They may be “multi-tied” – which could mean virtually independent or closely linked to only two insurers.
- 1.9 New methods of selling insurance are constantly being introduced. For example, the intermediary may be a retailer which offers a limited range of insurance products (such as extended warranties) as a sideline; or the intermediary may be a large recognised brand (such as a supermarket or a bank) which distributes insurance products under its own logo (known as “white-labelling”). Information technology has prompted considerable change as internet selling and price comparison sites have become increasingly important.

### The way insurance is sold: recent data

- 1.10 Over the last 15 years there has been a major reduction in the number of traditional small insurance intermediaries providing advice to the consumer. Data from the Association of British Insurers (ABI) show that between 1992 and 2007, the independent intermediaries' proportion of motor business reduced from 71% to 37%; their proportion of property insurance reduced from 58% to 37%; and in other personal lines it reduced from 49% to 30%.<sup>4</sup> A report from Swiss Re suggests that this under-estimates the extent of the reduction in advice through independent firms, as firms classified as independent intermediaries are no longer necessarily providing the consumer with advice.<sup>5</sup>

<sup>4</sup> *ABI Data Bulletin: Sources of Premium Income for General Insurance 2007*. The classifications are: “independent”; “company agents”; “banks/building societies”; “retailers/affinity groups”; “direct”; and “other channels”.

<sup>5</sup> Swiss Re, *Term and Health Watch*, 2008.

- 1.11 At the same time, there has been a dramatic rise in the importance of price comparison websites (known as “aggregators”), particularly for motor insurance. Research by Datamonitor found that in 2008 three-quarters (76%) of customers visited such sites at the time of their car insurance renewal, and these sites passed 40% of new motor business to insurers.<sup>6</sup>
- 1.12 For property insurance, an increasing amount of business comes through banks and building societies and, to a lesser extent, high-street retailers (around 40%). Datamonitor estimate that in 2008, only 4% of home insurance was introduced by price comparison websites, though this is likely to grow rapidly.
- 1.13 For life insurance, critical illness and income protection insurance, Swiss Re record that between 44% and 55% of business comes through “IFA/independent” intermediaries, while a similar amount comes from “tied sales”. However, Swiss Re comment that this distinction is more complex than first appears:
- The data reported are based on the regulatory status of the distribution channels used by life offices [“independently authorised” or “appointed representative”] and do not, therefore, record whether a case was transacted on an advised or non-advised basis. Although some product providers hold this information for all term sales, the practice is not universal.<sup>7</sup>
- 1.14 As far as term life assurance is concerned, Swiss Re noted “a very significant growth in the number of new, non-advised protection sales coming from directly authorised intermediary firms whose business model is very different from the traditional advice-led proposition”. They estimated that around 15% of independently regulated intermediaries offered the consumer a policy based on price and speed of service “rather than being led by advice”.
- 1.15 Recent public concern over critical illness and income protection insurance have led the Financial Services Authority (FSA) to ask firms for quarterly product sales data. The figures for April 2007 to March 2008 show that 8,967 firms sold such policies. However, over half of these firms (57%) sold five or fewer contracts over the year, accounting for just 2% of sales. On the other hand, the 1% of firms who sold 1,000 or more contracts accounted for 78% of total sales. Over half of all policies were sold by the top 28 firms who each sold more than 5,000 policies. Of these 28 firms, half were financial advisers or brokers with independent authorisation.<sup>8</sup>
- 1.16 Further change in the way that insurance is sold is likely, but difficult to predict. The law needs to be sufficiently flexible to cope with rapid change, prompted by new technologies and changing commercial relationships.

<sup>6</sup> Datamonitor, *UK Insurance Aggregators 2008*.

<sup>7</sup> Swiss Re, *Term and Health Watch*, 2008, p 11.

<sup>8</sup> FSA, *Pure Protection Contract: Produce Sales Data Trends Report*, September 2008, p 9.

## **THE WAY THE LAW DEALS WITH THE ISSUE**

- 1.17 Difficulties arise in relation to the placing of insurance when the agent does not pass on relevant information from the insured to the insurer, or passes on the relevant information incorrectly. This may be simply a careless mistake – for example, the agent transcribes the information given by the insured incorrectly onto the proposal form. Or it may be fraudulent behaviour – for example, the agent deliberately excludes information relating to the insured’s ill health in order to ensure that the proposal is accepted and commission is earned. In the Consultation Paper we highlighted a fairly typical case in which the intermediary had told the consumer that her asthma was too minor to be worth mentioning.<sup>9</sup>
- 1.18 One of the more difficult issues in insurance law is to determine on whose behalf the intermediary is acting at any given time. Is the intermediary the agent of the insurer or insured? This is important because under general agency rules, an intermediary’s actions and state of mind are imputed to the principal. Therefore:
- (1) If the intermediary is acting for the consumer when placing the insurance policy, the intermediary's knowledge and behaviour are deemed to be that of the consumer. Any misrepresentations that the intermediary makes on the proposal form will therefore be treated as if they were made by the consumer. Thus if the intermediary has deliberately falsified information on the proposal form, the insurer is entitled to treat the consumer as if he or she had made a deliberate misrepresentation and could avoid the policy. This is the case even where the consumer has acted honestly and reasonably throughout.
  - (2) If the intermediary is acting on behalf of the insurer, then any misrepresentations the agent makes cannot be attributed to the consumer, and the insurer is treated as knowing any relevant information known by the intermediary.

<sup>9</sup> Consultation Paper, p 216.

- 1.19 *Whitlam v Hazel*<sup>10</sup> is an example of how this works in practice. The defendant needed motor insurance. He approached a broker for a quote. The defendant worked as an assistant in a golf shop but also trained, in his spare time, to be a professional golfer. He filled in a hand-written application for motor insurance and passed it on to the broker. The broker produced an electronic version of the form in order to obtain a quotation and then printed a copy, which the defendant signed. This signed version subsequently formed the basis of the insurance contract. The printed form was in a slightly different layout and contained some differences when compared to the hand-written form. It stated that the defendant's employment was "shop assistant retailing" and did not specify the type of shop. The hand-written form contained a reference to "golf". The claimant insurer sought a declaration that the insurance policy was void on the basis of the non-disclosure that the defendant was a trainee golfer. Had the insurer been aware of this they would not have offered the insurance. The Court found that if the proposal form had contained the word "golf" it would have been rejected by the insurer's computer system. It concluded that the defendant had made an incomplete and misleading answer. The fact that he did so in good faith and that the misrepresentation was made by his broker when he produced the electronic form did not make any difference. The broker was the agent of the consumer in the placing of the insurance so any misrepresentation made by him was imputed to the consumer.
- 1.20 Our reform proposals would mitigate the position as we are proposing to abolish the duty on consumer policyholders to volunteer information for which they have not been asked. However, even if our general proposals on non-disclosure and misrepresentation are implemented, the consumer would still bear the consequences of the intermediary's actions where the intermediary fails to answer a question on the proposal form correctly, or advises the consumer to answer it incorrectly. The intermediary's actions may be either negligent or fraudulent.

### **WHY IT MATTERS**

- 1.21 It could be argued that this is really a question of form rather than substance. Whichever party bears the loss as a result of the agent's negligence or wrongful conduct will be able to claim damages from the agent for the amount of that loss. For example, where an insurer refuses to pay a life insurance claim because it can show that the consumer's agent has deliberately omitted requested health details on the insurance form, the consumer will be able to bring a claim in negligence against his agent.<sup>11</sup>
- 1.22 So why does it matter whether the consumer has to sue the insurer or the intermediary?

<sup>10</sup> [2004] EWCA Civ 160 (CA).

<sup>11</sup> At one stage, there was a concern that the intermediary may become insolvent, but as we explained in the Consultation Paper, that problem is now resolved. Intermediaries are required to insure against their professional negligence, and if that insurance fails, the consumer has a claim against the Financial Services Compensation Scheme: Consultation Paper, paras 9.113 to 9.115.

### **The consumer's point of view**

- 1.23 From the consumer's point of view, claiming under an insurance policy is undoubtedly more straightforward than bringing an action for negligence or fraud against an intermediary. The first the consumer will learn of any problems with the policy is when the insurer rejects the claim. The consumer is then likely to complain to the insurer that the claim should not have been rejected because he or she was not at fault, and may then pursue this complaint to the FOS. Indeed, a consumer who fails to pursue the complaint against the insurer runs the risk that the intermediary may deny liability on the ground that the insurer is to blame.
- 1.24 In our analysis of FOS decisions, we found several instances where consumers had pursued complaints against insurers to a final ombudsman decision, only to be told to start again against the intermediary.<sup>12</sup> At this stage, consumers may lose heart, especially if they are in vulnerable circumstances, such as bereaved or suffering from a critical illness. We commented:

Although FOS procedures are outside the scope of 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.<sup>13</sup>

- 1.25 A consumer may also be disadvantaged by having an insurance claim denied because of a misrepresentation. This is likely to impact adversely on their ability to find alternative insurance.

### **The insurer's point of view**

- 1.26 If the law were to hold that insurers were responsible for the actions of intermediaries, insurers would be left with the opposite problem. Where an insurer turns down a claim because a consumer has, for example, failed to declare asthma and the consumer then makes an allegation against the intermediary, the insurer would have little practical means of disproving it.
- 1.27 Insurers are legitimately concerned about taking responsibility for the actions of independent agents, whose internal methods and working practices they have no practical means of monitoring. If the law were to impose responsibilities without control, they may no longer be prepared to sell insurance through a network of small independent intermediaries.

### **FINDING A BALANCE**

- 1.28 Insurers are legitimately concerned about taking responsibility for the actions of independent agents, whose internal methods and working practices they have no practical means of monitoring. If the law were to impose responsibilities without control, they may no longer be prepared to sell insurance through a network of small independent intermediaries. In their response to us, FSA put the point in the following terms:

<sup>12</sup> Consultation Paper, paras 9.119 to 9.123.

<sup>13</sup> Consultation Paper, para 9.124.

Changes that make the insurance intermediary the agent of the insurer for the collection of pre-contractual information might have a structural effect on the market for the distribution of insurance. For example, insurers might decide that they need to exercise more control over the distributors of their policies than they currently do. This could in turn lead to a preference on the part of insurers to do business through large broker networks or tied sales forces, at the expense of smaller intermediaries.<sup>14</sup>

- 1.29 The present law has the potential to create a perverse incentive, which could result in insurers benefiting from the actions of dishonest intermediaries. Below we reproduce the illustration we gave in the Consultation Paper, which shows how the right to avoid all claims on policies submitted through dishonest intermediaries allows insurers to retain the bulk of premiums without incurring any risk.

***The fraudulent intermediary: an example***<sup>15</sup>

An insurer writes critical illness policies, from which it anticipates one claim for every 100 policies. The average premium during the lifetime of the policy is £1,000, of which £500 is used for underwriting costs.<sup>16</sup> The average payment where a claim is made is £50,000.

One intermediary is fraudulent. To gain the maximum commission, he routinely tells his clients to lie about their health, so that their applications will be accepted without delay.

He tells 100 clients to lie about their health, and deliberately suppresses their various ailments. These misrepresentations mean that the risk has doubled: this group produces not one claim but two claims. Clearly, if the insurer were not granted a remedy, it would have to pay £100,000 in claims (instead of £50,000), leading to a loss of £50,000.

If the intermediary is taken to act for the insured, the insurer is entitled to avoid both policies. For these 100 clients, it pays no claims at all. It simply returns two premiums. It has received £100,000 in premiums, of which £50,000 was intended to cover claims, and has returned £2,000. Compared with “normal” cases submitted through honest intermediaries, the insurer retains £48,000.

<sup>14</sup> Letter from Clare Boyle, 18 April 2008.

<sup>15</sup> Consultation Paper, p 254.

<sup>16</sup> The other £500 covers sales commission, administration costs etc. On the basis of underwriting costs alone, the policy breaks even.

- 1.30 Clearly this incentive would only work when the insurer is able to discover the problem at the time of claim. However, in some markets such evidence may be available. Thus our survey of ombudsman decisions on non-disclosure from 2003 to 2005 found particular problems in critical illness insurance at the time. These policies were largely sold through intermediaries, who asked consumers for detailed information about their medical records. In the event of a claim, the insurer would then retrieve the medical record and check the application form against it, looking for discrepancies. Industry estimates suggest that in 2005/6 insurers found discrepancies in around 12% of all claims.<sup>17</sup> This appears to have contributed to a reduction in confidence in critical illness insurance, leading to falling sales.<sup>18</sup>
- 1.31 We do not think that this perverse incentive would ever lead an insurer to condone dishonest practices among its intermediaries as the risk to their reputation would be too great. The existence of such an incentive, however, suggests that insurers may do less than they might otherwise do to prevent intermediaries from introducing inaccuracies into the process.
- 1.32 In practice, there are several ways in which an insurer could monitor and control fraud by the intermediaries who place insurance with it. For example, where the intermediary places a large volume of business, the insurers could monitor applications as they come through to check whether the forms provided by a particular intermediary reveal much lower rates of standard illnesses than one might expect from comparisons with the general population. For example, a particularly low level of reported asthma might indicate that an intermediary was discouraging clients from mentioning asthma on application forms.
- 1.33 Another possible solution to the problem of intermediary fraud is “tele-underwriting”. This removes the incentive for fraud, by ensuring that the people who ask the questions are not paid commission for sending through “clean” forms (that is without answers that might lead to the application being rejected). Under “tele-underwriting” schemes, intermediaries provide advice on policies and help the consumer to reach a decision about the right insurance for them but do not take consumers through the proposal form. Instead, consumers telephone a call centre, in which the staff who ask the questions are not paid on a commission basis.

<sup>17</sup> Consultation Paper, Appendix B, London Economics report, p 43.

<sup>18</sup> The FSA data show that sales of stand-alone critical illness policies fell by 49% from 86,000 in 2006/7 to 44,000 in 2007/08 (*Pure Protection Contracts: Product Sales Data Trends Report*, September 2008). Swiss Re comment that “concerns around the viability of the product, premium increases and generally negative comment around entitlement to, and payment of claims, were all seen as contributing factors to this decline”: *Term and Health Watch*, 2008.



- 1.34 The PricewaterhouseCoopers (PwC) research submitted to us by the ABI noted an interesting study on this issue.<sup>19</sup> The study took a sample of “clean” cases in which consumers had been guided through a proposal form by a commission-based intermediary, and had raised no health problems. The consumers were then contacted by telephone by staff not paid on a commission basis. In 75% of cases, the consumers mentioned something which had not been included in the form, and in 25% of cases the issue was significant. The consumers had not changed: if they were lying they would have lied to the telephone staff as well. The main difference was in the way the person asking the question was remunerated.
- 1.35 On the other hand, we are mindful of the point put forward by the FSA and the insurance industry. An insurer is less able to monitor and control small intermediaries who put only a small amount of business its way. If an insurer is responsible for intermediaries it is unable to control, it may be less prepared to accept business from them. We do not wish to damage the network of accessible independent intermediaries. As we said in the Consultation Paper:

If insurers were made responsible for the actions of all intermediaries, the reform could have a deleterious effect on small, independent 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 if their standards were irreproachable.<sup>20</sup>

### **RESPONSES TO THE CONSULTATION PAPER PROPOSALS**

- 1.36 In the Consultation Paper we provisionally proposed that an intermediary should be regarded as acting for the insurer for the purpose of obtaining pre-contract information, unless it is clearly an independent intermediary acting on the insured’s behalf. This would have brought greater clarity to the law. It would also have resulted in a partial but significant shift towards treating the intermediary as the agent of the insurer, as single and multi-tied agents would become the agent of the insurer. However, it would preserve the rule that traditional “independent financial advisers” would remain the consumer’s agent.
- 1.37 However, this proposal was not well received. Of the 67 consultees who responded on this point, just over half (36) disagreed. Professors Merkin and Lowry argued strongly that the proposals did not go far enough and that, in order to reflect the reality of the situation, the agent should generally be treated as acting for the insurer.<sup>21</sup> Our proposals would not have been of assistance in a case such as *Whitlam v Hazell*,<sup>22</sup> where the broker was independent and had searched the market.

<sup>19</sup> “Clean” applications? How clean?, MorganAsh, cited by PricewaterhouseCoopers LLP, *The Financial Impact of the Law Commission’s Review of Insurance Contract Law*, ABI Research Paper 5, p 49.

<sup>20</sup> Consultation Paper, para 10.25.

<sup>21</sup> R Merkin and J Lowry, “Reconstructing Insurance Law” (2008) *Modern Law Review* 95.

<sup>22</sup> See para 1.19 for discussion of this case.

- 1.38 In contrast, most insurers thought that the proposals were too radical and went too far in making insurers responsible for intermediaries. Their arguments were mainly based on the cost and disruption that such a change would cause. One noted that the proposed change would “come with huge implications on underwriting and broking practices”.<sup>23</sup> It was suggested that “there would need to be a complete overhaul of insurers’ intermediary application/assessment processes... at substantial cost”.<sup>24</sup>
- 1.39 The economic analysis commissioned by the ABI and prepared by PwC did not support this contention. PwC pointed out that among cases involving a non-disclosure, it would only affect the small proportion which had been sold through multi-tied (or similar) agents and where it was established that the intermediary was at fault. Furthermore, insurers could re-write their terms of business agreements with intermediaries to recoup the cost of such claims directly from the intermediary. PwC commented:
- Many insurers were initially concerned about trying to seek remedial damages from intermediaries, one insurer even coining the phrase “commercial suicide”. But... given the small costs and ease of putting clauses into existing terms of business arrangements we do not expect the Law Commission’s proposals here to result in “commercial suicide”.<sup>25</sup>
- 1.40 PwC thought that the proposal may even have some advantages for insurers in terms of “increased clarity regarding the responsibilities and liabilities and how these are split between themselves and the intermediary”.<sup>26</sup>
- 1.41 However, most large composite insurers expressed concern about the proposal on the grounds that they were often not able to monitor or control intermediaries, especially when they had thousands of agreements in place. The ABI argued that it would lead insurers to restrict those firms with whom they traded, thereby making it harder for new firms to enter into the market.
- 1.42 In the Consultation Paper, we then went on to discuss how an “independent intermediary” should be defined. We asked whether it would be sensible to adopt the Insurance Mediation Directive test, which uses the concept of an intermediary who undertakes to conduct a “fair analysis” in the market.
- 1.43 This test was particularly unpopular. Of the 64 consultees who responded, almost two thirds disliked this test. Most suggested that it was unpredictable. Many of those working in the market appeared to be genuinely uncertain about what it means and were, therefore, reluctant to extend its influence any further.

<sup>23</sup> Chartered Insurance Institute response to the Consultation Paper. For further details of responses, see our Summary of Responses on consumer issues, put on our website in May 2008.

<sup>24</sup> ABI response to the Consultation Paper.

<sup>25</sup> PricewaterhouseCoopers LLP, *The Financial Impact of the Law Commission’s Review of Insurance Contract Law*, ABI Research Paper 5, p 88.

<sup>26</sup> Above.

1.44 In this paper we consider alternative ways of bringing clarity to this difficult area of law.

## PART 2: COMPARATIVE LAW

- 2.1 Before considering alternative options for reform, we have looked briefly at how the issue is addressed in other common law jurisdictions. We have chosen three countries with similar laws of agency and misrepresentation: the United States, Australia and New Zealand.
- 2.2 The issue is clearly a difficult one in all three jurisdictions. The issue has, to a greater or lesser extent, been left to the courts, and the courts have struggled to apply clear principles. However, in most of the United States and in Australia we think that in a case such as *Whitlam v Hazell*<sup>1</sup> the insurer would be required to pay the claim.

### THE UNITED STATES

- 2.3 In the US, insurance law is decided at the state level, so it is difficult to generalise. However, the issue of whom an intermediary acts for is usually dealt with under general principles of agency law. Although the starting point is that the intermediary acts for the insured, is it common for dual agencies to arise, whereby the intermediary acts as agent for the insured for some purposes (such as giving advice) but as agent for the insurer for other purposes (such as collecting premiums). Professor Clarke<sup>2</sup> notes a case from Illinois, which sets out the following criteria for determining whom an intermediary is acting for at any given time:
- (1) who set him in motion first;
  - (2) who could control his actions;
  - (3) who paid him; and
  - (4) whose interest he was to protect.<sup>3</sup>
- 2.4 Most courts have held that when an agent procures an application for insurance and reduces it to writing, it acts as an agent for the insurer. The outcome is that an insured is not bound by the intermediary's misrepresentation if the insured has not participated in making it.<sup>4</sup>

<sup>1</sup> See para 1.19 above for discussion of this UK case.

<sup>2</sup> M Clarke, *The Law of Insurance Contracts* (5<sup>th</sup> ed 2006) 7-1D.

<sup>3</sup> *Hardin, Rodriguez & Boivin Anesthesiologists Ltd v Paradigm Insurance Co* (1992) 962 F 2d 628 (1992), at p 635.

<sup>4</sup> For further discussion, see Robert H Jerry II, *Understanding Insurance Law* (3<sup>rd</sup> ed 2002) p 283.

2.5 For example, in *Saunders v Allstate Insurance Co*,<sup>5</sup> the insured had provided the agent with truthful and accurate information but the agent put down incorrect information on the application. Even though the insured signed the application, the Ohio Supreme Court held that there was no evidence the applicant knew or should have known the insurer was being deceived. Where the applicant relied on the intermediary in good faith and where there was no evidence of fraud on the part of the insured, the insurer was estopped from relying on the falsity of the statements to avoid liability.

2.6 In *Stewart v Mutual of Omaha Insurance Co*<sup>6</sup> the intermediary gave misleading advice about what was relevant. The agents filled in a disability insurance application form but omitted a variety of medical conditions from which the insured had previously suffered. There was no indication that those agents had attempted to prevent the consumer from reading the application, and he had had numerous opportunities to review it for error. However, there was evidence that the agents had told the insured that it was not necessary to include all the information on the application, and that the insured had relied on this. In reversing a summary judgment from a lower court which had gone against the insured, the Court of Appeals of Arizona held that:

[T]he insurer cannot rely on incorrectly recorded answers known to the insured where the incorrect answers are entered pursuant to the agent's advice, suggestion or interpretation.

2.7 There are three caveats to the general rule that an insurer may not reject a claim based on the intermediary's error:

- (1) The insured cannot escape the effect of the incorrect statements if the jurisdiction imposes on the applicant a duty to read the application and binds the applicant to the literal language of the application if it is not read.<sup>7</sup>
- (2) If the insured is sent a copy of the policy with the application attached, it has been held that the insured has an opportunity and hence a duty to read the application and correct any misrepresentations on it. Uncorrected misrepresentations are deemed ratified by the insured, and hence available to the insurer seeking to invalidate the coverage.<sup>8</sup>

<sup>5</sup> (1958) 151 NE 2d 1 (Ohio).

<sup>6</sup> (1991) 817 P 2d 44 (Ariz).

<sup>7</sup> See for example *Jones v New York Life & Annuity Corp*, (1993) 985 F.2d 503 (10<sup>th</sup> Cir).

<sup>8</sup> *Strother v Capitol Bankers Life Ins Co* (1992) 842 P 2d 504 (Wash).

- (3) It is said that insurers “often insert statements in the application or the policy that purport to limit the authority of the insurer’s agents”.<sup>9</sup> The general rule of agency is that a party who knows the extent of the agent’s authority cannot later claim that the agent bound the principal by an act in excess of the disclosed authority. Thus courts have held that an express limitation may be sufficient to put a reasonable person on notice that the agent does not act for the insurer. However, judges are not always sympathetic to insurer’s attempts to limit their liability in this way. Courts have found that the insurer is still to be bound by the agent’s representations – because, for example, that the insured did not receive ample notice of the limitations on the agent’s authority.<sup>10</sup>

2.8 Thus in the US the courts have generally accepted the argument that an intermediary acts for the insurer in helping the insured to complete the insurer’s application form. This means that consumers are not automatically held responsible for the faults of the intermediary. Where, for example, an intermediary gives advice that information is not relevant, and it is reasonable for the consumer to rely on that advice, insurers have been required to pay the claim. However, the courts have refused claims where a consumer ought to have read the form and failed to do so.

## AUSTRALIA

- 2.9 Australian law follows the same common law agency principles as the UK and has met many of the same problems. In 1980, the Australian Law Reform Commission (ALRC) published a Report examining the position of insurance agents and brokers.<sup>11</sup> Most of the 1980 Report focused on the way in which intermediaries’ conduct of business should be regulated, including how brokers should deal with conflicts of interest and handle client funds. However, the it also contained a brief discussion of agency principles.
- 2.10 The 1980 Report outlined how, under the common law, an insurer was not generally responsible for the conduct of a broker with whom it deals. The two main exceptions were where there was a binder agreement and in relation to the acceptance of premiums. It concluded that the general issue of responsibility should be left to the common law, but these exceptions should be clarified.<sup>12</sup>

<sup>9</sup> Robert H Jerry II, *Understanding Insurance Law* (3<sup>rd</sup> ed 2002) p 285.

<sup>10</sup> See for example: *Rickborn v Liberty Life Ins Co* (1996) 468 SE 2d 292 (SC); *Protective Life Ins Co v Atkins* (1980) 389 So 2d 117 (Ala).

<sup>11</sup> ALRC, *Insurance Agents and Brokers*, Report No 16 (1980) at <http://www.austlii.edu.au/au/other/alrc/publications/reports/16/16.pdf>. This was a separate report to the better known 1982 Report on insurance contracts.

<sup>12</sup> ALRC, *Insurance Agents and Brokers*, Report No 16 (1980), above, at para 51.

- 2.11 Most of the 1980 Report on agents and brokers was implemented by the Insurance (Agents and Brokers) Act 1984, which was passed alongside the Insurance Contracts Act 1984. The Agents and Brokers Act defined the term “insurance broker” as “a person who carries on the business of arranging contracts of insurance... as agent for intending insureds”.<sup>13</sup> The Act did not define “insurance agent”, although the term is taken to mean an intermediary who acts for the insurer. The definition of “intermediary” included both.<sup>14</sup> Although these definitions established a helpful nomenclature, they did little to clarify when an intermediary is a “broker” and when an intermediary is an “agent”. As recommended by the ALRC, the issue was generally left to the courts. However, the Act did include a provision stating that an intermediary who has authority to bind the insurer to cover acts for the insurer.<sup>15</sup>
- 2.12 The Insurance (Agents and Brokers) Act was repealed in 2004, when the Financial Services Reform Act 2001 came into force.<sup>16</sup> However, the identical definitions of “intermediary” and “broker” in section 11 of the Insurance Contracts Act 1984 remain.
- 2.13 In 2004 the Australian Treasury reviewed the operation of the Insurance Contracts Act 1984. It commented that the law remained uncertain as to whether a non-disclosure or misrepresentation by an intermediary could be said to be that of an insured.<sup>17</sup> The review received several submissions pointing out that “it was not always clear whether an agent acts for an insurer or an insured”. However, there were no easy answers. The Review concluded that the issue should be left to the courts to decide under agency principles: in the few cases where the position was not clear, it would be “preferable that the issue continue to be decided on its merits”.<sup>18</sup>

### **Factors considered by the Australian courts**

- 2.14 The type of factors which the courts take into account in deciding agency issues is illustrated by *Norwich Union Fire Insurance Society Ltd v Brennans*, a decision of the Supreme Court of Victoria.<sup>19</sup> Here the court was asked to decide whether an intermediary had acted for the insurer in accepting premiums. Mr Justice Lush offered the following guidance as to the difference between a broker (who acts for the insured) and an insurance agent (who acts for the insurer):

<sup>13</sup> Insurance (Agents and Brokers) Act 1984, s 9.

<sup>14</sup> Insurance (Agents and Brokers) Act 1984, s 9.

<sup>15</sup> Insurance (Agents and Brokers) Act 1984, s 15.

<sup>16</sup> This created a unified licensing and regulatory regime for financial services (along the lines of the Financial Services and Markets Act 2000).

<sup>17</sup> Australian Treasury, *Review of the Insurance Contracts Act 1984, Final Report on Second Stage*, June 2004 para 4.38. The review pointed to a suggestion by the High Court of Australia that an insured might not be responsible for the insurer’s non-disclosure: see *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* (2003) 197 ALR 364. However, the point was not determined.

<sup>18</sup> Above, para 4.39.

<sup>19</sup> *Norwich Union Fire Insurance Society Ltd v Brennans (Horsham) Pty Ltd* [1981] VR 981.

Neither of these is a term of precision but the broad distinction is between a person, firm or company which carries on an independent business of placing insurance upon the instructions of clients whose basic relationship of agency is with client, and the insurer's agent whose function is to procure persons to insure with his principal, the insurer, and whose basic relationship of agency is therefore with the insurer.<sup>20</sup>

- 2.15 This focuses on the pre-existing relationship: if the insurer had a close relationship with the intermediary before the consumer approached the intermediary, then it suggests "a basic relationship of agency with the insurer". It is consistent with Lord Esher's comment in the English case of *Bawden v London, Edinburgh and Glasgow Assurance Co*:

He was an agent of the company. He was not like a man who goes to a company and says, I have obtained a proposal for an insurance; will you pay me commission for it? He was the agent of the company before he addressed Bawden.<sup>21</sup>

- 2.16 In *Brennans*,<sup>22</sup> Mr Justice Lush went on to look at a wide range of factors. He placed particular emphasis on the degree of control the insurer exercised over the intermediary.<sup>23</sup> Interestingly, he held that where the insurer had not adduced evidence of its written agreement with the intermediary, the court could draw the inference that it had not done so because the evidence would have been adverse to its case.<sup>24</sup>

### **Using discretion to protect to consumers against intermediary fraud**

- 2.17 In practice, the courts have developed a different technique to protect consumers who are faced with the rejection of a claim because their intermediary has acted in a fraudulent way. Under the Insurance Contracts Act 1984, the courts have a discretion to prevent the insurer from avoiding a contract for fraudulent misrepresentation. Professor Merkin notes that it has been used to protect consumers who have acted in good faith, but who are at risk of avoidance because of fraud by an intermediary.<sup>25</sup>

<sup>20</sup> Above, Lush J at 981. The term "insurance broker" was later defined under the 1984 Insurance (Brokers and Agents) Act, s 9, as "a person who carries on the business of arranging contracts of insurance... as agent for intending insureds". The Act did not define "insurance agent" although it is generally taken to mean an intermediary who acts for the insurer. As discussed above, the 1984 Act has now been repealed.

<sup>21</sup> [1892] QB 534, Lord Esher MR at p 539.

<sup>22</sup> *Norwich Union Fire Insurance Society Ltd v Brennans (Horsham) Pty Ltd*, above, Lush J at 981.

<sup>23</sup> Above, at 987.

<sup>24</sup> Above, at 987 to 988.

<sup>25</sup> R Merkin, *Reforming Insurance Law: Is There a Case for Reverse Transportation?* [http://www.lawcom.gov.uk/docs/merkin\\_report.pdf](http://www.lawcom.gov.uk/docs/merkin_report.pdf).



- 2.18 The discretion is based on a recommendation of ALRC in its 1982 Report on insurance contracts,<sup>26</sup> and is set out in section 31 of the Insurance Contracts Act 1984. This gives the courts the power to prevent the insurer from avoiding the contract for a fraudulent misrepresentation “if it would be harsh and unfair not to do so”. Instead an insured may recover “the whole or such part” of the amount claimed “as the court thinks just and equitable in the circumstances”. The power must be used sparingly. It may be exercised only where the insurer has not been prejudiced or the prejudice is “minimal or insignificant”. The court is required to have regard to the need to deter fraud, and to weigh the extent of the insured’s culpability against the magnitude of the loss the insured would suffer.
- 2.19 There is nothing in the 1982 Report to suggest that section 31 was intended to deal with fraud by intermediaries. However, in practice the courts have been prepared to use section 31 to protect an insured who might suffer through the fraud of his broker.<sup>27</sup> It has also been held that the fact that the insured might have a good claim against a broker does not affect the power of the court to grant relief under section 31.<sup>28</sup>
- 2.20 A particular complication is that section 31 only applies to claims of fraudulent misrepresentation or non-disclosure. It does not cover negligent misrepresentations. Here the court must apply proportionate remedies.<sup>29</sup> This means, for example, that if the insurer had shown that it would not have entered the contract at all had it known the truth, it can refuse the full claim. In some cases, a consumer whose intermediary is careless may be worse off than a consumer whose intermediary is fraudulent. Clearly, this was not the intention of the 1984 Act.
- 2.21 In 2004, the Treasury Review recommended that this anomaly should be rectified.<sup>30</sup> Under the draft Insurance Contracts Amendment Bill 2007, section 31 is to be extended to non-fraudulent breaches of the duty of disclosure.<sup>31</sup> This would provide consumers with a similar protection against negligent intermediaries.

<sup>26</sup> ALRC, *Insurance Contracts*, Report No 20 (1982) at <http://www.austlii.edu.au/au/other/alrc/publications/reports/20/20.pdf>.

<sup>27</sup> *Evans v Sirius Insurance Co Ltd* (1986) 4 ANZ Ins Cas 60-755.

<sup>28</sup> *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cases 60-926.

<sup>29</sup> See Insurance Contracts Act 1984, ss 28 and 29.

<sup>30</sup> Australian Treasury, *Review of the Insurance Contracts Act 1984, Final Report on Second Stage*, June 2004, para 8.8 and recommendation 8.2.

<sup>31</sup> The exposure draft was open for consultation until March 2007, but has not yet been implemented.

## NEW ZEALAND

- 2.22 New Zealand is presently updating its insurance contract law as part of its wider Review of Financial Products and Providers. The Ministry of Economic Development carried out the initial consultation and policy work on the role of insurance intermediaries. It concluded that feedback from the insurance industry showed that it was unreasonable that the insurer should bear the cost of an intermediary's failure to conduct itself appropriately during the placing of the insurance on the basis of the intermediary's entitlement to a commission only. At the same time, policyholders should be informed as to whether the intermediaries with which they are dealing are acting as agent for them or for the insurer. The Ministry concluded that the agency should be determined on the basis of a written authorisation by an insurer. Where no such written authorisation was in place the intermediary would be deemed to be the agent of the insured.<sup>32</sup>
- 2.23 However, the New Zealand Cabinet revised these proposals as the legislation went through Parliament. It agreed that the agency should be determined on the basis of a written authorisation from the insurer or the consumer. This would provide certainty in what had previously been an unclear area. However, where there was no written authority from the insurer or policy holder, and the insurer had accepted a risk in relation to that policyholder through an insurance intermediary, then that insurance intermediary would be deemed to be the agent of the insurer. This was said to place an incentive on insurers to check whether the policyholder is aware when an insurance intermediary is the agent of the policyholder and not the insurer.<sup>33</sup>

<sup>32</sup> New Zealand Ministry of Economic Development, *Review of Financial Products and Providers*, September 2006.

<sup>33</sup> Office of the Minister of Commerce, *Insurance: Contracts, Agency and Assignment*, January 2008. <http://www.med.govt.nz/upload/55058/insurance-contracts.pdf>.

## PART 3: THE WAY FORWARD

- 3.1 We continue to think that the law should distinguish between those intermediaries who are sufficiently close to the insurer to be controlled and monitored by the insurer, and those who are not. We accept the argument that it is often difficult for insurers to exercise any realistic level of control over firms who are not closely linked to them and who put only a small percentage of business their way. If insurers were made responsible for such intermediaries, they may become unwilling to deal with them. On the other hand, where insurers are in a position to control intermediaries, the law should provide them with appropriate incentives to exercise that control so as to prevent intermediaries from transmitting mis-information.
- 3.2 In the light of the responses that we received on consultation, we no longer intend to pursue the provisional proposals that we put forward in the Consultation Paper. We can understand insurers' concerns about dealing with a small independent intermediary when they cannot be sure whether that intermediary is making a fair analysis of the market. We think our proposals might have resulted in an undue shift towards the independent intermediary being treated as agent of the insurer in some "multi-tied" arrangements, even when the intermediary submits only a handful of applications and has little relationship with the insurer. Furthermore, we accept the arguments advanced by some consultees that the "fair analysis" test would be unworkable. It is too uncertain in its application.
- 3.3 Although we no longer intend to pursue the proposals outlined in the Consultation Paper, we remain of the view that there should be a restatement of the agency relationship between the insurer, the consumer and the intermediary. The case law that we have is of some date, so provides little guidance as to how the relevant principles of agency would be applied to many arrangements that exist today. Increased use of technology is rapidly changing the way the insurance industry operates. Many of the cases in this area date back to the early 20<sup>th</sup> century, and it can be hard to distil the relevant principles and apply them to a modern market scenario. Nor does the case law reflect the way in which the FOS determines agency disputes that come before it. For example, we understand that the FOS will normally treat the intermediary who places products with a single insurer as the agent of that insurer even though there is no clear authority for this in the case law.
- 3.4 The responses that we received to the Consultation Paper showed that there is much confusion on this issue. Insurers appeared to over-estimate the extent to which intermediaries would be taken to act for the consumer in providing pre-contract information. For example, several insurers, and the ABI, appeared to suggest that the relationship depended on the Terms of Business Agreements (TOBAs) entered into between insurer and intermediary. It was common for agreements to include a statement that the intermediary acts on behalf of the insured, and some insurers have argued that this would be definitive. We do not think that such a statement should be taken as definitive, either as matter of current law or as a matter of policy. The court would need to consider all aspects of the relationship between the insurer and the intermediary, rather than rely on a single statement.

- 3.5 On the other hand, consumers appeared to under-estimate the extent to which they are responsible for the actions of an intermediary. The FOS has reported to us that consumers generally believed that they were dealing with the insurer itself and not an intermediary.

#### **PROBLEMS WITH REQUIRING DECLARATIONS FROM INTERMEDIARIES**

- 3.6 Several consultees (including brokers, lawyers and insurers) suggested that intermediaries should at the outset make a declaration to the consumer stating for whom they are acting. The declaration would be decisive, providing much needed certainty as to the nature of the relationship. For example, it was suggested that the law should consider the intermediary as acting for the insurer unless the consumer was told that the intermediary acted for him or her.
- 3.7 We have considered this proposal carefully, but have concluded that it has insuperable problems. We think that, in practice, insurers would take the opportunity to exclude their own liability for the intermediary's errors. A well-advised insurer would demand that its intermediaries declare themselves to be acting for the consumer, irrespective of the reality of the relationship. The closer the relationship between the insurer and the intermediary, the more the insurer could insist that the declaration was made and the less it would reflect the commercial reality.
- 3.8 Meanwhile, consumers would be unlikely to find the information helpful. It would be difficult to understand the implications of the statement without a detailed understanding of insurance law, and would need to be absorbed at a time when consumers are already overloaded with important information. In 2006 the Davidson Review commented that intermediaries were already required to give consumers too much information at the point of sale. Much of it was "unnecessary and not read by the consumer", was "expensive for firms to produce", and added to the records they were required to keep.<sup>1</sup>
- 3.9 Finally, a general rule stating that an intermediary was taken to act for the insurer unless there was an indication to the contrary would cause problems for insurers. For example, where an independent agent failed to send out the required declaration, the insurer could unwittingly find itself responsible for the actions of the intermediary, even though the insurer had no realistic possibility of preventing the problems. We are concerned that an undue emphasis on whether a particular declaration was or was not given to a consumer would put the decision in the hands of the least appropriate person, that is the fraudulent intermediary. An intermediary who wished the insurer to suffer the consequences of its actions could deliberately fail to send the required form.

<sup>1</sup> Davidson Review on the Implementation of EU Legislation, *Final Report*, November 2006, para 2.21.

3.10 In the Consultation Paper, we set out the information that intermediaries are required to provide to consumers under FSA rules. This includes whether the firm provides advice or information on the basis of a fair analysis of the market;<sup>2</sup> whether the insurer has a holding in the intermediary of more than 10%;<sup>3</sup> and whether the intermediary holds money on behalf of the insurer.<sup>4</sup> We explained that although some of these issues may be relevant to the issue of who the insurer acts for in transmitting pre-contract information, they do not determine the issue. In the Consultation Paper we proposed that the question of fair analysis should be given a definitive role, but most respondents argued against this. The concept is too uncertain.

3.11 The FSA has reviewed the rules about what insurance intermediaries should disclose in the commercial market. In March 2008 it drew attention to the problems facing commercial customers in this area, stating that “a key concern is the lack of clarity about whether the intermediary is acting for the customer, for the insurer or, in some cases, both”.<sup>5</sup> In December 2008 it issued a Feedback Statement, stating that:

If the intermediary is concerned that their capacity is unclear, then we believe it is appropriate for them to explain their relationship with the insurer to the customer (for example, by setting out all the paid services they undertake for the insurer). Again, we believe it appropriate for the customer to receive this information in good time before conclusion of the contract and that it form a prominent part of the sales process for new contracts and renewals.<sup>6</sup>

3.12 However, the FSA would prefer this matter to be dealt with by industry guidance rather than FSA rules. As the FSA put it:

We believe that if intermediaries adopt and adhere to the guidance that is being developed, it would be neither necessary nor proportionate for us to make rules to achieve these outcomes for customers. However... we will keep this under review.<sup>7</sup>

<sup>2</sup> FSA Handbook, ICOBS 4.1.6.

<sup>3</sup> FSA Handbook, ICOBS 4.1.62.

<sup>4</sup> FSA Handbook, CASS 5.2.3(3). For a discussion of these rules, see Consultation Paper paras 9.108 to 9.113.

<sup>5</sup> FSA, *Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market*, DP 08/2, March 2008. See also the research by CRA International, *Commercial Insurance Commission disclosure: Market Failure Analysis and High Level Cost Benefit Analysis*, December 2007, which showed confusion among commercial customers over whether their intermediaries provided a fair analysis of the market.

<sup>6</sup> FSA, *Feedback Statement: Transparency, Disclosure and Conflicts of Interest in the Commercial Insurance Market*, 08/07, 17 December 2008, p 22.

<sup>7</sup> Above, p 11, para 3.12.

- 3.13 We think that in the consumer market it would also be good practice for intermediaries to tell consumers the capacity in which they act. However, we do not think that such a statement should be definitive. The issue of whom the intermediary is acting for must depend on the true nature of the relationship between the intermediary and the insurer on one hand and intermediary and the consumer on the other. It cannot depend on a single statement made by the intermediary. Furthermore, we think the issue of whether there should be mandatory disclosure is better decided by the FSA than by us.

#### **NO BRIGHT LINE TEST**

- 3.14 Unfortunately we do not think that it is possible to set out a bright line test to say that any given intermediary always acts for one side or the other in receiving pre-contract information. Intermediaries stand between insurers and consumers and often “change hats” during the process. Take the case of an independent intermediary with authority to bind the insurer to temporary cover but not to main cover. Under current law, the intermediary acts for the insurer in receiving information in respect of the temporary cover but not in respect of the main cover.<sup>8</sup>
- 3.15 Another example would be where an independent intermediary completes a paper proposal form in face to face discussion with the consumer and is then paid by the insurer to transcribe the results onto the insurer’s system. Even if the intermediary acts for the consumer in the face to face discussion, we think the intermediary acts for the insurer while transcribing. The insurer would not be able to refuse a claim because errors occurred in the transcription process.
- 3.16 The responses we have received suggest that it is not possible to impose a single test to decide whether an intermediary is independent. Technology is changing the way in which insurance is distributed and sold. Although there is a need for greater clarity, we do not wish to restrict product development or place regulatory obligations on parties who are not in a position to enforce them.
- 3.17 Instead, we have concentrated on promulgating high-level principles and guidance to the FOS. We have thoroughly reviewed the case law and consider that it is possible to extract some general principles which are presently used to ascertain for whom the intermediary acts. Below we start by outlining the general principles of agency law. We then consider how these principles have been interpreted in the insurance context, and how they should be applied to modern day market scenarios. We go on to discuss the most appropriate means of setting them out – in statute, as some form of industry code, or as part of the Law Commissions' Report.
- 3.18 We conclude that setting out these principles in statute would provide useful guidance to all parties concerned in the placing of insurance as to their rights and obligations. It would clarify the present law, thereby providing the right incentive to all parties to ensure that their obligations are met and that the law is seen to be just. The principles that we have extracted are of such a high order that we do not consider that restating them in some clear way would inhibit their ability to keep pace with market development.

<sup>8</sup> *Stockton v Mason* [1978] 2 Lloyd's Rep 430.

## AGENCY LAW

3.19 Under general common law principles, a relationship of agency arises where one person, the agent, has the express or implied consent to act on behalf of another, the principal, in effecting legal relations with third parties. The consent given by the principal is said to confer “authority” on the agent to act on behalf of that principal. There are several forms of authority that an agent may have. These are generally separated into three broad and overlapping categories: (1) actual authority (which may be express or implied); (2) apparent or ostensible authority; and (3) authority arising through ratification. We consider each of these in turn.

- (1) **Actual authority:** An agent has actual authority where his authority arises from a consensual agreement between the principal and agent. This may be express or implied.
  - (a) *Express actual authority:* This needs little explanation. Express authority is that given by express words; and the extent of the agent’s authority depends on the true construction of the words of appointment.
  - (b) *Implied actual authority:* The consensual agreement between principal and agent may be implied rather than express. Implied authority may be inferred from the conduct of the parties, their relationship or the circumstances of the case. Different textbooks use different terminology to describe the various types of implied authority that can arise.<sup>9</sup> Two broad categories of implied authority are most relevant to insurance intermediaries:
    - (i) *Incidental authority* arises under English law where an agent is held to have implied authority to do acts which are incidental to the proper performance of his or her express authority. For example, in *Bawden v London, Edinburgh and Glasgow Assurance Co*,<sup>10</sup> it was not disputed that the intermediary who incorrectly completed the proposal form was the agent of the insurer when he approached the consumer with actual authority to obtain proposals.

<sup>9</sup> See for example: *Chitty on Contracts* (29<sup>th</sup> ed 2004), para 31.042; E Peel, *Treitel on The Law of Contract* (12<sup>th</sup> ed 2007), para 16.017.

<sup>10</sup> [1892] 2 QB 534 (CA). The case is followed in *Holdsworth v Lancashire and Yorkshire Insurance Co* (1907) 23 Times LR 521; *Thornton-Smith v Motor Union Insurance Company Limited* (1913) 30 Times LR 139; *Goldring v Royal London Auxiliary Insurance Co Ltd* (1914) 30 Times LR 350; and *Keeling v Pearl Assurance* [1923] All ER 307.

The court held that this also gave him authority to negotiate and settle the terms of a proposal, including compiling the relevant form (though not to make the insurance contract).<sup>11</sup>

- (ii) *Usual authority*<sup>12</sup> arises where an agent authorised to conduct a particular business is held to have implied authority to do whatever is normally done by persons carrying on such business.

(2) **Apparent or ostensible authority:** Even where there is no consensual agreement of agency between the principal and the agent, an agency relationship may still arise. Where a person represents to a third party that he or she has an agent who is authorised to act on his or her behalf, that person will not be allowed to deny the agency later and will be bound by any acts of the agent. For apparent authority to arise, certain conditions must be satisfied.

(a) There must be a representation of authority made by the principal to a third party. If the principal is said to “hold out” a person as being his agent, this may be sufficient to count as a representation.

(b) The representation must be one of fact and not law.

(c) The third party must have relied on the representation made.

(3) **Ratification:** The third type of agency relationship can arise through ratification. This occurs when the agent carries out unauthorised acts on behalf of the principal, but the principal later authorises or ratifies those acts. Like actual authority, ratification may be express or implied as a result of the course of dealings between the parties.

<sup>11</sup> Although note that this case was not followed in *Newsholme Brothers v Road Transport and General Insurance Co* [1929] 2 KB 356 (CA) where the Court of Appeal held that an agent who is generally acting for the insurer in the canvassing and procuring of proposal forms but who does not have actual authority from the insurer to complete proposal forms and who does so without the insurer’s knowledge but at the insured’s request is acting as agent for the insured when filling in the form, even if he is otherwise acting as agent for the insurer.

<sup>12</sup> In English law, this type of implied authority is sometimes referred to as customary authority, and “implied authority” reserved for a small category of cases (outside the context of implied actual authority) where an undisclosed principal has been held liable on a contract made by his agent where the agent’s authority had in fact been withdrawn: See FMB Reynolds, *Bowstead and Reynolds on Agency* (17<sup>th</sup> ed 2001) para 3-006.



## RELEVANT PRINCIPLES

3.20 As a preliminary point it is important to note that the intermediary can “change sides” throughout the insurance process – a concept referred to as “transferred agency”. For example, where an independent intermediary searches the market for the best insurance product, the intermediary will be acting as agent for the consumer. However, having placed the insurance, the intermediary may go on to act for the insurer when, for example, premiums are collected on the insurer's behalf. Here we are interested only in obtaining and passing on pre-contract information.

### (a) Principles extracted from the case law

#### *(i) As a general rule, an intermediary acts as agent for the insured*

3.21 It has long been established that, prima facie, an agent or broker, including a Lloyd's broker,<sup>13</sup> is the agent of the insured and not of the insurer for the purposes of placing of the insurance.<sup>14</sup> The fact that the insurer pays the agent commission is not enough to establish that the agent acts for the insurer. This is the normal arrangement in relation to contracts of insurance for the convenience of both parties.<sup>15</sup>

3.22 This general principle is clearly brought out in a consumer case, *Winter v Irish Life Assurance plc*.<sup>16</sup> The consumers bought life insurance through a large firm of brokers. The brokers knew that the consumers suffered from cystic fibrosis, but this information was not disclosed to the insurer. The High Court held that the brokers acted for the consumers, not the insurers. It was not sufficient that the insurers paid the brokers commission, or gave them publicity material overprinted with the broker's name, or provided guidance and training about how the forms should be filled in. The judge stressed that the consumers had approached the brokers to find them cover. He said that the position might have been different if the insurer had provided the broker with the names of various leads and asked the broker to approach potential clients in order to sell the insurer's products.

3.23 A second case illustrates how closely linked the intermediary may be to the insurer, and yet remain the agent of the consumer. In *Searle v A R Hales*,<sup>17</sup> the brokers advised the consumers to invest in a broker fund which was invested in discrete funds with the insurer. The insurer had prepared promotional literature in relation to the broker fund, had helped the broker in drafting the investor documentation, and, in correspondence with the brokers, had referred to the broker managed funds as “a joint venture between you and ourselves”. Despite this clear and close link, the court held that the broker acted for the consumer in the placing of the investment.

<sup>13</sup> *Rozanes v Brown* (1928) 32 LI L Rep 98 (CA); *North and South Trust Co v Berkeley* [1971] 1 WLR 470 (QBD); *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341.

<sup>14</sup> *Anglo-African Merchants Ltd v Bayley* [1970] 1 QB 311; *McNealy v The Pennine Insurance Co Ltd* [1978] 2 Lloyd's Rep 18 (CA).

<sup>15</sup> *Bancroft v Heath* 6 Com Cas 137.

<sup>16</sup> [1995] 2 Lloyd's Rep 274.

<sup>17</sup> [1995] CLC 738.

**(ii) Exceptions to the general rule: where an intermediary acts as agent for the insurer**

3.24 There are at least three exceptions to the general principle outlined above. In the following circumstances, the intermediary is regarded as agent for the insurer.

- (1) Where the intermediary is given actual authority by the insurer to complete the proposal form on the insurer's behalf. In this case he acts as agent for the insurer even where those answers are incorrect.<sup>18</sup> In such circumstances, it has been held<sup>19</sup> that the insurer could not rely on a clause in the proposal form which expressly states that the intermediary completing the form did so as agent for the consumer. However, the decision in the case was confined to its own special facts.
- (2) Where the intermediary has authority to bind the insurer to cover.<sup>20</sup> In *Stockton v Mason*<sup>21</sup> a consumer asked his broker to transfer cover from one car to another. The broker told her: "Yes, that will be all right. We will see to that, Mrs Mason." The consumer assumed that the insurance had been issued on the same terms as before. In fact, the new insurance only covered the insured (unlike the previous policy that also covered anyone driving with the insured's permission). The Court of Appeal held that as the broker had authority to bind the insurer to temporary cover, that meant that the broker was acting as agent for the insurer as regards the placing of that temporary cover. In *Woolcott v Excess Insurance Co Ltd*,<sup>22</sup> it was assumed that the same principle applied to issues of disclosure.
- (3) Where the intermediary has close links with the insurer and, on the insurer's instructions, approaches the consumer directly in order to solicit business for that insurer. In *Winter v Irish Life Assurance plc*,<sup>23</sup> the judge approved the following passage from *MacGillivray on Insurance Law*:

The kind of case where the broker is found to be the insurer's agent is where he is employed by them or is tied to them and in that capacity, initiated the relationship between the insurers and the assured.<sup>24</sup>

<sup>18</sup> *Stone v Reliance Mutual Insurance Society* [1972] 1 Lloyd's Rep 469 (CA).

<sup>19</sup> *Stone v Reliance Mutual Insurance Society* [1972] 1 Lloyd's Rep 469 (CA).

<sup>20</sup> *Woolcott v Excess Insurance Con Ltd and Miles, Smith, Anderson and Game Ltd* [1979] 1 Lloyd's Rep 231 (CA).

<sup>21</sup> [1978] 2 Lloyd's Rep 430.

<sup>22</sup> [1979] 1 Lloyd's Rep 231.

<sup>23</sup> [1995] 2 Lloyd's Rep 274. See also *Arif v Excess Insurance Group Ltd* 1986 SC 317; *Whitlam v Andrew Hazel for Lloyds* [2004] EWCA Civ 1600.

<sup>24</sup> *MacGillivray on Insurance Law* (10<sup>th</sup> ed 2003) para 18-6.

**(b) The implications of statutory regulation**

3.25 Under the Financial Services and Markets Act 2000 all insurance intermediaries are required to be authorised or exempt. An intermediary is exempt where it is the “appointed representative” of an authorised person. Where an insurer appoints an intermediary as its “appointed representative”, it is responsible for the representative’s actions or omissions. Under section 39(3), the principal:

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.

3.26 Technically, it could be argued that this provision only covers regulatory issues that fall within the scope of the Act, rather than issues of civil liability. We found, however, an almost universal acceptance within the insurance industry that if an appointed representative gives poor advice about how to complete a proposal form, the insurer is responsible for it. For example, in their response to us Aviva told us that “all appointed representatives should be the agent of the insurer”. As Aviva also said that the law should remain as it is, it seems that Aviva regard this to be the current law.

3.27 We think this general acceptance is sufficient to establish an agency arrangement on the basis of implied authority. As we discussed above,<sup>25</sup> usual authority arises where an agent authorised to conduct a particular business is held to have implied authority to do whatever is normally done by persons carrying on such business. Here, the market generally considers an agency relationship for regulatory purposes to give rise to an agency relationship in transmitting pre-contractual information. Given that insurers are required to monitor and control their appointed representatives, we think this must be correct as a matter of policy, as well as a matter of law.

<sup>25</sup> See para 3.19 above.

### (c) Insurance agents and Value Added Tax

- 3.28 In several recent cases the VAT Tribunal has had to decide whether a taxpayer has acted as an insurance agent or broker.<sup>26</sup> This is because there is a specific VAT exemption in relation to “the provision by an insurance agent or broker of any of the services of an insurance intermediary...”.<sup>27</sup> In two cases the taxpayer was a conduit for the sale of insurance via the internet.<sup>28</sup> The taxpayer provided a website which customers seeking insurance could use in order to find potential insurers. The taxpayers’ services varied from time to time and from case to case. For example, in the early years the website merely provided information in relation to potential insurers and insurance contracts based on the answers given by the consumer to an on-line questionnaire. However, at a later date the website provided instant premium quotes from various insurance companies and the consumer was able to enter into his or her preferred contract either by transferring to the insurer’s website or directly from the taxpayer’s website. The taxpayers were remunerated by commissions received from the insurance companies.
- 3.29 The success or failure of the taxpayers’ arguments depended on the specific detailed language of the relevant exemption and the exact nature of the taxpayer’s supplies.<sup>29</sup> However, for our purposes, what is most interesting is that in each case the taxpayer argued that it had acted as the agent of the insurer or panel of insurers from whom information or quotes could be obtained via the website. The taxpayer did not assert that it acted as the agent of the insured.

<sup>26</sup> *InsuranceWide.com Services Limited v HM Revenue and Customs* LON/06/221 15 October 2007, [2008] Lloyd’s Rep IR 422; *Governor & Company of the Bank of Ireland v HM Revenue and Customs* LON /06/0861 3 October 2008, [2008] STI 2516; *Royal Bank of Scotland v HM Revenue and Customs* LON/06/0016 22 October 2008, [2008] STI 2798; *Trader Media Group v HM Revenue and Customs* LON/06/0937 8 May 2008, [2008] STI 1690; *Leadx v HM Revenue and Customs* MAN/07/1190 19 December 2008, [2009] STI 448.

<sup>27</sup> Schedule 2, Group 2, Item 4 of the Value Added Tax Act 1994.

<sup>28</sup> *InsuranceWide.com Services Limited v HM Revenue and Customs* LON/06/221 15 October 2007, [2008] Lloyd’s Rep IR 422; *Trader Media Group v HM Revenue and Customs* LON 2006/0937 8 May 2008, [2008] STI 1690.

<sup>29</sup> In *InsuranceWide.com Services Limited v HM Revenue and Customs* LON/06/221 15 October 2007, [2008] Lloyd’s Rep IR 422 the taxpayer was held not to fall within the VAT exemption. The tribunal decided that the taxpayer was not acting as an insurance agent for the purposes of the VAT provisions as it did not have any power to bind the insurance company. The decision was not followed in *Trader Media Group v HM Revenue and Customs* LON 2006/0937 8 May 2008, [2008] STI 1690. Here the Tribunal held that in order to be an “insurance agent” it was not a necessary requirement that the intermediary should have power to bind its principal to an insurance contract. A central aspect of being an insurance agent was held to be the finding of prospects and their introduction to the insurer. This is exactly what the taxpayer was held to do.

## **MARKET MODELS WHERE THE POSITION IS NOT CLEAR**

- 3.30 So far, the relevant principles are fairly clear. They are, however, based on a market that no longer exists. Prior to the depolarisation of the market in 2005, an insurance intermediary had either to be independent, or tied to a single insurer. As we have seen, the market now is much more flexible. It would not be wise to assume that the broad statements stemming from 20<sup>th</sup> century case law, that the intermediary always acts for the insured, would necessarily apply.<sup>30</sup>
- 3.31 As Lord Woolf put it, “whether an insurance broker is at any particular time acting on behalf of the insured or insurer requires careful analysis of the nature of the activity concerned against its factual background”.<sup>31</sup> The problem is that it may not be clear which facts the courts should focus on. Nor has the case law kept pace with changes in the market. For example, there is no case law on the position of the independently authorised intermediary who sells the products of a limited number of insurers only. However, we would expect the correct approach to depend on the application of basic principles of agency.
- 3.32 We go on to consider four different types of intermediary. In each situation we have little case law to guide us on how the existing principles of agency would be applied to the different scenarios. To some extent this is because the models are so recent that relevant cases have not yet come through the courts; but largely this is because consumers generally use the FOS, rather than the courts, to settle their disputes.

### **(i) Independently authorised agents who place insurance with only one insurer: “independently authorised tied agents”**

- 3.33 The intermediary may sell the products of a single insurer, yet have its own independent authorisation rather than act as the insurer’s appointed representative. This situation can occur in a variety of ways. For example, the intermediary may be a financial provider, already authorised by the FSA, who assists in the placing of insurance with a single named insurer.

<sup>30</sup> Particular care should be taken with the statement by Scrutton LJ in *Rozanes v Bowen* (1928) 32 Ll L Rep 98 at p 101 that “in the case of marine insurance there is not the slightest doubt, and never has been the slightest doubt, that the broker is not the agent of the underwriter”. This judgment was delivered at the time of the hearing to an unrepresented plaintiff in a case where there were no special factors to suggest that the agent acted for the insurer.

<sup>31</sup> *Re Great Western Assurance Co SA* [1999] Lloyd’s Rep IR 377, at p 384.

- 3.34 Where the intermediary has authority to bind the insurer to cover, the intermediary will be acting on behalf of the insurer. However, in other cases, the issue is less clear cut. Although textbooks have suggested that at the time of polarisation “a tied agent was essentially the agent of the insurer”,<sup>32</sup> there is no direct authority on the point.<sup>33</sup>
- 3.35 The general principles of agency will regulate the relationship. The issue is whether the insurer has given the intermediary express, implied or apparent authority to collect information on its behalf. Tied agents do not act for the consumer in terms of giving them advice about which insurer to choose. Instead, most consumers would regard them as acting for the insurer in collecting information. Furthermore, the insurer may well be able to exert substantial control over the way the intermediary does business, directing the way that it explains and promotes the product.
- 3.36 Under the system operated by the FOS, the intermediary who places insurance with a single insurer is treated as the agent of that insurer, unless there are exceptional circumstances to show that the intermediary acted for the consumer. We consider that this is the correct approach. Where the intermediary places insurance with a single insurer, that insurer is likely to be able to exert greater control over the behaviour of the intermediary than any single consumer. Market discipline is therefore more likely to be maintained by making the insurer bear the risk of the intermediary’s negligent or fraudulent behaviour.
- 3.37 There is an argument that this is already the case under general principles of agency law. However, there are several dicta within the case law on insurance intermediaries that suggest a strong presumption that an intermediary always acts for an insured.<sup>34</sup> These dicta are not binding, but it may take a bold judge to disregard them altogether. We do not think that such a presumption is appropriate when an intermediary sells the products of only one insurer, and it may be helpful for statutory reform to clarify this point.
- 3.38 The FOS tells us that their conclusion that an independently authorised tied agent acts for the insurer “is accepted in many cases”. However, some insurers refer to a statement in their terms of business agreement with the intermediary to the effect that no relationship of agency should be implied. The FOS comments that:

Unhelpfully, this is the case even where the agreement clearly does create an agency, for example by delegating authority to bind cover.<sup>35</sup>

<sup>32</sup> M Clarke, *The Law of Insurance Contracts* (5<sup>th</sup> ed 2006) para 7-1B.

<sup>33</sup> Although there are some early cases to suggest that tied agents act for the insurer, they have been doubted. 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] 2 QB 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.

<sup>34</sup> See for example *Rozanes v Bowen* (1928) LI L Rep 98, discussed above at para 3.30 and footnote.

<sup>35</sup> Email 16 December 2008.

3.39 As discussed above,<sup>36</sup> where an insurer has granted an intermediary authority to bind the insurer to cover, the intermediary will always be taken as acting for the insurer for the purposes of receiving pre-contract information. Even in other cases, we doubt that a single statement in a terms of business agreement to the effect that the intermediary does not act for the insurer would carry much weight in deciding the status of the intermediary. The court or ombudsman would need to construe the agreement as a whole, looking at the true nature of the relationship between insurer and intermediary.

**(ii) Intermediaries placing a limited number of insurance products branded with their own name: “white-labelling”**

3.40 In recent years many insurers have entered into joint ventures with well-known retailers and financial providers (such as supermarkets and banks). The insurance product is branded with the “High Street” name, and only the astute consumer may realise that a different entity is acting as the insurer.

3.41 The “High Street name” may not be tied to only one insurance company. It may for example offer a portfolio of products, dealing with one insurer for motor policies, another for life policies and a third for critical illness insurance. However, in each segment of the market, only one product will be on offer. Under this model, the intermediary would not offer a range of directly competing brands.

3.42 The intermediary may assume a variety of roles. At one extreme, it may simply display leaflets at a supermarket till, requiring the consumer to telephone the insurer’s call centre. Few problems arise from this type of arrangement as the intermediary has little scope to introduce error. At the other extreme, the intermediary may have authority to bind the insurer to cover. Under this model, the law is clear: the intermediary is considered to be the insurer’s agent.

3.43 The uncertainties arise in the middle area, where the intermediary collects information and passes it to the insurer. The consumer may well not be aware that the intermediary and insurer are separate entities. Here the law is unclear and there do not appear to be any cases directly on the subject.<sup>37</sup> The court will need to look in more detail at the relationship between insurer and intermediary.

3.44 In practice, in such arrangements, the insurer and intermediary will effectively be engaged in a joint venture, acting together to promote and sell particular policies. The FOS have outlined a common scenario of this type:

<sup>36</sup> See para 3.24 above.

<sup>37</sup> In *Winter v Irish Life Assurance Plc* [1995] 2 Lloyd’s Rep 274, it was noted that in the early 1980s it was general practice for insurers to provide intermediaries with mailing facilities, in which their own literature was “over-printed with the broker’s name”. Sir Peter Webster suggested that this was not sufficient to establish an agency between broker and insurer. However, we think this limited practice is very different from the systematic branding that intermediaries carry out today.

The intermediary drafts the policy terms and fixes the price of its branded product. It then seeks tenders from underwriters to find the lowest price for the cover for one year. It includes a profit sharing arrangement with the insurer if claims are below a certain level. The policy is offered on a non-advised basis to all customers with the name of the insurer mentioned once only and hidden away. The policy is offered on a non-advised basis to all customers, at a higher price to existing customers and a lower price to new customers. Information received from the policyholder is entered into an on line application form that the consumer does not sign.<sup>38</sup>

- 3.45 In such a close relationship, the insurer ought to be aware of the way in which the intermediary is collecting information, and should have an incentive to assert control over it. We think that in close joint ventures of this sort, which involve providing the consumer with no advice about the choice of policy, the law should recognise an agency relationship between insurer and intermediary. The insurer has such a close relationship with the intermediary that it is in a position to assess the intermediary's actions. Furthermore, by permitting its policies to be branded with the intermediary's name, the insurer had represented to the consumer that the consumer is buying an insurance policy directly from an organisation that is an insurer. Most consumers will not even know that they are dealing with an intermediary at all, let alone think that they are dealing with an agent who acts for them in placing insurance.

**(iii) Other independently authorised agents who place insurance with a limited number of insurers: "multi-tied agents"**

- 3.46 There may be other forms of "multi-tied agents", which do not involve a joint venture between insurer and intermediary. The intermediary may for example have links with only a handful of insurers, without offering the agent's brand in the way we have described above. The links may be in the form of formal "ties" with the insurer, or some sort of more flexible "panel" arrangement.
- 3.47 There is no case law specifically on this type of arrangement to guide us. In our Consultation Paper, we argued that these agents should always be considered to act for the insurer. However, having considered the consultation responses, we think this went too far. Simply because an intermediary decides to offer only a limited number of policies does not necessarily mean that the insurer is in a position to monitor or control the intermediary's behaviour. The insurer may still be dealing with a large number of small firms, each one of which only sells a small number of its products.
- 3.48 On further consideration, we do not think that it is right to draw a distinction between intermediaries based purely on the number of competing brands they sell. Instead, the fact that an intermediary offers only a limited range of products should alert the court or the FOS to the fact that there may be a close relationship between the insurer and the intermediary. It will then be necessary to analyse the reality of the relationship between insurer and intermediary to see how far the insurer has assumed control over the intermediary's actions, construing the arrangements between them as a whole.

<sup>38</sup> Email 16 December 2008.



- 3.49 The case law suggests that it is also relevant to look at how far the insurer encouraged the intermediary to promote the product on its behalf, rather than simply respond to requests from consumers.<sup>39</sup> In 2007 the FOS wrote to us in similar terms, drawing a distinction between salesmen who simply sell policies on behalf of the insurer, and advisers who offer a service to consumers about which policy to buy.<sup>40</sup> We agree with the FOS that the greater the degree of control the insurer has over the intermediary's operations, and the greater the pressure the insurer puts on the intermediary to promote the product, the more the intermediary should be regarded as the insurer's agent.
- 3.50 The FOS has told us that it will also look at the degree of control exercised by the consumer.<sup>41</sup> We agree that it is relevant to consider the relationship between intermediary and consumer. If the intermediary is paid by the consumer, or discloses the full amount of their commission to the consumer, or has undertaken to act in the consumer's interests (by for example offering a fair analysis of the market), these factors would indicate strongly that the intermediary acts for the consumer. The more difficult issue, however, is how far the consumer's absence of control over the intermediary indicates that the intermediary acts for the insurer.
- 3.51 General agency principles suggest that where one party exercises considerable control over another, this is likely to indicate an agency arrangement. However, it does not follow that a lack of control necessarily indicates the absence of an agency arrangement. The main textbook on agency law in England, Bowstead and Reynolds, puts the point as follows:

Agents will often not accept control by their principals, and some will only accept instructions to act in accordance with the usages of their own market. Others may be authorised only to do specific things. In many such situations the principal's only control lies in his power to revoke the authority, a power which agency law assumes that he has at all times. It might seem therefore that control is not a significant feature of the internal relationship...<sup>42</sup>

<sup>39</sup> See the approval given to the statement in *MacGillivray on Insurance Law* that tied agents would be taken to act for an insurer where he "initiated the relationship between the insurers and the assured" in *Winter v Irish Life Assurance plc* [1995] 2 Lloyd's Rep 274 and *Arif v Excess Insurance Group Ltd* 1986 SC 317. This is discussed above at para 3.24.

<sup>40</sup> Consultation Paper para 10.13.

<sup>41</sup> Email 16 December 2008.

<sup>42</sup> FMB Reynolds, *Bowstead and Reynolds on Agency* (17<sup>th</sup> ed 2001) para 1.018.

- 3.52 The most difficult cases are where there are no features in the intermediary's relationships to indicate that it acts either for the insurer or the consumer. For example, the FSA trend data indicate that many independently authorised firms place only a handful of critical illness policies each year.<sup>43</sup> These small firms may have no special relationship with the insurer; the insurer may have little information about how these firms do business; and few practical means of monitoring what they do. However, the Swiss Re report shows that these firms are not necessarily giving independent advice to the consumer, or conducting a fair analysis of the market.<sup>44</sup> They may do no more than sell the consumer one product from a limited range.
- 3.53 The case law clearly establishes that, under current law, an intermediary acts for the consumer unless there are specific factors to indicate the contrary. In our Consultation Paper we proposed to reverse this rule: an intermediary would act for the insurer unless there were specific factors to indicate that it acted for the consumer. We accept that this might have caused difficulties where a small intermediary had little relationship with an insurer (sending, perhaps fewer than five applications a year), but the intermediary did not provide consumers with a fair analysis of the market. Under our current proposals, where no features indicate that an intermediary acts either for the insurer or the consumer, the law will assume that it acts for the consumer.

#### **(iv) Price comparison websites**

- 3.54 Price comparison sites (or "aggregators") are an increasingly important medium for selling insurance. As with other intermediaries, aggregators have the potential to introduce mistakes into the way information is transmitted. One particular problem that has been pointed out to us is where a website pre-populates the question form in order to obtain the lowest possible quote. For example, some quotation forms relating to car insurance will assume that the consumer has no driving conviction unless the consumer actively changes this default option. It would be easy for the consumer to overlook the point. Sometimes the aggregator's questionnaire is forwarded to the relevant insurer chosen by the consumer and will itself form the basis of the proposal form. In these cases any mistakes in the questionnaire will be passed on to the insurer.
- 3.55 Where the aggregator searches the market and is not closely linked to any particular insurer, then we consider that they are acting on behalf of the consumer. The proposals set out in this paper will not change this position.
- 3.56 It has been put to us that this might give consumers who buy through aggregators too little protection. For example, if the aggregator enters an incorrect "assumption" onto the form, consumers may be surprised to discover that their claims may be refused. However, the consumer is not wholly without a remedy where the aggregator has introduced faults into the process.

<sup>43</sup> FSA, *Pure Protection Contract: Produce Sales Data Trends Report*, September 2008.

<sup>44</sup> Swiss Re, *Term and Health Watch*, 2008.

- 3.57 First, this is an example of a situation where it will continue to be necessary for the consumer to bring a complaint against the aggregator directly. We hope that the FOS will examine its procedures to ensure that the consumer is able to do so without undue complexity.
- 3.58 Secondly, both as a matter of existing law and under our reformed scheme, an insurer who becomes aware of a particular practice and does nothing to stop it may be taken to have waived its rights to complain that the practice is negligent. For example, if an insurer is aware of the fact that an intermediary is pre-populating an email form with a misleading answer, and the insurer does nothing to prevent the practice, this will become part of the way that the insurer accepts pre-contractual information. The insurer will have waived its right to claim that the agent was negligent in submitting information in this way.

# PART 4: A SUMMARY OF RELEVANT PRINCIPLES

## THE PRINCIPLES

- 4.1 Here we consider whom an intermediary acts for in transmitting pre-contract information from a consumer to an insurer. Based on the previous discussion, the relevant principles may be summarised as follows.

### Cases where an intermediary acts for the insurer

- 4.2 In three circumstances, an intermediary is always considered to act for the insurer. The court does not need to weigh a variety of factors. Instead, if these circumstances are present, the answer follows automatically.
- 4.3 Thus an intermediary acts for the insurer if:
- (1) the intermediary has authority to bind the insurer to cover;<sup>1</sup>
  - (2) the intermediary is the appointed representative of the insurer;<sup>2</sup>
  - (3) the intermediary has actual express authority from the insurer to collect and pass on pre-contract information.<sup>3</sup>

### Cases where the court needs to consider all the circumstances

- 4.4 In other cases, the intermediary acts for the consumer unless there is a close relationship between the intermediary and the insurer so as to indicate that the insurer has granted the intermediary implied or apparent authority to act on the insurer's behalf. The issue would need to be determined by looking at all the circumstances, weighing the various factors in the case.<sup>4</sup> Note that under this test if there are no factors to indicate either that the intermediary acts for the consumer or for the insurer, the intermediary will be taken to act for the consumer.

<sup>1</sup> This is well established in the case law, see *Woolcott v Excess Insurance Con Ltd and Miles, Smith, Anderson and Game Ltd* [1979] 1 Lloyd's Rep 231 (CA). However, insurers are not always aware that this is the case. The Australian Law Reform Commission recommended that this rule should be enshrined in legislation, and we think it would be helpful to do the same in the UK.

<sup>2</sup> Perhaps surprisingly, this is not clearly established in the existing case law, though all the insurers we have spoken to work on this basis. Again, we think it would avoid doubt to enshrine this rule in legislation.

<sup>3</sup> Again this is well established, and follows from agency principles: see *Stone v Reliance Mutual Insurance Society* [1972] 1 Lloyd's Rep 469 (CA).

<sup>4</sup> Again this reflects general agency principles, and receives support from the case law. See for example, the statement by Lord Woolf in *Re Great Western Assurance Co SA* [1999] Lloyd's Rep IR 377, at p 384, that the issue "requires careful analysis of the nature of the activity concerned against its factual background". It also appears to be accepted within the industry. In its 2008 Guidance, the ABI emphasised that the issue "will depend on the facts and circumstances of each case": see *Non-Disclosure and Treating Customers Fairly*, January 2008, para 3.4.2.

## Factors

4.5 We think that it would be helpful to provide an indicative and non-exhaustive list of the factors that are relevant to decision.

- (1) Factors which indicate a close relationship between the intermediary and the insurer (so that the intermediary acts as insurer's agent) include the following.
  - (a) The intermediary only places insurance with a limited number of insurers. (The smaller the number of insurers, the greater the indication that the intermediary acts for the insurer).<sup>5</sup>
  - (b) The insurer sells that particular policy through only a limited number of intermediaries.
  - (c) The insurer permits the intermediary to brand its services with the insurer's name, thereby giving the intermediary apparent authority to act on its behalf.
  - (d) The insurer permits its policies to be branded with the intermediary's name, thereby representing that the consumer is dealing with an insurer rather than an intermediary.
  - (e) The insurer requests the intermediary to approach the consumer to market the insurer's particular product.
  - (f) The insurer exerts substantial control over the way that the intermediary conducts its business.
- (2) Factors which indicate that an intermediary acts for the consumer include the following.
  - (a) The intermediary undertakes to act in the consumer's interest by, for example, giving impartial advice or providing a fair analysis of the market.
  - (b) The consumer pays the intermediary a fee.
  - (c) The intermediary provides full disclosure to the consumer of the commission it has received from the insurer.

4.6 Note that the factors are non-exhaustive. We may have missed relevant factors, and others may emerge in the course of time. Market practice in this area has changed recently, with the advent of depolarisation and increased technology, and may well change again. It would, therefore, be unwise to ossify the application of the relevant principles.

<sup>5</sup> As we explain in Part 3, where an intermediary deals with a single insurer, we think that they should be taken to act for the insurer unless there are specific factors to show that they act for the consumer. However, where an intermediary deals with five separate insurers, the issue is much more open.

### **Dual agencies**

- 4.7 Finally we think it would be helpful to state explicitly that different agencies may arise in respect of different tasks. For example, an intermediary may act for the consumer is obtaining a quote from the insurer, but act for the insurer if they are paid to transcribe information from a paper form onto the insurer's computer system, in the way dictated by the insurer.

### **SHOULD THESE PRINCIPLES BE ENSHRINED IN LEGISLATION?**

- 4.8 There are four different ways in which we could set out these principles. The principles could be contained in legislation, in the FSA handbook, in industry guidelines, or a Law Commissions report.
- 4.9 Our current view is that the principles should be set out as a free-standing code in our proposed Bill on pre-contract information in consumer insurance. Below we explain why we have rejected the idea of putting these principles in FSA rules, in industry guidelines or in a report, and why we favour legislation.

### **FSA rules**

- 4.10 We considered whether it might be possible to set out more definitive answers to the issue, possibly in the form of FSA rules or guidance.
- 4.11 When we raised this with the FSA, they replied in the following terms:

It is legally questionable whether we can draft a rule that directly contradicts the common law. In addition, the FSA under its rule making powers cannot repeal existing law, only overlay it. Therefore, any rules created by the FSA would lead to multiple standards – general law, FSA rules (and the FOS approach in relation to individual cases)...

For these reasons, if the Law Commission decides to implement changes to the law of agency in relation to insurance, then we are of the opinion that it would be preferable for these changes to take place through legislation rather than through FSA rules, and that this should be done in the most flexible way possible.

- 4.12 We do not think that FSA rules are the way forward, for the reasons given by the FSA.

### **Industry guidance**

- 4.13 Another possibility would be setting out guidance in the form of an industry Statement of Practice. This method might be more certain and prescriptive than high-level principles, while retaining the benefits of flexibility in a rapidly changing market.

- 4.14 However, as a general approach, within our project in relation to consumers and pre-contract information, we are keen to move away from industry guidance and towards legal principles. We are attempting to bring the law and practice into line with each other. Omitting guidance in relation to insurance intermediaries from the proposed legislation would provide the opportunity for further gaps to open up between the two. Industry guidance would enable the FOS to reach fair decisions, but the courts would continue to be constrained by out-of-date case law.

#### **Law Commissions' report**

- 4.15 A quite different option would be simply to set out in a report what we think the current law is, and how we think that it would be applied to different market scenarios in the future. This might provide useful guidance to legal advisers to both consumers and the insurance industry. It could stimulate discussion and perhaps be influential in the future development of the case law.
- 4.16 However, as we explained, there are several dicta within the caselaw on insurance intermediaries that suggest a strong presumption that an intermediary always acts for an insured.<sup>6</sup> These dicta are not binding, but they may make judges feel overly constrained, and less able to adapt the law to changing market models. Although our proposals are mainly a restatement of the law, they involve some element of law reform of the law. On this basis we think they should be in statute.

#### **Legislation**

- 4.17 Our policy in relation to pre-contract information generally, has been to propose a short, general Bill, dealing with “high-level principles”. This would provide a framework upon which the courts and the FOS could expand. We consider that such an approach should also be adopted in relation to intermediaries.
- 4.18 At present there may be differences between the law of agency as strictly applied by the courts in relation to insurance intermediaries and the practice applied by the FOS. One of the major aims of our insurance project is to move the two into line, thereby reducing inconsistency, confusion and the injustice perceived by those who, for one reason or another, are unable to make use of the FOS services. This could only be achieved by including provisions in relation to insurance intermediaries within the scope of our proposed legislation.

#### **CONCLUSION**

- 4.19 Our proposal addresses the question of whom an intermediary acts for in transmitting pre-contractual information from a consumer to an insurer. We propose that the principles set out above (in paras 4.1 to 4.7) should be included within the Bill we are drafting on pre-contractual Information in consumer insurance as a free-standing code. We think this would provide the courts and the FOS with a framework of principles to apply to individual cases.

<sup>6</sup> See for example *Rozanes v Bowen* (1928) discussed above at para 3.30 and footnote.

4.20 The statutory principles would only have a direct effect in cases concerning faults in the transmission of pre-contractual information in consumer insurance. The statute would not apply to other areas of agency (such as who an intermediary acts for in collecting premiums) or to business insurance. However, if the courts found the framework useful for its primary purpose, they may find the same principles helpful in other areas.