

# *The Insurance Companies Deposits Act 1955: A legal audit*

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*The Insurance Companies' Deposits Act 1953<sup>1</sup> aims to provide security for policyholders who may have claims against an insurer. It attempts to protect the insured from insurer insolvency, and is thus a method of insurance company regulation.*

*The Government recently reviewed the regulatory regime in New Zealand. A report to the Minister of Justice in late 1992<sup>2</sup> recommended that the Deposits Act's requirement of deposits with the Public Trustee be discontinued in favour of a rating system. The rating system would provide information to the public on the ability of an insurer to meet its liabilities.*

*The Insurance Companies (Ratings and Inspections) Act 1994<sup>3</sup> is the result. Insurance companies must now have a current rating, from an approved rating agency, of their claims paying ability.*

*Despite the Brash report's recommendation, the Ratings Act did not repeal the Deposits Act. Instead it provides<sup>4</sup> that the Minister of Justice shall appoint someone to review the operation of Part I of the Ratings Act and at the same time review the Deposits Act. The review will take place two years after the first approval of an approved rating agency. It is the view of the author of the present article that the Deposits Act should not be repealed and that the review should cover also the Life Insurance Act 1908.*

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## **I INTRODUCTION**

### *A Scheme of the Deposits Act*

The Deposits Act has two basic requirements:<sup>5</sup> first, lodgment of deposits with the Public Trustee, and second, provision of financial statements. The liability to make deposits is imposed by section 3 (1):

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1 Referred to in this paper as the Deposits Act.

2 Referred to in this paper as the Brash report.

3 Referred to in this paper as the Ratings Act.

4 Section 24.

5 Once regarded, in respect of life assurance, as the "two great safeguards" of the system of control: GBPD, vol 12, ser 5, 1949-1962, 1909, cited in M Pickering, "The Control of Insurance Business in Great Britain" (1969) 4 Wisconsin Law Rev 1141, 1144.

**3. Liability to make deposits** -- (1) Deposits with the Public Trustee in accordance with the provisions of this Act shall be made by -

(a) Every local company, Commonwealth company, or foreign company which at the passing of this Act is carrying on in New Zealand any class of insurance business (except marine insurance business), or which thereafter commences to do so:

...

(e) Every person who commences after the 26th day of August 1974 to carry on in New Zealand marine insurance business, or to act in New Zealand as an underwriter in respect of marine insurance business, or to act in New Zealand as agent of a Commonwealth underwriter or of a foreign underwriter in respect of marine insurance business: ... .

A "Commonwealth company" is a company which has its chief office in a country other than New Zealand that is a member of the British Commonwealth of Nations. A "local company" is one having its chief office in New Zealand; and a foreign company is a company that is neither Commonwealth nor local. The distinction between Commonwealth and other foreign companies is a historical anachronism. The purpose is to give preferential treatment to Commonwealth companies, as shown by clauses 4 and 5 of the First Schedule to the Deposits Act whereby foreign companies must make deposits of greater amount than Commonwealth companies. The term "insurance business" excludes life insurance and earthquake insurance.<sup>6</sup>

The amount of deposit required is primarily determined by the First Schedule.<sup>7</sup> For example, a local company carrying on fire insurance business since before 26 August 1974 pays \$45,000, while a Commonwealth company pays either \$30,000 or \$45,000 and a foreign company pays either \$70,000 or \$100,000. However, greater amounts are payable in some cases. The Public Trustee is "authorised to accept" a deposit of \$500,000 from Lloyd's of London.<sup>8</sup> Companies beginning to carry on any class of insurance business after 26 August 1974 must pay \$500,000.<sup>9</sup>

The range of deposit requirements is complex, and it is incorrect to say that the Deposits Act requires deposits of \$500,000,<sup>10</sup> though a company commencing to carry on insurance business must pay that amount. Payment of deposits need not be in cash; approved securities of the equivalent value may be used.<sup>11</sup> The income from deposits belongs to the depositor. The Public Trustee must hold deposits as security for policyholders or claimants in respect of policies or other contracts issued, granted or entered into in New Zealand, provided that deposits made in respect of any class of

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6 Section 2.

7 Section 4 (1B). This rule is subject to the provisions of ss 4, 5, 6 and 6A.

8 Section 3A.

9 Section 4 (1) (a).

10 As the Brash report, *supra* n 2 p 7, incorrectly states.

11 Section 8.



insurance business are held in trust exclusively for policyholders and claimants in respect of that class.<sup>12</sup> The deposit is protected from being attached or levied upon or being subject to any debts of or claims against the depositor until all rights and claims in respect of the policies and contracts are cancelled.<sup>13</sup>

Non-compliance with the Deposits Act by any person (or officer of a company or mutual insurance association who knew or ought to have known of the default) is an offence punishable on summary conviction by a fine of up to \$100 per day.<sup>14</sup> The Act prohibits an agent from negotiating contracts of insurance on behalf of a defaulting company.<sup>15</sup> The Minister of Justice may by notice in the *Gazette* prohibit any person in default for 3 months from carrying on any class of insurance business, either absolutely or temporarily.<sup>16</sup> Carrying on business in contravention of the prohibition is an offence punishable on summary conviction by a fine of up to \$200 per day, along with any other penalty under the Act.<sup>17</sup>

Every person required by the Act to make a deposit must prepare business statements at the end of each financial year in the prescribed form.<sup>18</sup> Such statements must be audited and deposited with the Secretary for Justice within 9 months after the close of the financial year to which they relate.<sup>19</sup>

### *B History of Deposit Requirements*

The Deposits Act is similar to the Foreign Insurance Companies' Deposits Act 1894, and to enactments in 1908, 1921-22 and 1940.<sup>20</sup> The 1894 Act covered life assurance as well as other insurance business. It required foreign companies proposing to carry on business within the colony of New Zealand to obtain a certificate of authorisation from the Public Trustee,<sup>21</sup> which requirement was dropped from later Acts. Carrying on business without a certificate was unlawful. Foreign companies proposing to carry on accident insurance or a class of insurance other than fire and marine were required to pay a deposit of £10,000.<sup>22</sup> A deposit between £5,000 and £10,000 calculated on a sliding scale was required from foreign companies already carrying on such business. Deposits were held in trust for policyholders.<sup>23</sup> The 1894 Act also allowed

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12 Section 12 (1).

13 Section 12 (3).

14 Section 20.

15 Section 20A.

16 Section 21.

17 Section 22.

18 Section 16.

19 Section 16 (6).

20 The Foreign Insurance Companies' Deposits Act 1908; the Insurance Companies' Deposits Act 1921-22; the Insurance Companies Act 1940.

21 Section 4, Foreign Insurance Companies' Deposits Act 1894.

22 Section 8 (1).

23 Section 16 (1). The wording is almost identical to that in s 12 of the 1953 Act.

prohibition of a defaulting company from carrying on business where default had continued for 3 months and notice was given in the *Gazette* by the Colonial Treasurer.<sup>24</sup>

The 1894 Act was expressed to be read with the Life Assurance Companies Act 1873.<sup>25</sup> That Act contained deposit requirements similar to those found in the Life Assurance Companies Act 1870 (UK). The latter Act required companies carrying on the business of life insurance to pay a deposit of £20,000 to the accountant-general of the court of chancery. The deposit was to be returned to the company "so soon as its life assurance fund accumulated out of the premiums shall have amounted to £40,000".<sup>26</sup> Deposit requirements for life insurance companies continue in the Life Insurance Act 1908.

Moving the second reading of the New Zealand Life Assurance Bill in August 1873,<sup>27</sup> Colonial Treasurer Julius Vogel explained the purpose of the deposit requirements. The security given by the Bill was that it compelled companies to deposit a certain security for the due fulfilment of the policies contracted in the colony. At that time all insurance companies were headquartered overseas. It was quite out of the question, he said, for the colony to dispatch persons to Europe to investigate accounts. He attached more importance to the deposit requirements than to the compulsory publication of accounts requirement.

Vogel referred to occurrences in Victoria, Australia, where a mania for the establishment of new insurance offices had grown up. "Frightful" losses ensued when these offices became unable to meet their liabilities, and it was probable that such offices would send down their agents to establish branches in New Zealand.

The law in respect of non-life insurance was consolidated in 1953. The Honourable Mr Watts moved the second reading of the Insurance Companies' Deposits Bill. He said that the purpose of the original legislation was to require overseas insurance companies, both British and foreign, carrying on insurance business in New Zealand of any class other than life, marine or earthquake insurance, to lodge with the Public Trustee cash deposits of varying amounts.<sup>28</sup> The provisions of the principal Act were extended in 1940, he said, to cover all local companies and overseas companies carrying on business in New Zealand. The object of the legislation was "to ensure that there would be a sufficient amount deposited with an outside body - the Public Trustee - to cover claims against those companies from time to time". The year 1940 was the first occasion upon which insurance companies were given the option to deposit securities instead of cash.

Later, the Public Trust Office reported that for the year ended 31 March 1956 it held total deposits under the Insurance Companies' Deposits Act 1953 and Mutual Insurance

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24 Section 19.

25 Section 24.

26 33 & 34 Vict, c. 61, s 3.

27 NZPD 5 August 1873.

28 NZPD vol 300, p 1980, 22 Oct 1953.



Act 1955 of £2,484,802 on behalf of 72 companies and 3 mutual associations.<sup>29</sup> Deposits under the Act had risen to \$39,234,000 by 31 March 1994. Much of the increase is explained by the amendments made to the Act in 1974, when the amount of most deposits was increased substantially to \$500,000, as were deposits under the Life Insurance Act 1908.

Speaking to the second reading of the amendment Bills, Sir John Marshall (Opposition) commented<sup>30</sup> that there was probably some conflict between the two considerations which have to be taken into account in legislation relating to deposits. The first is the protection of the policyholder and the second is the promotion of insurance activity. Sir John thought that increasing deposits to \$500,000 was a clumsy approach to ensuring the financial stability of insurance companies, and he went on to say:

[T]he fixing of a deposit of this size may prevent new companies being established in the future. On the other hand, it may not be a sufficient guarantee to policyholders in some cases of the solvency or stability of a company, so it is important to emphasise that this Bill is an interim measure and that the officials and the Government are examining alternative measures of ensuring the solvency and stability of insurance companies in the interests of policyholders without placing insurmountable barriers against companies that wish to establish. I hope the Government will find it possible next year to introduce legislation to provide for adequate practical and realistic solvency tests or audits, provision for reinsurance, provision for minimum capital requirements, or a means by which assurance can be given to the policyholders that the company is sound and will be able to meet its obligations; and, on the other hand, to enable the development of the insurance industry.

The Insurance Companies (Ratings and Inspections) Act 1994 is at least a partial answer to Sir John's hopes, albeit twenty years later. Deposits required have not changed since 1974, despite the inflation that has occurred.

The Deposits Act and its predecessors were modelled on United Kingdom law. The Life Assurance Companies Act 1870 (UK) was the first to introduce a system of regulation.<sup>31</sup> That Act was repealed by the Assurance Companies Act 1909 (UK),<sup>32</sup> which Act required all persons carrying on life, fire, accident, employers' liability, and bond investment insurance business to deposit £20,000 with the Paymaster-General. Deposit requirements were continued until the Insurance Companies Act 1958 (UK) repealed the Assurance Companies Act 1909.

Deposit requirements were originally recommended by a select committee appointed in 1853 to make recommendations on insurance law.<sup>33</sup> As the insurance historian H E

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29 Report and Accounts of the Public Trust Office 1956, pp B.9.6 and B.9.7.

30 NZPD vol 395, p 5660 & 5661-5662, 7 Nov 1974.

31 *Medical Defence Union v Dept of Trade* [1979] 2 WLR 686 at 689, per Megarry V-C. 9 Edw 7, c 49.

32 H E Raynes *A History of British Insurance* (Pitman, London, 1948, revised 1950) 253.

Raynes explains, it had become apparent that the Joint-Stock Companies Act 1844 (UK) did not sufficiently protect the public in respect of insurance companies. There was excessive promotion in a field where business was limited, and it was difficult to ascertain the true financial position of companies owing to the lack of any satisfactory form of presenting the accounts. A writer in the "Assurance Magazine" had earlier said that a simple and unobjectionable remedy was available. He alluded to:

[S]uch a measure as that adopted in America. Much, if not all of the evil now so paramount would be got rid of by insisting upon a moderate deposit as a security for the proper organization and conduct of such undertaking.

The failure of the Albert Life Assurance Society in 1869 led to the 1870 Act which introduced the deposit idea into British law for the first time. The 1909 Act extended the idea by removing the provision for withdrawal of deposits that had reached £40,000. The deposit requirements were later abandoned by the United Kingdom in favour of margin of solvency provisions.

## II COVERAGE OF THE ACT

### A *Meaning of "Carrying on Insurance Business" and "Contract of Insurance"*

The Deposits Act applies to various entities "carrying on" insurance business.<sup>34</sup> "Insurance business" is defined<sup>35</sup> to include mortgage guarantee insurance and every other class of insurance business except life and earthquake insurance. Insurance includes reinsurance.<sup>36</sup> The Deposits Act does not define what activities constitute carrying on insurance business. Definition is left to the courts, which have approached the task with caution. Judges have invariably stated a preference for finding a principle on which to decide the case before them, rather than laying down a complete definition of an insurance contract. Consequently, or perhaps because the task is impossible, no completely adequate definition exists.

The modern development of the meaning of "contract of insurance" began with the decision of Channell J in *Prudential Insurance Co v Commissioners of Inland Revenue*.<sup>37</sup> Prudential contracted to pay a sum of £95 if the insured attained the age of 65, and £30 if he died under that age. The stamp duty payable on the contract would have been 2s 6d if it were a deed, or 1s if it were a policy of insurance. In holding that it was a life insurance policy, Channell J examined<sup>38</sup> the nature of a contract of insurance. He thought there were three requirements. First, the insured must benefit. "For some consideration ... you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event." He later rephrased

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34 Section 3.

35 Section 2.

36 Section 2.

37 [1904] 2 KB. 658.

38 Above, n 37, 663.



this requirement, saying<sup>39</sup> that a contract of insurance must be "a contract for the payment of a sum of money, or for some corresponding benefit such as the rebuilding of a house or the repairing of a ship". Secondly, there must be uncertainty whether the event will happen or not, or as to the time at which it will happen. Thirdly, the uncertain event must be prima facie adverse to the interest of the assured.

The first part of the judge's definition, extending the benefit to things corresponding to a payment of money, was obiter dicta, because the case before him did not involve any benefit other than money. However, the first requirement of the definition has been generally approved by later courts.

### B *Benefit Corresponding to the Payment of Money*

The meaning of "business" was in issue in *Department of Trade and Industry v St Christopher Motorists' Association Ltd.*<sup>40</sup> Members of the St Christopher Motorists' Association were entitled to the services of a chauffeur and a car if they became unable to drive. The cost was paid by the Association, not to the member, but directly to the hire company. The Department of Trade and Industry sought a declaration that the Association was carrying on insurance business under the Insurance Companies Act 1958 (UK). No argument was heard from the company. Templeman J said<sup>41</sup> that the issue was whether the benefits provided were such as to enable classification of the contract as a contract of insurance, and held that they were such benefits.

Templeman J said that there is no all-embracing definition of insurance, and the probability is that it is undesirable that there should be, "because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included".<sup>42</sup> His Lordship observed<sup>43</sup> that the definition appearing in *Chitty on Contracts*,<sup>44</sup> that an insurance contract was a contract to pay money to or for the benefit of the assured, relied on the old case of *Rayner v Preston*<sup>45</sup> where it was never relevant to consider whether every contract of insurance provided for payment of money to the insured. He applied Channell J's definition, finding that the provision of a chauffeur and car was a benefit corresponding to the payment of money to the insured. The judge could see<sup>46</sup> no logical difference between the Association paying the cost direct, or paying it to the insured.

The meaning of "some benefit corresponding to the payment of money" was again considered in *Medical Defence Union Ltd v Department of Trade*.<sup>47</sup> Sir Robert Megarry VC had to decide whether there was a contract of insurance within the Insurance

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39 Above, n 37, 664.

40 [1974] 1 WLR 99.

41 Above, n 40, 101.

42 Above, n 40, 101.

43 Above, n 40, 104.

44 *Chitty on Contracts* (23 ed, 1968) v 2, p 477, para 991.

45 (1881) 18 ChD 1.

46 Above, n 40, 106.

47 [1979] 2 WLR 686.

Companies Act 1974 (UK), a successor to the 1958 Act. Members of the Medical Defence Union were entitled merely to require the union to consider whether to conduct proceedings on their behalf, or provide indemnity, so that the provision of the union's services was discretionary not obligatory. However, it was said that a member's request was rarely refused.<sup>48</sup>

The short point for decision by Megarry VC was, he said,<sup>49</sup> whether the "something" that the member was entitled to was "some benefit", "ranging from matters such as peace and quiet to the pleasure of listening to the arguments of counsel in this case, and much else besides",<sup>50</sup> or was just "money or money's worth". Counsel for the union had argued that the benefit must be restricted to money or money's worth, a phrase which he used to describe the test of Channell J requiring payment of money or some corresponding benefit.<sup>51</sup> Megarry VC considered<sup>52</sup> that Channell J had in mind only those benefits which sound in money's worth, because Channell J used examples that did not go beyond that principle. Those were the examples of rebuilding a house or repairing a ship, which may be seen as monetary benefits because they require money to be paid out by the insurer. The Vice Chancellor found nothing in either *Prudential* or the *St Christopher* case to justify generalisation of the definition beyond money or money's worth.<sup>53</sup>

Two criticisms of Megarry VC's decision may be mentioned. First, Merkin<sup>54</sup> says that the argument that a discretionary benefit cannot be insurance, since there is no legally binding obligation to confer the benefit, is essentially circular. It assumes the point in issue, namely that the obligation must be to confer the benefit. But there seems no reason to doubt, says Merkin, that a fully paid-up member whose case was rejected by the committee without due consideration would have an unanswerable action for breach of contract. In other words, the binding contractual obligation to duly consider the case is itself a benefit which may well satisfy the benefit test.

Second, O T Roberts argues<sup>55</sup> that the benefits in the *Medical Defence Union* case are money's worth. He submits that, given that it is extremely rare for the union to refuse assistance, it is unlikely that any doctor, faced with an allegation of negligence, would deny that he is getting "money's worth" from the union. The doctor is the beneficiary of a contractual obligation that in all probability will be financially advantageous. The meaning of "money's worth" is discussed below. Accepting the arguments of Merkin and Roberts, which seem valid, it is hard to avoid the conclusion that *Medical Defence Union* was wrongly decided.

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48 Above, n 47, 691.

49 Above, n 47, 693.

50 Above, n 47, 696.

51 Above, n 47, 691.

52 Above, n 47, 694.

53 Above, n 47, 696.

54 R M Merkin *Insurance Contract Law* (Kluwer Publishing), A.1.1-08.

55 O T Roberts "Contracts of Insurance" (1980) 43 MLR 85, at 88.



### C Money or Money's Worth

The meaning of the phrase "money or money's worth" has received scant attention in the law reports, and seems to be one of those terms that judges just assume to have a fixed and known meaning. Megarry VC did not attempt to define it in *Medical Defence Union*. If it is to be the test of an insurance contract, as seems to have been judicially accepted, then it needs elucidation.

The Oxford English Dictionary defines money's worth as "something that is worth money, or is recognized as equivalent to money", and "an equivalent for the sum of money paid or to be paid". The courts have held that marriage is not valuable consideration in money or money's worth, and nor is a parent's covenant on a child's marriage.<sup>56</sup> "Money's worth" means equivalent to money in the sense of something essentially material, and not emotional or spiritual reward.<sup>57</sup> In *Secretan v Hart* Buckley J said:<sup>58</sup>

The expression "consideration in ... money's worth" is, of course, one which is very familiar to lawyers as being a way of expressing the price or consideration given for property where property is acquired in return for something other than money, such as services or other property, where the price or consideration which the acquirer gives for the property has got to be turned into money before it can be expressed in terms of money.

Applying this dictum to insurance contracts reveals that it is not a very helpful one. For example, consider the *Medical Defence Union* benefit. The member has paid membership fees, in consideration of which the union assumes the obligation to properly consider the member's application for assistance. That obligation is a service; it is acquired beneficially by the member in return for property, in this case money. It may be true to say that the service has to be turned into money before it can be expressed in terms of money. Since the parties placed no money value on the service in their contract, the money value is not yet known, but in order to express the value in money is it necessary, as Buckley J suggests, to actually turn it into money? Common sense would suggest that a service can be valued without the necessity to turn it into money, that is, to sell it. This problem can be resolved by assigning to Buckley J's phrase "turned into money" the meaning "valued". This test produces the result that the service is money's worth, provided that the service is capable of valuation in money. The Union's obligation is capable of valuation.

Something that is worth money is something for which a market exists. This in turn means that the seller has the capacity to confer legal rights on the buyer. The right to have the member's application considered is a legal right conferred by the Union through the law of contract. The union has the capacity to carve out of the law an obligation to the member which may be offered in consideration for money. This is

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56 *Stroud's Judicial Dictionary* (5 ed, London, Sweet & Maxwell, 1986).

57 *Gideon's International Service Mark* [1991] RPC 141.

58 [1969] 3 All ER 1196, 1199.

achieved by making a contractual promise. The promisee member has a recognised legal cause of action. Where the beneficiary can obtain no legal right, such as on a promise of natural love and affection, then no value can be placed on the benefit and it is therefore not money's worth. The lack of an existing legal right explains the decision of Westbury LC in *Floyer v Bankes*<sup>59</sup> who decided that marriage was not a "valuable consideration in money or money's worth" within the Succession Duty Act 1853 (UK). He said:

A bare possibility of future dower or freebench in non-existing estates, would not have been a subject of value at the time of settlement, and the release of such a possibility would not in my judgment answer and satisfy the words 'valuable consideration in money's worth'.

#### D *Forgiveness of Payments as Benefit*

The suggested test of whether the benefit is capable of valuation, rather than whether it can be turned into money, is more helpful where the benefit involves no payment. Such a benefit occurred in *The Motorcycle Specialists Ltd v The Attorney-General*.<sup>60</sup>

#### I *The Motorcycle Specialists Ltd*

The Motorcycle Specialists Ltd, the plaintiff, was a motor dealer that offered its customers a hire purchase agreement whereby the plaintiff agreed to forego up to six of the monthly hire purchase payments, if the purchaser became disabled or unemployed through redundancy. The plaintiff had not paid a deposit pursuant to the Deposits Act. It contended that it was not obliged to do so, and sought a declaration as to whether the hire purchase agreement constituted a contract of insurance.

Davison CJ reviewed the definitions of contracts of insurance found in *Prudential* and *St Christopher Motorists' Association*. His Honour took particular note<sup>61</sup> of the statement in *Halsbury* that insurance postulates that a sum of money will be paid by the insurers. This, his Honour noted, overlooked the references in *Prudential* and *St Christopher Motorists' Association* to "some corresponding benefit". However, he said, *Chitty on Contracts*<sup>62</sup> had included reference to such benefit in its definition. Davison CJ included<sup>63</sup> "some corresponding benefit" in his own formulation of the definition.

His Honour then considered contracts when no money or some corresponding benefit is paid. In his view, the *Medical Defence Union* case concerned such a contract. He quoted Megarry VC's description<sup>64</sup> of the three requirements of an insurance contract, and agreed with that judge's opinion that "some benefit" was too wide an extension of

59 33 LJ Ch 1, 4.

60 (1988) 2 NZBLC 103,358.

61 Above n 60, at 103,360.

62 *Chitty on Contracts* (25 ed) para 3661.

63 Above n 60, at 103,360.

64 *Medical Defence Union Ltd v Department of Trade* [1979] 2 WLR 686, 690; [1979] 2 All ER 421, 424.



the usual element of payment of money. He gave no reason for that view, apart from quoting the reasons of Megarry VC, who himself had not provided satisfactory reasons. His Lordship had said<sup>65</sup> that money or money's worth seemed adequate for all normal circumstances; that the authorities did not support going beyond that;<sup>66</sup> that "benefit" is far too wide an expression;<sup>67</sup> and that the business of the union was too far removed from the business generally accepted as insurance business.<sup>68</sup> These are little more than ex cathedra pronouncements, echoing earlier judges like Templeman J in *St Christopher Motorists' Association*,<sup>69</sup> who said that the case before him came very near what "without any guidance, I would have thought was the essence of insurance". The purported knowledge of "normal" or "traditional" concepts of insurance is contradicted by the warnings given by the same judges who claim the knowledge, such as the warning of Megarry VC<sup>70</sup> that the definition of a contract of insurance is "plainly a matter of considerable difficulty".

## 2 *Ratio decidendi* of *Motorcycle Specialists*

Davison CJ, like Megarry VC, said<sup>71</sup> that he did not have to decide whether the "something" that the hirer was entitled to under the contract must be money or money's worth. His Honour then gave three paragraphs of reasons leading to the conclusion that the contract was not a contract of insurance. Since those paragraphs appear to contain the ratio decidendi of the case, some analysis of them is necessary .

In the first of the three paragraphs, the judge records the submission of counsel for the plaintiff that the contract to forego monthly instalments did not require the plaintiff to pay out anything. In the second paragraph, his Honour gives the opinion that it is the absence of a payment that distinguishes the case from the *St Christopher* case. The implied reason is that the motorists' association had an obligation to make payments, albeit to a third party, whereas the *Motorcycle Specialists* plaintiff did not. The judge then says that the *Motorcycle Specialists* case is more akin to the *Medical Defence Union* case. His Honour's reasoning is again not explicit, but appears to be that there was no entitlement to payment in *Medical Defence Union*, whereas there was an obligation to forgive payments in *Motorcycle Specialists*. So these two paragraphs focus on the word "payment" in the *Prudential* definition.

In the third paragraph Davison CJ recognises that it might be argued that a hirer under the plaintiff's hire purchase agreement, although not receiving any money, is still receiving money's worth by reason of the plaintiff foregoing the instalments. The argument is a good one because, based on the discussion earlier in this paper of the meaning of money's worth, the foregone payments are the equivalent of money; and

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65 [1979] 2 WLR 686, 696.

66 Above n 64, 696.

67 Above n 64, 698.

68 Above n 64, 698.

69 [1974] 1 WLR 99, 103.

70 Above n 64, 695.

71 Above n 60, 103,362.

they are not only capable of being valued in money, they are actually expressed in money terms. The forgiveness may be seen in effect as a shortcut for the true transaction, a payment to the hirer by the plaintiff, followed by a return of the money to the plaintiff in the form of the normal monthly payments; that is, the plaintiff pays the hirer's instalments to itself on behalf of the hirer.

Nevertheless, the Chief Justice dismisses<sup>72</sup> the argument that the forgiveness is money's worth with the comment, "... once one has the case where the suggested insurer is a vendor of goods who, as a term of his contract of sale, agrees in return for a consideration to forego payment of part of the price on the occurrence of a certain event, then one has a contract which is becoming far removed from the traditional concept of a contract of insurance". The case postulated is very similar to the facts of *Motorcycle Specialists*, the only difference being that the payments foregone by the plaintiff in *Motorcycle Specialists* may include, as well as part of the purchase price, interest and other charges. His Honour does not explain in what respects the case is removed from traditional concepts, or what those traditional concepts might be. The statement that the contract is far removed from the traditional concept of insurance is another *ex cathedra* pronouncement.

Thus the ratio decidendi of the *Motorcycle Specialists* decision is that the contract is not an insurance contract because the first essential of the common law definition, that a payment be made or some corresponding benefit in money's worth be given, is not met. The reason is that nothing is to be paid by the insurer, and in any event the forgiveness of instalments is not money's worth. The ratio can be criticised on two grounds, first that the forgiveness is in fact money's worth, as argued above, and secondly that where entitlement is to a benefit in money's worth, there is no requirement that the benefit be actually paid.

### 3 *Subsidiary grounds for decision in Motorcycle Specialists*

Davison CJ gave some subsidiary grounds for his decision which are obiter dicta. First, he said that the hire purchase agreement was not "primarily or essentially" a contract of insurance, because the forgiveness of payments was only a small, optional, part of it. However his Honour does not appear to have regarded this fact as conclusive, as he went on to say that if he had found that the clause itself created an insurance provision, he would then have had to decide the difficult question whether or not the hire purchase agreement then created an insurance contract.

The Chief Justice then shifted to the question whether, if the clause did create an insurance contract, the plaintiff would be carrying on insurance business. It might have been thought that entering into insurance contracts would be *prima facie* evidence of carrying on an insurance business. Davison CJ admits the possibility that a company could carry on more than one business; but concludes that the plaintiff was not doing so. His Honour's reasons<sup>73</sup> were, first, that the Act applied only to those whose

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72 Above n 60, 103,362.

73 Above n 60, at 103,362 - 103,363.



principal business is insurance, second that the plaintiff's scheme was optional for the hirer, third that the service offered was a waiver which was an inherent part of the hire agreement, and fourth that there was no need under the Act to provide security for policyholders in a situation where no payments were to be made.

The first reason is not supported by the Deposits Act. The Act does not say that it applies only to businesses that are the company's principal business. Such a limitation would leave a large loophole in the Act's coverage and remove protection for many policyholders.

The second reason, optionality, is belied by counsel's submission, accepted by the court, that "the client may choose to effect insurance elsewhere". This implies that the plaintiff is providing a service at least equivalent to insurance.

The third reason, waiver as an inherent part of the agreement, appears to conflict with the previous submission that the client may choose whether the clause applies. It is difficult to see how the clause could be at once both inherent and optional. The waiver submission is unclear. No reason is given why the waiver of payments should be seen as an inherent part of the agreement merely through being in the form of a waiver. Nor is a reason given why inherence is significant. Presumably the implied reason is that inherence implies normality for the waiver type of clause in hire purchase agreements, which in turn implies that the contract is a business contract not an insurance contract. However, the correct test for an insurance contract is not normality; it is whether the contract is for the payment of money or for provision of some corresponding benefit on the happening of an uncertain event.

His Honour's fourth reason may have more substance than the other three. In his view<sup>74</sup> the purpose of the Deposits Act is to provide security for policyholders who may have claims against an insurer, as section 12(1) indicates. That section directs the Public Trustee to hold deposits as security for policyholders or claimants. In respect of the forgiveness of instalment payments clause, his Honour says, the plaintiff is not required to pay any moneys at all. Therefore, a deposit would provide no security to the hirer, so there is no need for a deposit.

This is an attractive argument; it would be pointless to require security for non-existent payments. But there are some possible counter-arguments. First, the Act expressly requires all companies carrying on the relevant classes of insurance business to pay the deposit to the Public Trustee. An apparent conflict with the policy of the Act is not sufficient reason to override its clear requirements. Secondly, the Act may contain other policies as well as that discovered by Davison CJ; for example, the deposit obligation may encourage companies to treat the insurance business seriously, as befits contracts of utmost good faith. Also, perhaps there is an intended side-effect of the Act, that of discouraging companies that are not very sound financially from entering the insurance business. Thirdly, the forgiveness of payments could reduce the financial pool available to other claimants on a liquidation. Unsecured creditors could be prejudiced by

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74 Above n 60, at 103,363.

the foregivenesses due, which prejudice would be alleviated by a policyholders' trust fund.

*E Is Amendment Necessary?*

The meaning of "carrying on insurance business," and the concept of insurance, are hazy at the fringe, and this fact needs to be acknowledged. No definition will be entirely satisfactory. The amendments suggested here are only incremental improvements, at best.

The "money's worth" test of the benefit to be secured on the happening of some event is well established. Its precise meaning is not. Criticisms of the *Medical Defence Union* case, where the nature of the contractual obligation was to give due consideration to the exercise of a discretion, suggest that the Deposits Act ought to be amended to clarify the nature of the benefit that satisfies the test of an insurance contract. The amendment could establish that "money's worth" includes a likely financial advantage, capable of valuation in money.

Whether "money's worth" ought to include a forgiveness of debt, so as to cover the *Motorcycle Specialists* type of case, is more problematic. Davison CJ's conclusion that forgiveness is not money's worth is open to criticism. But assuming his Honour was wrong on this point, there remains his substantial argument that there is no need for a deposit because there are no payments to be secured. The writer suggested three counter-arguments, namely the express wording of the Act, policies implicit in the Act other than provision of security for policyholders, and prejudice to unsecured creditors. Acceptance of one or more of these counter-arguments would mean that businesses like *Motorcycle Specialists* would have to deposit \$500,000 with the Public Trustee. This would be a disincentive to business that in the writer's opinion outweighs any potential danger to policyholders or legislative policy. The suggested amendment to the Act defining "money's worth" should therefore explicitly exclude forgiveness of debt.

### III REGULATORY SCHEMES

*A Objectives of Regulation*

An Ohio judge has said<sup>75</sup> that laws regulating and supervising those engaged in the business of insurance were enacted chiefly in the interests of the people to make it as certain as possible that the fund created by their contributions would be held, managed and disbursed in a prudent and proper manner. Protection against insolvency is usually the main objective of insurance regulation. Davison CJ said in *The Motorcycle Specialists Ltd v The Attorney-General*<sup>76</sup> that it was the object of the Deposits Act.

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<sup>75</sup> *State ex rel Herbert, AG v Standard Oil Co* (1941) 35 NE 2d 437 (Zimmerman J).

<sup>76</sup> Above n 60.



However solvency need not be the sole objective of regulation. Professor S L Kimball lists<sup>77</sup> a number of objectives that may conflict with the primary objective. They are: equity, for example ensuring reasonableness of premiums and equitable treatment of policyholders; fairness to policyholders; and social goals. Social goals may be political, for example about democracy, liberty and protectionism; economic, for example about socialisation of risk, freedom of enterprise, and capital accumulation; or moral, for example about reduction of gambling, risk control, loss prevention, and avoidance of corruption.

Hellner considers the case where a seller in an instalment sale undertakes to release the debtor if he dies before the debt is paid.<sup>78</sup> He notes that the debtor does not risk suffering an unexpected loss by reason of the fact that the seller cannot fulfil the insurance part of the promise, but says that if an object of regulation is to ensure that premiums are not excessive, then regulating such contracts may be justified. Otherwise it is outside the scope of insurance law. It will be seen that according to this view the result of the *The Motorcycle Specialists* case would depend on the object of the legislation. There is nothing in the Deposits Act to indicate the intention to regulate prices, so on this view the case would fall outside the scope of the Act. This accords with Davison CJ's view, but still conflicts with the common law definition of insurance as including payments in money's worth.

The Brash report identified opportunity for fraud as a significant reason for regulation. It said:<sup>79</sup>

[I]nsurance offers particular attraction to crooks and fraudsters. Entry costs are low, and by the use of a glamorous name and glossy promotional material, silver tongued salesfolk can persuade otherwise sensible citizens to part with premiums. The international trade journals month after month report the activities of individual fraudsters who flit from state to state setting up scam after scam.

Julius Vogel, if he were able to read this, would not be surprised.

## *B Methods of Regulation*

Methods of regulating insurance business include deposit requirements, minimum capital maintenance requirements, authorisation and licencing systems, rating systems, requirements to publish information such as financial statements, and solvency test rules.

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77 S L Kimball, "The Purpose of Insurance Regulation" (1960-61) 45 *Minnesota Law Review* 471. See also J Hellner, "The Scope of Insurance Regulation: What is Insurance for Purposes of Regulation?" (1963) 12 *AmJCL* 494.

78 Hellner, above, n 77, pp 507 and 541-542.

79 Brash Report, above n 2, 5.

## 1 *Deposit requirements*

The Brash report writers said<sup>80</sup> that the "requirement to deposit \$500,000 with the Public Trustee is ... significantly too small to provide much comfort to anybody except a liquidator (and in any case applies to little more than 60% of insurers)". The writers had information that the failure rate of new entrants to the industry is not high, but that large insurers still do become financially distressed. An example is MMI in the United Kingdom, the major insurer of local government property. The report went on to say that:<sup>81</sup>

Statutory deposits with the Public Trustee also serve little purpose apart from raising the cost of entry, and provide false comfort. The level of these deposits can never be such as to provide adequate security against claims arising from disasters. The abolition of the statutory deposit scheme would, however, result in the taxpayer being more likely to have to meet the residual cost of liquidation, as is the case with other companies.

We nevertheless recommend that deposits with the Public Trustee no longer be required.

A deposit of \$500,000 is small compared with the amount of liabilities of a typical established insurance company. However, this inadequacy does not necessarily imply that deposit requirements should be removed altogether. In fact the deposits can provide at least some protection for policyholders.<sup>82</sup>

Brash's information that the failure rate of new entrants is not high is presumably derived from recent statistics, which would cover only companies which had entered the industry through being able to pay the current level of deposit. If new entrants did not have to have the wherewithal to pay the \$500,000, then failure rates may be much higher.

It is unclear what the Brash report meant by its comment that abolition of deposits would result in taxpayers meeting the residual cost of liquidation. The deposit fund is held on trust for policyholders and is not available for liquidation costs. If the deposit funds were not held on trust they would be potentially available for distribution by the liquidator, thus reducing demands on the taxpayer.

A deposit system has the advantage of being comparatively cheap to administer; the commissions paid to the Public Trustee are quite small. There is also the advantage of exclusion from the industry of companies without substantial assets.

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80 Brash Report, above n 2, 7.

81 Brash Report, above n 2, 17.

82 In *Re ACL Insurance Ltd (in liq)* [1989-1992] BCLD 849, the High Court remarked on the inadequacy of the deposit amount and suggested its increase by the legislature.



2 *Capital maintenance rules*

The Brash report writers thought that the present minimum capital requirement of \$100,000 is clearly totally inadequate for all but the smallest operations.<sup>83</sup> Assessment by a rating agency was seen to be a preferable system.

3 *Authorisation requirements*

The Insurance Companies Act 1982 (UK) prohibits the carrying on of insurance business without authorisation. As a corollary, the Policyholders Protection Act 1975 (UK) indemnifies policyholders prejudiced by the inability of authorised insurance companies to meet their liabilities, in effect a government guarantee that authorised companies will remain solvent. This should counteract to some extent the reluctance to cancel an authorisation, because the authority has to pay for its mistakes. The policyholders' protection scheme has its own disadvantages though, such as the tendency to encourage fraud and inefficiency. Authorisation schemes rely heavily on Government and would be unlikely to gain acceptance in New Zealand.

4 *Rating systems*

The Brash report recommended a rating system because it would reduce the role of Government in insurance, would reduce the "moral commitment" of Government to compensate the policyholders of failed insurers, and would provide much better information to consumers. Flight by policyholders from poor performers would put pressure on directors to raise more capital or go into liquidation. Private enterprise would be more flexible, for example able to pay high salaries for expert analysts without being bound by Public Service conditions, and would have more incentive to perform. Financial strength requirements would be a more successful barrier to entry to the industry than authorisation and deposit requirements. The system requires no special provisions for an insurer to exit the industry, other than those applicable to all companies under the Companies Act, the report said.<sup>84</sup>

It remains to be seen just how reliable and effective the ratings and inspections system will be. For example, the question of the rating agent's liability to the policyholder for negligence has yet to be addressed.

5 *Publishing requirements*

The requirement to lodge annual accounts with the Department of Justice is entirely appropriate, the Brash report said,<sup>85</sup> but the current obligation, which requires accounts to be filed within nine months of the end of the company's financial year,<sup>86</sup> provides information which may be of no use by the time it is received.

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83 Companies Act 1955, Part XIII.  
84 Brash Report, above n 2, 19-20.  
85 At p 7.  
86 Section 16(6) Deposits Act.

The Financial Reporting Act 1993 requires company directors to ensure that financial statements are prepared within five months of balance date.<sup>87</sup> The Companies Act 1993 requires these statements to be sent to shareholders.<sup>88</sup> There is no requirement in either the Companies Act 1993 or the Deposits Act to send statements to policyholders. However, the importance of publication of financial statements should decrease with the requirement to undergo rating, with its attendant scrutiny by financial analysts.

## 6 *Solvency rules*

Pursuant to the Companies Act 1993, distributions to shareholders may not be made unless the solvency test in section 4 is satisfied.<sup>89</sup> That test has two parts: the company must be able to pay its debts as they fall due, and the value of its assets after the distribution must be greater than the value of its liabilities including contingent liabilities. In determining the value of a contingent liability for the purposes of the section, account may be taken of the likelihood of the contingency occurring and of any reduction or extinguishment reasonably expected from claims the company is entitled to make.<sup>90</sup> As R Dugan says, "In view of the prospect of personal liability for a wrongful distribution, a cautious director will be tempted to value the contingent liability at the same amount as the underlying obligation".<sup>91</sup> Professionals advising the directors will want to limit their own liability exposure for inaccurate advice and will thus be reluctant to set a figure on the liability.

Insurance companies have a greater proportion of contingent liabilities than other companies. The face value of a policy of insurance is theoretically a contingent liability, but it would be unreasonable to expect the full value of all policies issued by a company to be included in the accounts as contingent liabilities. The company would appear to be insolvent when in reality only a proportion of its policies will ever need to be paid out. Insurance companies must tread the fine line between conservatism, leading to overestimation of liabilities, and optimism, leading to the appearance of greater solvency.

### C *Retention of Deposits Act Desirable*

Policy on insurance regulation has been steadily diverging between New Zealand and Britain. A cross-national study published in 1986 discerned a world wide trend towards less strict regulation, that is, deregulation, except in Great Britain.<sup>92</sup> Raynes' 1948 history of British insurance says that in the preceding fifty years, the activities of the

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87 Section 10.

88 Sections 209(1), 210(1)(a) and 211(1)(b).

89 Section 52.

90 Section 4(4).

91 *Company Law, A transactional approach* (Wellington, Butterworths, 1994) 140.

92 Finsinger and Pauly *The Economics of Insurance Regulation* (St Martin's Press, New York, 1986) 6.



State had generally taken on a "more positive aspect"<sup>93</sup> than would have been thought right or proper in the individualistic Victorian period. The level of intervention has, if anything, increased in Britain since 1948. Meanwhile New Zealand has adopted the policy reflected in the Ratings Act of leaving regulation to the market as much as possible.

This policy divergence is reason to question the retention by New Zealand of a legislative instrument (the Deposits Act) that developed in 19th century England. However, there are good reasons for its retention, though preferably in amended form. The Deposits Act is one facet only of the changing matrix of rules used to regulate insurance, and the arrival of new forms of regulation such as ratings does not negate the benefit derived from the deposit system. The presence of uncertainties in the ratings system indicates prudence is required with respect to the future of the Deposits Act.

#### IV CONSEQUENCES OF BREACH OF THE ACT

##### A *Illegality of Contracts*

##### 1 *New Zealand law: the Act*

The Deposits Act mandates that deposits be made by certain companies carrying on insurance business.<sup>94</sup> There are pecuniary penalties for non-compliance.<sup>95</sup> Negotiation of insurance contracts by an agent of an insurer who has not made the required deposit is prohibited.<sup>96</sup> Section 21 provides that a default in compliance with the Act that continues for more than three months may result in a notice in the *Gazette* prohibiting the person from carrying on insurance business. Further pecuniary penalties apply where a person carries on insurance business after being prohibited in accordance with section 21. The Act makes no provision for the effect of a breach of the Act on insurance contracts.

New Zealand courts have not yet had to consider the effect on an insurance contract of non-compliance with the Act by the insurer. The issue has arisen in Australian and English cases, though the statutes in question were not identical to the Deposits Act. Further, courts in the two countries have taken different approaches to the issue. Nevertheless, guidance as to the correct approach in New Zealand can be obtained from judicial statements made in the leading English and Australian cases. The provisions of the Illegal Contracts Act 1970 that empower the courts to give discretionary relief against illegality, unique to the New Zealand jurisdiction, reduce the importance of the common law.

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93 H E Raynes *A History of British Insurance* (Pitman, London, 1948, revised 1950) 366.

94 Sections 3 and 4.

95 Section 20.

96 Section 20A.

2 *English law*

In *Phoenix General Insurance Company of Greece S.A. v Administratia Asigurarilor de Stat*<sup>97</sup> the Court of Appeal allowed an appeal from a decision made under the Insurance Companies Act 1974 (UK). The 1974 Act prohibited the carrying on of classes of insurance business without authorisation.<sup>98</sup> The plaintiff is referred to as "Phoenix" and the defendant as "Adas". Phoenix sought payment under a reinsurance contract with Adas. Adas submitted that Phoenix had not been authorised to write the reinsurance business comprised in the primary contracts of insurance and therefore those contracts were illegal and void.

The Court of Appeal held that Phoenix had been authorised to write the business. The court's comments on the illegality issue were therefore obiter. The court proceeded to discuss the illegality issue because it recognised its importance to the commercial community, particularly in view of the conflicting decisions of the High Court in *Bedford Insurance Co Ltd v Instituto de Resseguros do Brasil*<sup>99</sup> and *Stewart v Oriental Fire and Marine Insurance Co Ltd*.<sup>100</sup>

Delivering the judgment of the Court of Appeal, Kerr LJ discussed the authorities on illegality. He said<sup>101</sup> it was settled law that any contract which is prohibited by statute is illegal and void. Prohibition can be either express or implied. His Lordship thought there was great force in the arguments of counsel for *Phoenix* that a number of authorities had emphasised the importance of considering the mischief at which the statutory prohibition is directed. For instance, Pearce LJ said in *Vita Food Products Inc v Unus Shipping Co Ltd* that where one party is ignorant of the illegality it would be unsatisfactory to have to hold that the contract is necessarily void. To do so would "injure the innocent, benefit the guilty, and put a premium on deceit".<sup>102</sup> Kerr LJ said:<sup>103</sup>

[O]ne merely has to contrast money-lending contracts with a contract of insurance to see why it is good public policy to refuse to enforce the former but bad policy in the case of the latter. In both cases the legislation is designed to protect the customer, but the protection which he requires is wholly different. In cases of money-lending the contract leaves virtually every subsequent obligation to be performed by the borrower, whereas in contracts of insurance the position is precisely the opposite. Once the contract has been made and the premium paid, every relevant obligation is imposed on the insurer. ... To treat the contracts as prohibited would of course prevent the insured from claiming under the contract and would merely leave him with the doubtful remedy of seeking to recover his premium as money had and received.

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97 [1987] 2 All ER 152; (1988) 5 ANZ Insurance Cases ¶60-837.

98 Insurance Companies Act 1974 (UK), ss 2(1) and 11(1).

99 [1984] 3 All ER 766; (1985) 3 ANZ Insurance Cases ¶60-608.

100 [1984] 3 All ER 777; (1985) 3 ANZ Insurance Cases ¶60-809.

101 (1988) 5 ANZ Insurance Cases 75,234.

102 [1939] AC 277, 293.

103 (1988) 5 ANZ Insurance Cases 75,238.



In his Lordship's view *Phoenix* would be readily distinguishable from the earlier cases in which statutes were found to have prohibited a contract if the 1974 Act permitted resort to considerations of public policy. If both parties are prohibited from concluding or performing a contract the contract itself is impliedly prohibited. Whether a statute containing a unilateral prohibition only impliedly prohibits the contract itself depends on considerations of public policy.

However, the unilateral prohibition on unauthorised insurers in the Insurance Companies Act 1974 (UK) did not merely prohibit them from carrying on the business of effecting contracts of insurance, but went further and prohibited the business of "carrying out" contracts of insurance. The 1974 Act prohibited the carrying on of classes of insurance business without authorisation, but the definitions of classes of insurance to which the Act applied referred to "the business of effecting *and carrying out* contracts of insurance," not just carrying on insurance business. The Court of Appeal found that this feature distinguished *Phoenix* on its facts from other cases. Kerr LJ concluded that this extension of the prohibition implied that contracts made without authorisation are prohibited and therefore void, regardless of the fact that the prohibition is unilateral only.

With respect, it is difficult to see any real difference in principle between "effecting" a contract and "carrying out" a contract. There is little point in effecting a contract unless it is going to be carried out. His Lordship was of the opinion that a court could not enforce a contract against an unauthorised insurer when Parliament has expressly prohibited him from carrying it out. This argument ignores the fact, acknowledged by his Lordship, that Parliament has made only a unilateral prohibition. Parliament cannot have had the intention of penalising the innocent party.

The effect of *Phoenix* was negated by the Financial Services Act 1986 (UK), section 132, which permits enforcement of a contract made by an unlicensed insurer. The *Phoenix* problem does not arise in New Zealand as the New Zealand legislation is quite different. The Deposits Act refers to the carrying on of insurance business, but does not mention "effecting and carrying out" insurance contracts.

### 3 *Australian law*

*Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd*<sup>104</sup> is the leading Australian decision. The High Court of Australia had to construe a section of the Banking Act 1959 (Cth), which provided that a body corporate "shall not carry on any banking business" without authorisation. The respondent bank had lent a sum of money to the appellants. Default having been made in repayment, the bank sued the appellants. The appellants pleaded that the mortgage was rendered illegal and void by the Banking Act, since the bank was carrying out banking business without authorisation. The Banking Act made no reference to contracts entered into in the course of carrying out the business of banking, and so the issue was whether the statute impliedly prohibited the loan contract.

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104 (1978) 139 CLR 410.

Mason J, with whom Aickin J agreed, said<sup>105</sup> that the question was whether the statute intended merely to penalise the person who contravenes the prohibition or whether it intended to go further and prohibit contracts the making of which constitute the carrying on of the business. Banking business covered a wide range of types of contract and a mortgage loan contract was not necessarily distinctive of the business. Mason J thought that the object of the statute was not only to protect depositors but also to aid the Government in regulating the economy. Prohibiting contracts made with unauthorised banks would prejudice depositors not protect them, and it was not rational to suppose that Parliament intended to advantage the wrongdoers and penalise the innocent. He concluded<sup>106</sup> that the purpose of the Act was adequately served by the prescribed penalty, and that it did not prohibit transactions entered into in the course of carrying on banking business.

Gibbs ACJ also held that the loan contract was not prohibited. He said<sup>107</sup> that the language of the statute was directed, not at the making or performance of particular contracts, but at the carrying on of any banking business. A test restricting the class of invalidated contracts to those central to the business of banking would be vague and unsatisfactory, he said.

## *B Consequences of Illegality*

### *1 Construing the Act*

Contracts made by an insurer in breach of the Deposits Act are of two types:

- (i) those made while the deposit requirements are unmet, and
- (ii) those made while the company is expressly prohibited from carrying on business under section 21.

For each type, it is a question of construction of the Act whether the insurance contracts made by the defaulting insurer are impliedly prohibited and illegal. The overriding inquiry is as to the intention of the legislature. The language used, the scope and purpose of the statute, and other relevant considerations are to be examined to determine whether the contract is prohibited. *Phoenix* is authority for holding that a contract is illegal if the language of the Act prohibits performance not just formation. But if the prohibition is simply against the carrying on of the business, then *Yango* suggests that the making or performance of particular contracts is not the object of the prohibition.

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105 (1978) 139 CLR 410, 426.

106 Above n 104, 427.

107 Above n 104, 415.



2 *Failure to make required deposit.*

It is unlikely that the legislature intended to impliedly prohibit the first type of contract, a contract made by an insurer in default of section 3. Here there is no express prohibition. The Act simply says that deposits shall be made by certain companies. The language of the Deposits Act is different from that of the Insurance Companies Act 1974 (UK) and the Banking Act 1959 (Cth), among others. The last mentioned Acts expressly prohibit the carrying on of business, but section 3 of the Deposits Act does not. The language of section 3 may be contrasted with that of section 21.

Carrying on insurance business is expressly prohibited by section 21, which reads in part:

**21 Prohibition against carrying on business** - (1) If any person makes default in complying with any of the requirements of this Act, and such default continues for a period of 3 months, the Minister of Justice may by notice published in the *Gazette* prohibit that person from carrying on insurance business or any class of insurance business in New Zealand, either absolutely or for such time as he declares.

An implication is that unless a prohibition notice is published, the carrying on of business is not prohibited. This in turn implies that performance of contracts by an insurer who is in default of section 3 of the Act would not be illegal.

3 *Prohibition on carrying on insurance business.*

The problem is whether there is a further implication in section 21, that an insurer duly prohibited by *Gazette* notice enters into and performs contracts illegally. Kelly and Ball's view<sup>108</sup> is that the carrying on of insurance business necessarily involves both making and performing contracts. In that sense, prohibiting the carrying on of business can be said to expressly prohibit the performance of contracts entered into in the course of carrying on the business. However, this view conflicts with the decision in *Yango*, that is, carrying on insurance business does not necessarily include the carrying out of insurance contracts.

If section 21 implies prohibition, it is at most unilateral. Therefore the court must, following Kerr LJ's statement in *Phoenix*, consider whether the contract itself is impliedly prohibited. This depends upon considerations of public policy.

C *Relief against Illegality*

If the contract is illegal, section 6 of the Illegal Contracts Act 1970 provides that it shall have no effect, subject to the provisions of the Act.

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108 D St L Kelly & M L Ball *Principles of Insurance Law in Australia and New Zealand* (Butterworths, Sydney & Wellington, 1991) ¶13.138.

The grant of relief under section 7 of the Illegal Contracts Act 1970 is at the discretion of the court. The court must have regard to the conduct of the parties, the object of the enactment, the gravity of the penalty provided for breach thereof, and such other matters as it thinks proper.<sup>109</sup> The Act requires that the court shall not grant relief if it considers that to do so would not be in the public interest. Given what has been said by many judges about the hardship on the innocent party to an insurance contract, it will always be in the public interest to validate such contracts.

In exercising its discretion, the court will consider the object of the Act, that is, protection of policyholders. In *Harding v Coburn*<sup>110</sup> Cooke J said that in practice validation of an illegal contract "might well be out of the question if it would produce a result contrary to another enactment. It is no part of the purposes of the Illegal Contracts Act to undermine the social or economic policies of other measures". It is unlikely that validation of an illegal insurance contract would undermine the policy of the Deposits Act. Validation will allow the insured to recover under the policy, which is precisely the aim of the Act. Thus there will be a strong prima facie case for relief in most instances.

## V CONCLUSION

The Deposits Act is no longer fully appropriate for regulation of modern insurance business. The distinction between Commonwealth and other foreign companies is anachronistic and must be amended. The deposits required are too small to significantly protect consumers, though they do provide some protection. Amounts should be increased, but it must be recognised that increasing deposits raises the barrier to entry to the industry.

The matrix of rules regulating insurance companies is changing, but the deposit requirements have still a minor role to play. It is a part of the overall mix of regulation, alongside the Ratings Act, Companies Act 1993 (solvency test), Financial Reporting Act 1993 (publication of financial information), and Companies Act 1955 (minimum capital rules). On balance there is probably more to be gained by retaining the Deposits Act than repealing it.

Should the Act not be repealed, a definition of "carrying on insurance business" should be included in it. This would define the benefit to be received on the happening of an uncertain event as "money or money's worth," that is something capable of valuation, and at least likely to provide financial advantage, but excluding forgiveness of debt.

Clarification of the effect of breach of the Act on the enforceability of contracts is desirable. Since relief under the Illegal Contracts Act 1970 will normally be available to the insured as the innocent party to the breach of the Deposits Act, it might be better to

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<sup>109</sup> Section 7(3).

<sup>110</sup> [1976] 2 NZLR 577 (CA), at p 584. Approved in *Ross v Henderson* [1977] 2 NZLR 458, 465 (PC); applied in *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA).



simply amend the Act to state that a breach has no effect on enforceability of insurance contracts. Thus the status of contracts made would be clear and litigation under the Illegal Contracts Act for the grant of a discretionary remedy would be unnecessary.

Given the similar deposit regime in the Life Insurance Act 1908, any review of the Insurance Companies' Deposits Act 1953 might more usefully cover both Acts.