

Consumer protection insurance in New Zealand: An examination of law and practice

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A glance at a random sample of consumer credit agreements (hire purchase agreements or instruments by way of security) will show that a high proportion of them contain a payment for some sort of payment protection. What is also clear to anyone working in the field of consumer advice or protection is that there are numerous varieties of this type of agreement and that the lack of regulation in this field has meant that a wide variety of practices are used to secure payment for repayment protection. The author examines and analyses the various methods by which the consumer's repayments on a credit agreement are ostensibly protected in the event of some unforeseen event occurring that affects the ability to repay.

I INTRODUCTION

The use of consumer credit is increasing in New Zealand. For consumers (especially consumers who are not good credit risks) the use of insurance to protect not just the goods but the repayments as well is becoming an established way of ensuring additional security for the creditor. The Crowther Report¹ which led to the Credit Act 1974 (UK) noted that the relationship between a consumer and the creditor is an occasional and intermittent one that is best protected by making "use of the technical device of insurance against illness and unemployment, the cost of which can be absorbed in the finance charge".

In the absence of any written material outlining the various mechanisms by which consumers' repayment might be protected, it is essential to begin by defining what the agreement, commonly called consumer protection insurance, is.

A *Protecting Repayments*

There are many ways that consumers can protect their earning capacity to ensure that their financial obligations are met in the event of their earning capacity being lost or lessened. This paper will not examine policies of insurance where a consumer independently contracts with an insurance company for protection - for example, income insurance or trauma insurance.

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¹ Consumer Credit - Report of the Committee (1971) Cmnd 4596.

The types of agreement that will be considered here are always an integral part of a credit transaction and form part of the amount financed or the total cost of credit. They are sold to consumers by creditors either by way of an underwritten insurance policy or by the creditors themselves providing the protection. The present analysis will be limited to credit agreements such as hire purchase agreements or instruments by way of security (cash loans). Property mortgages and property mortgage repayment insurance will not be examined. The agreements into which consumers enter as part of their credit agreement will be referred to as consumer repayment protection agreements.² In analysing these agreements in relation to insurance law it is necessary to outline the three different mechanisms³ by which the protection is allegedly secured:

- 1) The creditor sells to the consumer an insurance policy which is underwritten by an insurance company. The consumer, on entering the credit agreement, pays an identifiable premium for protection over their repayments. This protection is usually for loss of earnings through death, disablement, sickness or redundancy.
- 2) The creditor offers the consumer repayment protection by way of agreement to alter the terms and conditions of the agreement should any of the specified events occur which affect the consumer's ability to make their repayments.⁴ Alternatively, where the finance agreement is assigned to another party, the agreement may provide that the creditor may make the payments him/herself, should the specified event occur.
- 3) The creditor takes an amount of money from the consumer which is entered onto the financial agreement as some sort of repayment protection but offers no policy or terms to the agreement. Sometimes the consumer is told that it is for protection of the repayments although the creditor takes no other action to ensure this protection, but simply takes the money.

For many consumers, insurance over their credit repayments makes the paradisiacal world of credit attainable. Generally the cover given under such agreements purports to protect the consumer debtor against death, disablement, redundancy or illness or any

2 In practice, these agreements are variously called consumer credit insurance, consumer debt insurance, payment protection plan, consumer debt insurance.

3 Of these three types of insurance sales practices only types 1 and 2 have any merit as valid contracts and therefore require further analysis under insurance law principles. Type 3 contracts can be challenged on the basis that they are void for uncertainty, void for the misrepresentations made in selling them and so on. Despite the high percentage of consumer repayment protection agreements that fall within type 3, they are not worth analysing in terms of insurance law because they frequently lack any validity as legal agreements. Consumers will have better redress options if they attack such agreements at the Disputes Tribunal level on the grounds that the agreements are non-enforceable under general contract law.

4 See *The Motorcycle Specialists Ltd v The Attorney-General* (1988) 2 NZBLC 103 358, per Davison CJ.

combination of the above. Such agreements are often sold to the consumer by an intermediary acting as agent for the insurance company.⁵

B Problems in Practice

Despite a growing trend in consumer awareness and consumer protection, buyers of consumer repayment protection remain relatively uninformed about the product or their own need for the product. Five factors common to many consumer repayment protection contracts explain why consumers are particularly at risk in this sector of the credit market:⁶

- Consumers lack the ability to shop around for the product most suited to their needs. This is because creditors usually buy standard insurance policies in bulk from the underwriting insurer or, if there is no underwriter, creditors may not have the information on the contract available at point of sale.
- The premium is often simply part of the whole package being offered by the creditor.
- The consumer lacks the necessary resources to establish how the total cost is made up.
- There is no standardisation of such agreements in either the financial disclosure or in the policies themselves.
- There is a dearth of information on consumer repayment insurance in the marketplace and at point of sale.⁷

Unlike many consumer products there is little opportunity for the consumer to shop around for the best deal. Common features are relative ignorance about the product and a reliance on the creditor's word as to what is required when entering into a credit agreement.

Insurance companies generally prefer to market these policies through credit providers. Such policies are not available on the open market and are sold only as part of a credit agreement. Most insurance companies do not control the level of mark-up on

5 The Trade Practices Commission [TPC] in Australia conducted a study of consumer credit insurance [CCI] in Australia and found that 80% of CCI transactions are arranged by the provider of credit. The remaining 20% are made up of other types of retailers or finance brokers, a high proportion of which are motor vehicle dealers. From *The Market for Consumer Credit Insurance* (Trade Practices Commission, Canberra, June 1991) - [the TPC report].

6 These five factors correspond to the problems identified in the TPC report. See above n 5.

7 Note that the TPC study was concerned only with those situations where the consumer was sold an underwritten insurance policy.

the policies which means that consumers cannot find out the true cost of protecting the risk of their inability to repay the creditor.⁸

The following examples come from the Ministry of Consumer Affairs' files.⁹ The examples chosen represent the most common type of complaints.¹⁰

Cash loan agreement of \$4110.24 is charged \$340.80 "PPI" (payment protection insurance). No policy is issued.

Motor vehicle bought on hire purchase for \$7500. \$100 charged for "CPI" although the consumer is unaware of the charge or the concept. No policy is issued.

Consumer buys a motorcycle on hire purchase from a motor vehicle dealer. He is sold "CPI" as a non-negotiable element of his contract. He is told that it protects him if he loses his job although no policy is issued. He loses his job on account of colourblindness affecting his ability to pick fruit and is told he is ineligible for the insurance payout as he has a 'pre-existing condition' which was a prohibited term of the agreement. On further inquiry, it transpired that the seller was not taking out any insurance policies with the 'premium' paid.

A seasonal worker is sold "CPI" which he is told covers payments in the event of accident and disability. He is injured at work, pruning trees in a forest. His claim is rejected because there is a specific exclusion for people engaged in forestry work. The Disputes Tribunal rejects the consumer's claim on the grounds that the policy was valid as was the exclusion.

Consumer enters into agreement with a total payable balance of \$3177.83 over 2 years, at \$30.56 per week. The cost for insuring her repayments was \$205.00. The policy provided for 90 days cover if the consumer was made unemployed by redundancy. If the consumer was required to claim on the policy, the insurer/creditor would only be liable for around 12 weeks of payment (\$397.28) - not much more than the premium the consumer paid for the benefit.

8 *Ministry of Consumer Affairs A Discussion Paper: Consumers and Credit* (Ministry of Consumer Affairs, Wellington, 1988).

9 The Ministry of Consumer Affairs' Advice Service is a free service for assistance on consumer problems. It specifically targets low income, Maori and Pacific Island consumers with the understanding that they are the most vulnerable sector of the community in terms of both practices and access to redress.

10 The Advice Service receives on average 30,000 requests for assistance each year. Approximately 5% of these are credit complaints and most credit agreements include some charge for consumer repayment protection.

The premium costs of these agreements vary widely. The following table shows that the link between the amount borrowed and the premium is extremely tenuous.¹¹

AMOUNT BORROWED	REPAYMENT PROTECTION
\$2000	\$855
\$690	\$475
\$8200	\$720
\$1600	\$475
\$1300	\$600

Many consumers who are charged for repayment protection are in no position to bargain with the creditor, their main concern is that credit is granted to them. It is very common for consumers to be totally unaware that there are any terms or conditions to their policy. Some may be told that the insurance covers their payments if they lose their job, fall ill, etc. but an easy to understand policy is rarely issued.

C *Does Insurance Law Suit this Problem?*

In the New Zealand credit market consumer repayment protection agreements are troublesome. This paper considers whether it is suitable to regulate these agreements by the same rules and laws that apply to insurance contracts generally. Insurance law has been built up over many years by statute, common law and market self-regulation. Is it sufficiently wide-ranging to provide protection for consumer debtors in the sale of consumer credit insurance? If the law of insurance is applied to these agreements unchanged, will the problems be resolved?

II WHAT CONSTITUTES A CONTRACT OF INSURANCE?

A *Defining Insurance*

In *Prudential Insurance Co v Commissioner of Inland Revenue*,¹² Chanell J identified four elements of a contract that would render it a contract of insurance. He said that the contract must be one in which the insurer agrees to pay a sum of money or give a benefit in return for consideration (usually the premium) payable on the happening of an event. The event must have some uncertainty about whether or not it will occur and the person to whom the money will be paid must have some interest in the outcome of the event.¹³

¹¹ These figures are taken from a sample of instruments by way of security from the same creditor.

¹² [1904] 2 KB 658.

¹³ For the elements of an insurance contract readers should consult Kelly and Ball (Eds) *Principles of Insurance Law in Australia and New Zealand* (Butterworths, Sydney, 1991). See also *Medical Defence Union Ltd v Department of Trade* [1979] 2 All ER 421, and *Department of Trade and Industry v St Christopher Motorists' Association* [1974] 1 WLR 99.

Exactly what constitutes the business of insurance has never been satisfactorily defined in New Zealand.¹⁴

The Insurance Companies Deposits Act 1953 which requires that any person or company carrying on the business of insurance must deposit \$500,000 with the Public Trustee¹⁵ does not provide a useful definition of insurance but rather assumes a common application of the concept of insurance. As the Insurance Companies Deposits Act was established to afford some protection to insureds who were owed money by an insurer which disappeared or became insolvent, it is unlikely that it is useful to consumers who are harmed by the practices of creditors offering consumer protection insurance. The Act will be of some use to consumers who are owed money by an insurance company.¹⁶

B Contract of guarantee, warranty or insurance?

Many consumer transactions have elements similar to those outlined by Chanell J in the *Prudential Insurance* case. How can contracts that are contracts of insurance be distinguished from other contractual agreements such as guarantees or warranties which may be similar contracts to those of insurance? For example: a shop sells a consumer a computer and says that for an extra \$100 she can buy a guarantee which provides free repairs of the computer should it fail due to mechanical failure in the first twelve months.

If consumer repayment protection agreements are treated as insurance, it is important to differentiate between guarantees, warranties and insurance. However it is not a distinction that courts or commentators have found easy to make. In *Dane v The Mortgage Insurance Corporation Limited*¹⁷ the majority judgment of the Court of Appeal held that an agreement which made the defendant company liable for a set sum of

14 See *The Motorcycle Specialists Ltd* (above n 3) where Davison CJ ruled that a contract between a consumer and a motorcycle seller was not one of insurance where the seller agreed to forgo 6 payments to the credit contract if the buyer should lose his ability to earn through designated circumstances. Davison CJ reached this conclusion on the bases that

- no "money or moneys worth" was paid to the buyer if the event occurred, and
- the seller was not primarily in the business of selling insurance.

See also *Medical Defence Union Ltd v Department of Trade* [1979] 2 All ER 421 for discussion of the concept of "money or money's worth" as a central concept in defining insurance.

15 The business of insurance is defined as including all types of insurance except life and earthquake insurance -Insurance Company Deposits Act, s 2.

16 The Insurance Companies Ratings and Inspections Act 1995 is similarly unhelpful as a piece of consumer protection legislation as its main focus is to offer would be insureds a method of establishing the financial security of one insurer from another.

17 [1894] 1 QB 54.

money if the plaintiff's bank defaulted in releasing her funds on demand was a contract of insurance:¹⁸

It seems clear to me that the *intention* was that this contract should be one of insurance, and that those who entered into it with the plaintiff should be in a position of underwriters. An underwriter is not a surety. He is a person who undertakes to pay money in a certain event. The form of a policy is not that of a guarantee.

The dissenting judgment (Kay LJ) looks purely at the contractual intention and not at the form of the agreement at all:¹⁹ "It does not seem to me material to consider whether the contract sued upon is a contract of suretyship or a contract of insurance...".

The protection offered a consumer under consumer repayment protection agreements is limited under general rules of credit law. To benefit from insurance law, it is important to identify if these agreements are insurance, or merely some form of guarantee.

The lack of clear distinction between guarantees and insurance was made clear in the Court of Appeal in *Seaton v Heath*; *Seaton v Burnard* by Romer LJ:²⁰

...[T]he difference between these two classes [guarantee and insurance] does not depend upon any essential difference between the word "insurance" and the word "guarantee". There is no magic in the use of those words. The words, to a great extent, have the same meaning and effect.

However Romer LJ does go on to make some more concrete statements about contracts of insurance:²¹

Contracts of insurance are generally matters of speculation, where the person desiring to be insured has means of knowledge as to the risk, and the insurer has not...the same means. The insured generally puts the risk before the insurer as a business transaction, and the insurer, on the risk stated fixes a proper price to remunerate him for the risk to be undertaken; and the insurer engages to pay the loss incurred by the insured in the event of specified contingencies occurring.

This judgment was brought into modern usage in *Hallmark General Insurance Co Ltd v Commissioner of Stamp Duties*.²² In that case the contract between a financier and a debtor required the financier to pay a specified sum of money towards the debt in the event of disability or involuntary unemployment. Despite submissions that the agreement was a contract of guarantee, the Supreme Court held that it was a contract of insurance for two reasons. First, that the agreement was one in which the debtor had all the relevant knowledge about the risk and the financier had none, which resulted in the

18 Above n 17, 60, per Esher, MR; emphasis added.

19 Above n 17, 62.

20 [1899] 1 QB 782, 792.

21 Above n 20.

22 Unreported, 19 October 1988, Supreme Court, Tasmania.

duty of disclosure that is typical of insurance contracts. Second, the agreement appeared, in its terms, to be an insurance agreement:²³

...the risk is hedged about by many provisions which are typical of insurance policies, such as age limitations, notice requirements, reservation of rights to make enquiries, exclusions...and the like... In all matters of form and structure the contracts are typical of contracts of insurance, and I have no doubt that this is what they are.

Is this a satisfactory test for identifying contracts of insurance? That they *appear* to have similar characteristics to insurance?

Kelly and Ball identify the fact that distinguishing insurance from a guarantee is not always an easy task:²⁴ "... there is no magic touchstone...the distinction is one of degree. The basic question is whether the purpose of the contract is to transfer the risk of the loss to the insurer..." According to Kelly and Ball it is the aspect of transferring risk from the party who has knowledge of the risk's likelihood (the insured) to the party who has little knowledge of the risk occurring (the insurer) that gives rise to principles of insurance law such as utmost good faith and duties of disclosure.

In the example given above of the computer purchase, the risk associated with the happening of the event (the failure of the computer) *is* transferred to another party - the seller of the computer - and yet Kelly and Ball deny that these are contracts of insurance. In relation to a seller's warranty, Kelly and Ball say that the essential purpose of the contract is the sale of goods, not the passing of risk.²⁵ In subsuming the potential insurance element of this agreement into a wider, easily definable category, Kelly and Ball appear to have fallen into the same trap as Davison CJ in *The Motorcycle Specialists* when he held that the company was carrying out the business of selling motor vehicles, not the business of insurance.²⁶ What benefit is there in limiting the scope of the law to one sector of the agreement? Is it not possible to have an element of insurance in a completely unrelated agreement? Or does the concept of insurance mean a single contractual arrangement that, without the insurance component, would cease to have any meaning for the parties? If it is recognized that insurance can be part of a multi-faceted agreement, then the approach contemplated by Kelly and Ball is unnecessarily limiting.

Kelly and Ball make an interesting observation when they say:²⁷

Although [the utmost good faith principle] may originally have been regarded as arising *because* a contract was one of insurance, it has now become one of the main criteria for deciding *whether* a contract is one of insurance.

23 Above n 22, 14.

24 Above n 13, 9.

25 Above n 13, 7.

26 And was therefore not required to make the necessary deposit under the ICD Act.

27 Above n 13, 6.

This is not an appropriate way for this decision to be made. The principle reflects the fact that historically parties to the contract were perceived to have different strength in the contract: the insured having all the knowledge about the likelihood of the event occurring and the insurer taking on that risk, relatively uninformed. But today there are many types of insurance (eg travel insurance and earthquake insurance) where the insurer is usually more knowledgeable about the rules than the insured.

The difficulty in defining insurance may lie in the different policy reasons behind decisions made on what is or is not insurance. For example in *The Motorcycle Specialists* the court was required to make a decision based on legislation that has at its core the solvency of the company. By contrast, in *Dane*²⁸ the court was anxious to avoid giving strength to a contract that had an unfair result. These decisions have provided different definitions of an insurance contract, not because either of the decisions is deficient in any way, but because both decisions were concerned with different policy issues. With competing reasons for decisions in the insurance area, it is little wonder that the question of what is insurance is a vexed one.

Ultimately though the decision will come down to an instinctive reaction by the court about what should and should not be classified as insurance. Utmost good faith may simply be one of the many factors that is taken into account for that decision to be made. Other factors may be the classification by the parties. For example if a contractual agreement is titled "Consumer Protection Insurance", this must be relevant in the decision as to whether or not the contract is one of insurance.²⁹

On this analysis most consumer repayment agreements will constitute insurance contracts, either because of their form or their effect. Of the three types of consumer repayment agreements mentioned in Part I A, types 1 and 2 will come within the bounds of insurance law. For the most part, type 3 agreements are not considered in depth in this paper.

III ANALYSIS OF PROBLEMS WITH CONSUMER REPAYMENT PROTECTION AGREEMENTS

In practice many forms of repayment protection are called insurance, whether or not the agreements actually constitute a contract of insurance. Nevertheless the three distinct forms of agreement outlined in Part I all have consumer problems arising from them; some are common problems, others are particular to the marketing practice used to sell the agreements. Part III A contains an exposition of the different types of marketplace problems and an analysis of whether the application of contract and credit laws assists consumers with consumer repayment agreement problems. Part III B provides a discussion on how the financial disclosure regime of the Credit Contracts Act 1981 and the Hire Purchase Act 1971 allows creditors the opportunity to hide the true cost of borrowing the credit from the consumer. The placement of the cost of consumer

28 Above n 17.

29 As expressed by Esher MR in *Dane*, above n 17, 60.

repayment protection can lead to the manipulation of the finance rate, foiling the Credit Contracts Act's attempt to discourage deception in lending.

A *Different Types of Consumer Repayment Agreement*

1 *Creditor acts as agent of the insurer*

By far the most "reputable" type of repayment agreement is that which is underwritten by a third party insurer on whose behalf the creditor contracts with the consumer. These agreements are generally standard form insurance contracts in that they contain terms, conditions and exclusions, they refer to the consumer as the insured and they clarify the relationship between the insurance company and the creditor. Despite this there are still some problems in the marketplace.

It is standard practice not to notify anything to the consumer in relation to the insurance but the cost. The Hire Purchase Act 1971 provides in section 40 that the creditor may nominate a particular insurance company. Consumers are often faced with a creditor who insists on an insurance package with a certain insurer.³⁰ Although traditional contract law declares that parties to a contractual agreement negotiate their acceptance or rejection of terms, the commercial reality for many consumers using credit is that they are not in a position to negotiate the terms to suit their own needs. As the consumer wants to be granted the credit, they may be prepared to accept such terms. Many contracts do not have their terms explained at all. Consumers may be completely unaware that the initials CPI or CDI mean that they have bought insurance. Another misconception is that the insurance is over the goods bought on hire purchase and consumers are often surprised to learn that they have also bought insurance over their repayments.³¹ As will be pointed out in more detail in Part III B the standard form credit agreement leaves no room for distinction between different types of insurance.³²

A related problem occurs where the consumer may be told of the general nature of what they are paying for but is not given any terms or conditions to the agreement. This is particularly difficult when the consumer wishes to use the insurance protection, only to find that an exclusion applies or they have breached a term of the agreement. Regardless of the status of such a contract, many consumers will be told that they have no right to the insurance protection and so will not attempt to enforce their rights. Does the written contract override the oral representations made by the financier? It is submitted that a court or tribunal may well rule on the basis of the written contract despite the consumer's claim of misrepresentation.

30 The financier may or may not be a company linked with the insurer. Regardless, the financier will get a financial reward for selling the insurer's products.

31 Some policies include both types of insurance in the same agreement.

32 Compare this to the Australian Credit Act 1984 (Cth), which prescribes the type of information required to be on the form in relation to repayment insurance. The creditor is required to show on the face of the agreement information such as the amounts payable in respect of each separate contract of insurance, the insurer's name, and a statement of the risk to which the payment relates.

The rule in *Scammel v Ousten*³³ will apply where an agreement is deemed void for lack of certainty if no contractual terms and conditions are agreed upon. However this rule provides little comfort for a consumer who is attempting to enforce the agreement made with the creditor. Consumers would also have an action in misrepresentation against the creditor under the Fair Trading Act and could enforce their right to have the insurance contract that they entered into upheld on the basis that the precontractual representations were false or misleading.³⁴

This all assumes that the consumer has access to legal advice. Some consumers, when told by the insurance company (not the creditor) that they have failed to meet a term or an exclusion applies, may not know where to go for assistance. Many consumers are loathe to complain about debt problems, especially if there is an ongoing relationship with the creditor at stake.

Another problem with underwritten agreements is that insurance is sometimes sold as a necessary part of receiving credit, regardless of whether or not the insurance cover is relevant to the consumer's situation. The Ministry of Consumer Affairs sees many situations where insurance is sold to consumers for whom it has no relevance at all. For example, the sale of insurance to protect a Social Welfare beneficiary's repayments in the circumstances that they are made redundant, fall ill and lose income or die.³⁵ This finding is borne out in the Trade Practices Commission's study of Consumer Credit Insurance (CCI).³⁶ The study undertook questioning of a random sample of CCI agents on their methods of selling CCI. 71% of the interviewees used "instant" policies which are filled out at the point of sale. 75% of the interviewees said that they sold the standard policy with no consideration of the consumer's need for such cover.

Can a consumer who discovers that they have been sold a policy that will never be able to be used by them claim a refund of the premium? The Consumer Guarantees Act 1993 requires that services are carried out with reasonable skill and care,³⁷ thus codifying the "due skill and care" requirement of service providers from the common law. A consumer may be able to argue that the mandatory provision of an irrelevant policy is in breach of that duty. However if the duty simply requires that the creditor acts as an average creditor would in the same circumstances and the TPC study shows that it is common practice to sell CCI policies regardless of the need, is the duty breached at all? There may not be a breach in this circumstance. Section 30 of the Consumer Guarantees Act requires that all services are fit for their intended purpose that is either required by the consumer or stipulated by the service provider. If a creditor tells a consumer that the policy will protect their repayments, even if that consumer's

33 [1941] AC 251. A vehicle was to be purchased on hire purchase terms but there was no indication of which type of hire purchase agreement would be used. The contract was held to be void for insufficient certainty.

34 Fair Trading Act 1986, ss 9, 11 and 13.

35 See Consumers and Credit.

36 Above n 5.

37 Consumer Guarantees Act 1993, s 29.

circumstances mean that she is ineligible for cover, section 30 of the Consumer Guarantees Act may help. A further difficulty will arise where the agreement is like that in *The Motorcycle Specialists*, where no contract of service exists for the purpose of the repayment protection agreement.

There is no doubt that commission earning on consumer protection agreements is worthwhile for many creditors. The disclosure regime for credit contracts means that consumers are unable to ascertain what they are paying as premium to the insurer and what they are paying in profit to the creditor. The examples outlined in Part I show how the charges fluctuate enormously and bear little resemblance to the amount financed or the potential risk.

The common law rule relating to commission to an agent may assist were it to be enforced by insurers with the problem of creditors using the commission to increase their profits at consumers' expense. That rule states that any money taken by the agent over and above the commission agreed to between the agent and the principal belongs to the principal (the insurer) and must be returned. The rule is of no benefit where there is no term of the contract agreeing to a set commission. Even if the insurer and the financier agree to such a term, such information is not easily accessible to consumers who want to challenge the cost of their premium.

As this type of agreement involves an agency relationship, many of the rules relating to agency will apply to assist the consumer. For example situations occur in the consumer repayment insurance area where the creditor fails to pass on vital information either to the insured or to the insurer, which adversely affects the consumer's entitlement under the agreement. Where a creditor fails to pass on relevant information to the insuring principal, the rule in *Blackley v National Life Assurance of Australasia Ltd*³⁸ will apply. In that case the Court of Appeal held that disclosure to an agent which was not passed on to the principal constituted full disclosure to the principal.

Similarly where a consumer makes correct disclosure to an agent creditor who either advises the consumer against disclosing this on the documentation or makes an untrue entry on the documentation him or herself, the consumer can argue that the correct disclosure was made and deploy the doctrine of estoppel to prevent the insurer relying on the misrepresentation or non-disclosure to deny liability.

There is also the question of what is the legal position of a consumer who has bought a consumer protection insurance policy, who has been told that the cost was for insurance to pay the repayments if they could not, but who has not been given any documentation. Assume that the consumer consequently loses her entitlement to the sickness benefit and on the standard unemployment benefit can no longer afford her payments. Can the consumer enforce the protection against the insurer if the policy only provides protection for loss of earnings through illness, redundancy or death? While a Disputes Tribunal may order that the payments be made by using the "regard to

merits and justice" provision of the Disputes Tribunal Act 1988,³⁹ a court may not have the same freedom. There is a danger that a court would look at the agreement and find that the reasonable person should have known that the insurance carried some terms and conditions like all other insurance contracts. The consumer could take an action under the Fair Trading Act 1986 or the Consumer Guarantees Act 1993 in non-liability for the rest of the repayments against the creditor, but the situation is less than satisfactory for two reasons: first, the consumer may wish to retain the creditor's goodwill for further credit opportunities, second the creditor may threaten or carry out repossession of the goods on security if the consumer does not meet the payments, regardless of the dispute.

The insurance industry needs to take a closer look at how its agents are performing and what representations they are making to consumers who buy their (the insurers) products. The insurance industry is subject to both self and governmental regulation and is in a better position to provide adequate redress for consumers and codes of practice for its members. This will be more effective than consumers arguing for their rights on an individual basis.

2 *Creditor forgoes a set number of payments*

Situations in which the creditor agrees to forgo a certain number of payments in the event of the specified event which prevents the consumer from making repayments are less common, at least in complaints to the Ministry of Consumer Affairs' Advice Service. Such situations, like that in *The Motorcycle Specialists*, have many problems in common with the above category of consumer repayment protection. Non-disclosure of vital terms and inappropriate selling of the protection exist here too. Nonetheless the creditor has to face the consumer directly when the dispute arises and cannot pass the blame onto the third party's policy requirements. In this regard it may be less confusing for consumers to see who their remedy is against.

Under these agreements, the consumer does not have access to the insurance industry's system of complaint handling, for example, the Insurance Council's enquiry line nor the Insurance and Savings Ombudsman. As was shown in *The Motorcycle Specialists* the court is loathe to apply the concept of insurance to such an agreement and the consumer may not even have the benefit of arguing breach of common law insurance rules in order to seek a remedy.

B *Repayment Agreements as Part of the Credit Contract*

Consumer repayment agreements are only an issue where there is a credit contract. The three major pieces of legislation that govern such transactions in the consumer market are the Credit Contracts Act 1981, the Hire Purchase Act 1971 and the Chattels Transfer Act 1924. None of these Acts has specific provision for consumer protection insurance. However the disclosure requirements of the Credit Contracts Act and the Hire Purchase Act do have some relevance in relation to these repayment protection agreements.

³⁹ Disputes Tribunal Act 1988, s 18(6).

The Credit Contracts Act ostensibly provides a system of disclosure to ensure informed entry by debtors into credit agreements. Creditors are obliged to disclose certain information in specified credit agreements. The Act is intended to be self-enforcing; no enforcement body has been set up and debtors with Credit Contract Act problems are required to invoke the civil penalties contained in the Act themselves, or to take civil action on an individual basis through the court/Disputes Tribunal system. Given that the worst abuses of consumer repayment agreements are in low income sectors, this is a highly unsatisfactory form of redress.

1 Disclosure of credit protection agreement as part of the credit contract

(a) Credit Contracts Act 1981

The long title to the Credit Contracts Act states that the Act was intended to reform the law relating to the provision of credit by, inter alia, ensuring that all terms of the contract are disclosed to debtors before they are irrevocably bound to them, and by ensuring that the cost of credit is disclosed to debtors on a uniform basis in order to prevent deception and to encourage competition. In the area of consumer repayment protection alone, this intention is flouted again and again.

The Credit Contracts Act requires certain information to be disclosed as set out in the Second Schedule. The requirement as to whether additional charges form part of the amount financed or the total cost of credit is set out in section 3(3) of the Act. However the requirement is by no means easy to follow, especially in relation to the disclosure of the premium.

Section 3(3)(a) states that "incidental services"⁴⁰ and legal services relating to the contract are not to be part of the "money's worth provided or agreed to be provided under the contract" (the amount financed). The definition of "incidental services" in section 2 of the Credit Contracts Act does not indicate who the benefit has to be for.

However, section 3(3)(b)(i) of the Credit Contracts Act makes it clear that the benefit must be to the debtor/mortgagor. Section 3(3)(b)(i) states that if there is a reasonable charge made for incidental services provided to the debtor then the charge must correctly be made as part of the amount financed. As shown in Part II of this paper, consumer repayment protection agreements frequently have minimal, if any, benefit to the consumer. The Ministry of Consumer Affairs sees many standard policies sold inappropriately to consumers who are either unemployed or self-employed that cover their repayments if they lose their job through illness, redundancy or death. The incidental benefit⁴¹ to the consumer in these cases is virtually non-existent. Where there is no incidental benefit to the debtor the charge should be loaded as part of the total cost of credit, which will have the effect of increasing the finance rate as shown below.

40 Credit Contracts Act 1981, s 2.

41 This benefit must be incidental to the granting of credit: Credit Contracts Act 1981, s 3(3)(b)(i).

If the agreement does contain some benefit for the consumer then it should be loaded as part of the amount financed. If the policy contains benefit for both the debtor and the creditor, the creditor can treat it as a benefit to the consumer and call it an incidental service for the purposes of the Credit Contracts Act.

This argument depends on whether the insurance is a requirement of the credit contract or an optional extra. If the consumer is required to take out CPI it is not incidental to the credit contract, but an integral part of the granting of credit.⁴² These distinctions are rarely made in disclosing consumer credit agreements. Financial disclosure of consumer protection insurance is made in such a haphazard way that it makes a mockery of the intention of the statute. Consumers who are unfamiliar with concepts of financial disclosure only have the finance rate to work on as a guide to the cost of the credit. As this rate can be easily manipulated, it is useless at best and misleading at worst, in consumer transactions.

The following example shows the problem.

Amount of loan	\$1000.00	Amount of loan	\$1000.00
Documentation		Documentation	
Fee	\$150.00	Fee	\$150.00
CPI	\$300.00		
AMOUNT FINANCED	\$1450.00	AMOUNT FINANCED	\$1150.00
Finance charges @ 12%	\$174.00	Finance charges @ 12%	\$138.00
Other charges	nil	Other charges	nil
TOTAL	\$174.00	TOTAL	\$438.00
Balance payable	\$1624.00	Balance payable	\$1588.00
Total cost of transaction	\$1624.00	Total cost of transaction	\$1588.00
Additional cost over cash transaction	\$174.00	Additional Cost over cash transaction	\$438.00
Period of loan	2 years	Period of loan	2 years
Payment Period - Fortnightly @	\$44.06	Payment Period - Fortnightly @	\$44.06
Total amount to be repaid	\$2291.12	Total amount to be repaid	\$2291.12
FINANCE RATE	49%	FINANCE RATE	78%

If creditors are able to hide the cost of consumer repayment agreements in the amount financed they profit even more from the premium. In those cases where there is no benefit to the consumer, the cost is clear profit for the loan provider. Entries for consumer repayment protection agreements are frequently disclosed in the manner on the right hand side.

The combination of more than one strand of law confuses how to resolve market problems. There is no need to unnecessarily limit the range of options open to consumers by limiting the solutions to one branch of law. Most consumers do not

⁴² See Gault J in *Elia v Commercial and Mortgage Nominees Ltd & Ors* (1988) 2 NZBLC 103,296 at 103,319 on the lack of clarity in the term "incidental services".

understand how the financial calculations are made on their credit agreements, let alone appreciate the method by which they can calculate the penalty against the creditor. Insurance law principles may be easier to access for consumer redress and, in this branch of credit law, may offer more equitable solutions to the problem.

IV CONSEQUENCES OF CALLING THE AGREEMENTS INSURANCE

Despite consumer repayment protection agreements being contracts of insurance, the key to providing sufficient protection for consumers who enter into these agreements may not lie in the application of insurance law at all. In this section some of the basic tenets of insurance law and their application to the common problems in the consumer credit insurance market will be examined.

A *Utmost Good Faith*

1 *Misrepresentation and non-disclosure*

The common law rule that makes contracts of insurance contracts *uberrimae fides* - of utmost good faith - essentially requires that all parties to the contract act honestly, reasonably and fairly.⁴³ Although this doctrine applies to all dealings within the contract and to both parties, it is most commonly used against the insured to ensure true and accurate representations at the time of making the contract.⁴⁴ In making disclosure to the insurer, the consumer will be required to disclose all material facts, (material being that which would induce a prudent insurer to enter the contract).⁴⁵ Is it therefore possible for an insurer to reject a consumer's claim for failure to disclose a material fact where the consumer was unaware of any terms and conditions on the repayment insurance contract? Given that the definition of material is based on the benchmark of the prudent insurer's expectation, this scenario is possible. As many contracts of repayment protection insurance are sold without the consumer needing to fill out any forms or to make an application for cover to the insurance company, the likelihood of full disclosure of all material facts being made by the consumer is slim. The insurer can avoid the contract and refund the premium if the consumer fails to disclose all material facts.

Where an insurer fails to make adequate disclosure to the consumer (for example fails to fully disclose all or any terms and conditions to the contract or misrepresents the contract in some way), the consumer is left in a poor position at common law. There is no chance for the consumer to claim damages under general rules of contract and can only treat the contract as void and claim back the premium.

43 K Sutton *Insurance Law in Australia* (The Law Book Company, Sydney, 1991) 101.

44 Sutton, above n 43.

45 *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665; Kelly and Ball, above n 13, 149 -152.

The patent unfairness of the effect of this remedy on the insured was noted at first instance in *Banque Keyser*⁴⁶ where the court upheld the plaintiff's claim for damages for breach of the doctrine of utmost good faith against the insurer. However the decision was overturned in the English Court of Appeal and the House of Lords.⁴⁷ Kelly and Ball question whether the remedies for non-disclosure and misrepresentation necessarily exclude remedies under the law of tort. To some extent the argument is redundant for New Zealand consumers, given section 29 of the Consumer Guarantees Act 1993, which provides a guarantee that services normally bought for personal, domestic or household use are fit for any particular purpose made known to the service provider by the consumer or for which the service provider indicated they were fit. Section 32 provides the remedy for breach of this guarantee which includes a claim for damages. Despite the common law remedy, a consumer could claim damages under the Consumer Guarantees Act.⁴⁸ The Contractual Remedies Act 1979 would also provide damages for a person induced to enter a contract by misrepresentation of the other party to the contract, whether innocent or fraudulent.

B Breach of Warranty

At common law, the breaching of an essential term to the contract (a warranty) meant that the insurer's liability was discharged, even though there may not be a causal link between the breach of the warranty and loss suffered by the insured. The rule has been recognised as harsh and some courts have gone to considerable lengths to find that a warranty had not been breached in order to preserve the liability of the insurer.⁴⁹

In New Zealand the Insurance Law Reform Act, section 11, relieves the effect of temporal exclusions, removing the automatic right of the insurer to escape liability where the insured can prove that her breach of warranty did not cause or lead to the loss claimed for.⁵⁰

Difficulties for consumers who buy repayment insurance will arise where no terms and conditions are made known to the consumer. For a condition to function as a warranty both parties must be aware of the term. If complete non-disclosure is made by the agent of the insurer, can the insurer deny liability to indemnify the consumer if she does act contrary to a warranty term?

Take for example the situation where a consumer enters into a hire purchase agreement and is sold an underwritten repayment insurance policy which will see his repayments made for a period of 90 days if he dies, loses his job or is unable to work due to accidental injury. The terms of that policy require that for the period of cover the

46 Above n 43.

47 [1990] 1 QB, 665 and [1991] 2 AC, 249.

48 Although insurance contracts are specifically covered by the Consumer Guarantees Act, s 2(1), they must still meet the use test of being goods or services "of a kind ordinarily acquired for personal, domestic or household use or consumption."

49 *State Insurance General Manager v Harney* [1973] 1 NZLR 276.

50 Kelly and Ball, above n 13, 275.

consumer does not participate in certain activities deemed to be potentially dangerous. If these terms are not disclosed to the consumer and he is injured skydiving (in breach of warranty), losing his earning ability for several months, the insurer will be able to reject liability due to the causative nature of the breach and the consumer's recourse will be against the creditor as the insurer's agent. The consumer will have to take action on his own behalf to either the Disputes Tribunal or through the court. If the disputed amount falls outside the jurisdiction of the Disputes Tribunal, it will probably not be worth the average consumer's while to pursue the matter.

Similarly where a consumer is told that the repayment insurance will protect his repayments if he cannot make them and is given the insurance policy which he does not understand, an insurer could avoid liability if the breach was causative of the loss.

Action against the agent in this example may be difficult - did the agent misrepresent the policy by saying it will protect repayments if the consumer cannot make them? Arguably there is no misrepresentation. The court will approach the contract from the point of view of the reasonable consumer and the injured consumer may end up without an accessible form of redress.

For the consumer who buys insurance as part of a credit transaction it is possible that the doctrines that have built up in insurance law can be used against her rather than as protection for her. Insurance law has a history of technical language and concepts which consumers cannot access easily without cost or the daunting prospect of defending their own action against an insurer.⁵¹ Consumers may be better served by consumer protection legislation such as the Consumer Guarantees Act 1993 and the Fair Trading Act 1986. Such legislation, with its focus on consumer protection, will take into account the power imbalance between consumer and trader/insurer and has the flexibility required to protect consumers from operating in a marketplace where they do not hold much knowledge or power. Insurance law also has a power imbalance to right but that imbalance is quite different to that of consumer and trader. Insurance is historically an area where the insured is in a better position to negotiate than the insurer, due to the insured's potential knowledge of the risk occurring. In consumer transactions, this imbalance is reversed: the consumer is undoubtedly less powerful as a contract negotiator and laws seeking to protect consumers recognise this.

⁵¹ The Ministry of Consumer Affairs reports that: "From a consumer perspective, several characteristics of the insurance industry make it particularly unusual. Chief among these is the complex nature of insurance contracts. It is clear to the Ministry that consumers do not understand their insurance contracts well. Terms used in insurance contracts which have acquired precise and specialised meanings within the industry through the development of insurance law provoke totally different concepts in the minds of consumers". *Ministry of Consumer Affairs Study of Insurance Practices* (Ministry of Consumer Affairs, Wellington, 1993).

C Double Insurance

It is possible for a situation to arise in which a consumer's ability to repay the credit agreement repayments is doubly insured. For example, if a consumer already has income protection insurance and takes out a credit loan for which insurance over the repayments is a requirement. The Ministry of Consumer Affairs does not see this happen often - indeed, consumers who are most at risk in the repayment insurance area do not generally take out independent insurance over their salary. Theoretically however, the situation could arise. In such a case the creditor/insurer may be only required to contribute to the loss in conjunction with another insurer. The difficulties that may arise are twofold: first, how can the creditor/insurer to the credit contract ensure that the credit contract payments are made with the proceeds of the insurance payout; and secondly, how to determine whether contributions from other insurers are required and if so, the rate at which the contributions are assessed.⁵²

Where the risk of the consumer losing their ability to fulfil their obligations is protected by an insurance agreement, the creditor is also protected because the insurance payout will usually go direct to them. This is possibly why so many creditors insist on the consumer taking the insurance that they nominate. The creditor's interest will be noted on the policy: security that the payments will be made if the insured against event takes place. If the consumer has double insurance over the risk of losing their ability to repay the creditor may lose the security of immediate payment of the amount insured against, because a general insurance policy may pay half of the payout direct to the consumer. Kelly and Ball note that many general insurance policies will require insured persons to notify the company if they enter into duplicate insurance agreements.⁵³ It is debatable whether or not the consumer will appreciate such a term of their general insurance contract over their income. To the creditor/insurer's advantage however is the situation where the credit insurance insurer pays out the full amount under the policy and then claims a contribution from the general insurer. The general insurer would have to be liable under the policy before the contributions could be sought.⁵⁴

D Subrogation

The doctrine which provides for the insurer to take any action against a third party in the insured's name is well established in insurance law.⁵⁵ Insurers may wish to deploy this doctrine in the credit repayment insurance situation where a consumer has lost their employment through unlawful dismissal, for example. But the automatic right of subrogation only applies to contracts of indemnity. Consumer protection insurance is not indemnity insurance as it does not limit the insurer's liability to the actual loss. Rather these agreements fix the liability of the insurer on the happening of a certain event, with the payout being previously fixed. Although parties to the contract could

52 See *Boys v State Insurance General Manager* [1980] 1 NZLR 87.

53 Kelly and Ball above n 13, 518.

54 Kelly and Ball, above n 13, 535.

55 See Kelly and Ball, above n 13, chapter 11 for a full discussion of this principle.

contractually grant subrogation rights to the insurer,⁵⁶ this is not done in the consumer repayment protection agreements that have come through the Ministry of Consumer Affairs.

In the event of subrogation being granted to the insurer the consumer would rarely benefit from the assignment of rights, except in so far as the insurer may be prepared to settle the claim without delay if it knew that it could take action to recover that loss from a third party. Given that the insurer's liability will be limited to the payout already agreed to in the contract, can the insurer claim a greater sum from the third party? Probably not: the purpose of the doctrine of subrogation is to prevent one party to the contract being unjustly enriched at the expense of another⁵⁷ which must preclude such action by the insurer unless any extra money above the amount of liability was given to the insured.

E Regulatory Requirements

The only legislative requirement for an insurer to comply with in this field is the Insurance Companies Deposits Act 1953 requirement for making deposits and regular reporting of financial status.⁵⁸ The Insurance Companies Deposits Act 1953 has protection of creditors of the insurance company from insolvency as its basis. Creditors that offer agreements which purport to protect the repayments in the event of a specified insurance will find the requirements onerous and with little benefit to the consumer in this area. One may question whether financiers offering consumer repayment protection agreements should be subject to the Insurance Companies Deposits Act 1953. On a general level, the requirements of the Insurance Companies Deposits Act 1953 may provide useful punitive measures for an agency in an enforcement role, but are of limited benefit to the individual consumer with a claim against the financier.

For example the Department of Justice recently threatened action under the Insurance Companies Deposits Act 1953 against a small cash loan provider who offered payment protection plans which the Department decided were insurance contracts, therefore deeming the financier to be "in the business of insurance". The result in this instance has been that the company has ceased its practice of selling non-underwritten (and usually non-disclosed) insurance agreements in favour of underwritten agreements with an established insurance company. Although consumers generally may benefit from this change, this paper has shown that there are serious problems in the consumer credit insurance area with underwritten agreements as well as non-underwritten. The use of the Insurance Companies Deposits Act 1953 to regulate the problems in the consumer repayment protection market is inappropriate.

56 Kelly and Ball above n 13, 480 & 487; Sutton above n 43, 879.

57 Sutton above n 43, 879.

58 See above Part II A2.

V CONCLUSION

The purpose of this paper was to determine whether or not the current rules and laws relating to insurance are sufficient to apply, unchanged, to the problems outlined with consumer repayment protection agreements.

Of the types of sales methods discussed, the rules of insurance law alone are not appropriate to provide protection and a method of redress for consumers who currently find themselves with a consumer repayment protection agreement dispute.

Practitioners who advise creditors as to the form of their consumer credit documents need to be wary of both the insurance and credit law implications of the documentation. While failure to comply may not currently attract any penalty sufficient to encourage creditors to comply with the law in the area of consumer repayment protection agreements, proposed changes by the Department for Courts to the jurisdiction of Disputes Tribunals will mean that consumers will have a cheap, speedy and fair forum in which to enforce not only their strict legal rights but also additional rights under the Tribunals specialist jurisdiction which enables the Tribunal referee to depart from strict legal rights or obligations and determine the dispute according to the "substantial merits and justice of the case".⁵⁹

Consumers who enter into repayment protection agreements are disadvantaged when it comes to a dispute because the rules that apply to their contracts assume that the contracting parties are equally matched in terms of resources, knowledge and bargaining power. So too when it comes to insurance law principles, the consumer is faced with a set of assumptions about their contractual strength that frequently do not match reality.

This paper has shown repayment protection agreements are troublesome because of the way they are marketed. Consumers may need more protection than that which is provided under traditional canons of contract law to ensure that they enter into the contract with sufficient knowledge of its contents to make an informed decision about the product and that they are given effective methods of redress to enforce their rights if necessary.

Consumer protection principles need not mean that consumers are treated differently throughout the contract. What it means is that the gulf that separates the commercial strengths of consumers and business is artificially closed, allowing traditional rules of law discussed in this paper to operate. The first step in this process must be to create a more balanced platform from which the parties can contract.

Once this has been achieved, it will be easier to assess how well insurance law fits the problems with consumer repayment protection agreements as outlined. One immediate problem will be that, under the analysis outlined in this paper, there will be two classes of consumer repayment protection agreements - one which is considered to be a contract of insurance and one which is not.

59 Section 18(6) of the Disputes Tribunals Act 1988.

As it is contended that the consumer with the insurance contract repayment protection has a greater form of protection than the consumer who buys a non-insurance repayment protection agreement, how can this disparity be resolved?

One possible solution is to require additional disclosure on the face of the document outlining whether the contract is one of insurance or not and let consumers make their decision. However adding complexity to already complex consumer credit contracts may not be desirable.

The alternative solution is to regulate the form and content of consumer repayment protection agreements. Given the uncertainty outlined in this paper over what constitutes insurance, legislative intervention on these agreements can decide the question once and for all so that there is uniformity of disclosure, coverage by law and redress options for consumers who are sold the agreement.